WORLD FINANCIAL SCANDALS AND THE IMPACT ON THE ACCOUNTING PROFESSION

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Abstract: *The financial scandals that have shaken the international economic environment of the last decades have had negative consequences on a profession that must protect the public interest, the accounting profession. The identification of creative accounting as the main cause for declaring major bankruptcies has affected the image and reputation of the professional accountant, known as rigid and impartial, and the confidence in the accounting profession has been considerably diminished. In this context, the profession of financial auditor has often been accused of failing to comply with the status of guarantor of the quality of the information provided by the financial statements prepared by the audited company.*

In this scientific approach, I set out to analyze the effect of financial scandals on the accounting profession, highlighting in particular the responsibility and role of the financial auditor in detecting creative accounting techniques, techniques that may underlie accounting fraud. In order to carry out this study, I resorted to the revision of the specialized literature, as well as to the analysis of the legislation in force, of the accounting norms and of the audit standards.

Keywords: *financial scandals, creative accounting, accounting fraud, financial auditing profession, independence, professional ethics.*

JEL Classification: *M41*

1. INTRODUCTION

The accounting profession is distinguished from other professions by assuming a responsibility towards the users of financial-accounting information. The role of professional accountants in the development of the national and world economy is fulfilled if the accounting profession continues to provide quality services. In fact, education and ethics are, along with quality, are fundamental objectives of a unique profession that puts the public interest first.

Over time, the accounting profession has earned the respect of communities and regulators, but the major financial scandals of recent decades have damaged the image of the responsible and moral accountant, especially the financial auditor who has been found guilty of producing these bankruptcies, either because it covered the companies that manipulated their reports, or because it did not discover the fraudulent practices in time.

The authorities' reaction to the audit work was harsh, with the Sarbanes-Oxley Act, issued in the United States in 2002, introducing public oversight of statutory auditors and audit firms. Until mid-2008, the law on public oversight was implemented at the level of the European Union, through the Eighth Directive adopting the authorization and record of statutory auditors and audit firms, standards of professional conduct and internal quality control of firms as well as the obligation of continuous professional development, systems of investigations and disciplinary sanctions and quality assurance of the services provided.

But, the big scandals were caused only by the accounting professionals who tried to fool the law? Only auditors who were not vigilant enough and did not detect fraud in a timely manner? Or are these scandals originating in the business environment and the accounting profession has been the only one blamed and accused of not following the rules of the market economy game?

In this context, I set out to research the literature, as well as the regulations in the field of auditing and professional ethics, in order to correctly identify the auditor's responsibilities in detecting fraud and distorted financial statements. Another aspect analyzed in this scientific approach refers to the impact that the most well-known financial scandals have had on the accounting profession.

2. THE PROFESSION OF FINANCIAL AUDITOR - ISSUES RELATED TO INDEPENDENCE

The professional accountant is the specialist who has a high level of training, the dedication to the profession being manifested by a commitment to a series of principles that focus on the public interest (Lazăr, 2008). The quality of the services offered by the professional accountant is expected at high rates by the users of the information in the financial reports and the professionalism is the one that ensures this quality (Bogdan, 2005).

The role of the accounting profession is to create trust in the business environment specific to the market economy, the fundamental objective of accounting being defined in accordance with the need for sincerity that the professional accountant must show: the presentation of the true image of annual accounts gives credibility to financial information.

The auditor, as a professional accountant, is considered a protector of the public interest. Thus, the auditing profession must be based on professional and ethical competence in carrying out the activity of certifying financial statements (Coman et al., 2022). One of the most important features of the financial auditor profession is that these specialists are not paid by those whose interests they represent. The audit report is useful to all those interested in the activity of the entity, but mainly to investors because the information on the success of the company is a key link between those who provide capital and those who use that capital (Staubus, 2005).

In the conditions in which the management of the entity requests the services of the specialist for the certification of the information provided by the financial statements, it is mandatory that the auditor meets the independence requirements provided in the rules of ethics and professional conduct.

The independence of the auditor is a fundamental value of the profession, its lack highlighting a discrepancy between the auditor's decisions and their own beliefs regarding the financial reporting policy of the audited company (Magee & Tseng, 1990). Seen as a feature of the auditor-client relationship (Elliot & Jacobson, 1998), independence assures users of certified accounting information that there is no hidden understanding between the manager and the auditor (Lee & Gu, 1998) and that if the latter discovered an irregularity, will expose it in the audit report (DeAngelo, 1981).

The studied literature, but also the regulations regarding the auditor's independence do not define the concept, but address the problem of lack of independence and point out that there must be a series of prohibitions and limitations regarding certain relationships that the financial auditor develops with the client company.

Conducting a quality audit mission involves two aspects: detecting and reporting significant error or omission. The first aspect concerns the professional competence of the auditor, the second refers to his morality and, implicitly, to his independence. Although the quality of the audit is based on independence, as a fundamental objective of the auditor, there are also authors who have proposed replacing this concept with the one of reability (trustworthy), because they considered that independence can be seen as a constraint from the authorities, which auditors will be tempted to avoid.

Regardless of the concept used, independence or reability, the perception of users of financial-accounting information derives from the perception of the quality of the audit and the lack of trust in the financial auditor leads to lack of confidence in the quality of financial statements prepared and presented by the audited company (Ionescu et al., 2021).

The perspective of the ethical principles imposed on the auditor is based on the regulations in the field of ethical conduct, at the international level being issued the IFAC code of ethics. It sets the rules of ethics for the ideal conduct of financial auditors and serves as a model for the development of national standards of ethics. The need for independence, along with compliance with the rules of conduct and integrity, is the premise of the financial auditor's ethical responsibility.

3. THE ROLE AND RESPONSIBILITY OF THE FINANCIAL AUDITOR IN DETECTING ACCOUNTING FRAUD

The role of the audit mission is to express an opinion or to draw a conclusion on the object of the audit process, informing on the degree of effectiveness and reliability of the observed systems adding value for users of accounting information (Munteanu et al, 2016). Moreover, the role of the financial auditor is to confirm that the information provided by the financial statements has been obtained, processed and presented in accordance with the accounting regulations in force. In other words, to reinforce the above, it is noted that the auditor is the only professional accountant who is able to provide reasonable assurance that the annual financial statements are not vitiated by fraud, material misstatement or other manipulation. Thus, the information certified following the audit engagement can be used with confidence in the decision-making process.

The responsibility of the professional accountant towards the users of financial-accounting information is established by the legal regulations and professional standards, but also by norms of ethics and professional conduct (Bran Stan, 2012). In this context, the financial auditor must carry out the activity of verifying compliance with the conceptual framework of accounting and internal procedures established by the company's management, using the ethical requirements imposed by the IFAC Code.

In order to verify and certify that the true and fair position and financial performance of the entity are reflected in the accounts, the auditor should be professionally skeptical in order to evaluate the audit evidence from a critical perspective. In this regard, ISA 200 “Overall objectives of the independent auditor and the conduct of an audit in accordance with international standards on auditing” stipulates that the auditor must plan and conduct the audit engagement with an attitude of professional skepticism, acknowledging that there may be circumstances in which the financial statements are significantly distorted.

The auditor should also use professional judgment to identify any material misstatement of the financial statements. Determining the significance threshold allows the auditor to provide reasonable assurance that the erroneous information contained in the financial statements cannot change or influence the decisions of those who use this information. A remark is necessary in this context: it would be unproductive (costs and impossibility) to impose on auditors the obligation to discover all insignificant errors and frauds.

ISA 240 “The auditor’s responsibilities relating to fraud in an audit of financial statements” distinguishes between two types of misleading information: errors and fraud. An error is unintentionally misrepresented in the financial statements. In contrast, in the case of annual accounts fraud, there is an explicit intention to mislead users of financial-accounting information. Both, errors and fraud, can be significant or insignificant.

Closely related to the idea of presenting distorted information in financial statements, another concept has appeared in the literature: tolerated or legal evasion. This phrase is attributed to the practical meaning by which an entity evades the payment of taxes, fees and contributions by taking advantage of gaps in the legislation. Given that this practice is also known as creative accounting, I consider it important to clarify that fraud has nothing creative, it is illegal and condemned by all existing professional bodies at national and international level.

We know about creative accounting techniques that, when used in an aggressive manner, they lead to distortions of financial statements, and this misleads users of accounting information. Therefore, in order to continue this research, I set out to answer the pertinent question: is creative accounting the cause of major financial scandals?

4. CREATIVE ACCOUNTING, THE CAUSE OF MAJOR FINANCIAL SCANDALS?

The revolution of professional accountants against rigid rules, both accounting and especially tax, rules that have governed their activity over time, is synonymous with the emergence of creativity in accounting. Compliance with the rules established by legal regulations has always been an obligation of professionals, an obligation that is not subject to the revolt of accountants, only that limiting professional judgment, suppressing the ability to express themselves freely and sometimes preventing the reporting of economic reality have led to dissatisfaction with this professional category, and implicitly, at the birth of creative accounting.

The complexity and evolution of human society is influenced by the most unpredictable factor possible, man. Although accounting is protected by ethical rules, not all actors in economic life are aware of the importance of respecting the code of ethics of the professional accountant. Hence the actions of certain people who use creative accounting techniques in their own interest, actions that have highlighted the negative nature of creativity in the field of accounting science. A selection of the most important financial scandals is presented in the following table.

Table no.1. **Creative accounting techniques, causes of bankruptcy around the world**

Economic entity (country, year of bankruptcy)	Causes of bankruptcy
EM. TV (media concern) Germany, 2000	Generation of artificial income and breach of generally accepted accounting principles, as the amounts published were partially unfounded.
Infomatec (internet surfstation technology) Germany, 2000	Incorrect presentation of the company's financial position and share transactions in the context of false ad-hoc communications.
Arthur Anderson (audit and consulting company) USA, 2001	Accounting fraud, obstruction of justice.
Enron (energy trade) USA, 2001	Distortion of financial position and performance by non-presentation of debts and presentation of non-existent profits.
HIH (insurance company) Australia, 2001	Securities market manipulation.
Lernout & Hauspie (software) Belgium, 2001	Defective consolidation of turnover, recording of unrealized income, as well as post-dating of procurement contracts.
SairGroup (airline) Switzerland, 2001	Violations of corporate governance principles and misrepresentations of financial position and performance.
Allied Irish Bank (bank) Ireland, 2002	Loss of $ 691 million in unauthorized transactions.
Bankgesellschaft Berlin (bank) Germany, 2002	Distortion of financial position and performance, as well as accounting fraud, as contingent liabilities were not presented, no necessary provisions were made for guarantees, in breach of the principle of realization.
Comroad (telematics provider) Germany, 2002	Counterfeiting of sales proceeds by unfounded invoices and fictitious exits as a result of counterfeit invoices received.
HealthSouth (health services) USA, 2002	Inflated income, keeping false documents and accounting records, conspiracy to commit fraud, bribery.
MI.P (financial services) Germany, 2002	Doubtful accounting practices such as non-presentation of hidden loans or expansion of commission expenses, so that the company's position and financial performance were too well presented.
Phenomedia (software) Germany, 2002	Capitalization of simulated receivables through unfounded registrations and enrichment of management through stock trading.

Economic entity (country, year of bankruptcy)	Causes of bankruptcy
Philipp Holzmann (construction concern) Germany, 2002	Incorrect presentation of the financial position by capitalization of expenses, cancellation of provisions, sale-and-lease-back transactions and application of the dividend distribution procedure and their recovery through a capital increase.
Tyco (concern mixt) SUA, 2002	Blurring financial position and performance by not making value adjustments and presenting values in a confusing way, as well as personal enrichment.
WorldCom (telecomunications) USA, 2002	Distortion of financial position and performance by activating expenses for the assignment of the right of use or by arbitrary cancellation of provisions.
Xerox (office equipment) USA, 2002	Revenue from sales presented in the financial statements at a level too high due to unauthorized anticipation.
Boeing (aeronautical industry) USA, 2003	Unethical behavior, violation of company policy, misconduct.
Parmalat (food) Italy, 2003	Unrepresented debt of $ 14.3 billion.
Royal Ahold (retail) The Netherlands, 2003	Presenting receivables at too high a level and anticipating the income and profits of the American subsidiary, obtaining loans through false claims and incorrect consolidation.

Source: Mocanu M., 2020, *Deontologia profesiei contabile. Dezbateri internaționale privind independența în auditul financiar*

The companies listed above have used the services of financial auditors and audit firms to certify their financial statements, and the lack of a reaction from the accounting profession to the financial difficulties they have faced has led the public to consider the auditor as the main culprit for filing for bankruptcy. The reputation of the professional accountant has been damaged, and suspicions about the auditor have shaken the trust of users of financial-accounting information in the reports of the audited entities.

The negative effects of financial scandals on the image of the auditing profession have not been differentiated (Backhaus et al., 2003), the whole profession coming to be held responsible for the fact that certain entities went bankrupt. Over time, the entity's management has placed responsibility for ensuring the accuracy of the information reported in the financial statements, but it is important to note that regulations on ethics and independence prohibit the auditor from taking over management responsibilities (Comandaru et al., 2020). The auditor is not responsible for the decisions taken by the entity's management. The assurance he provides about the financial statements is reasonable, not absolute, because due to limited resources (time, in the first place) it is impossible for the auditor to verify all the documents and transactions of the audited company.

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Table no.2. **Manipulations of the financial statements and audit firms concerned**

Audit firms (The Big Five)	Companies that have manipulated their financial statements
Delloite & Touche	Adelphia
KPMG	Xerox
Pricewaterhouse Coopers	Bristol/ Meyers – Squibb
	Micro Strategy
	Tyco
Ernst & Young	AOL/ Time Warner
	Computer Associates
	People Soft
	PNC Financial Services
Arthur Andersen	Enron
	Global Crossing
	Merck
	Qwest
	Waste Management
	WorldCom

Source: Schönauer S.R., (2006), Externe und interne Qualitätssicherung der Abschlussprüfung.

A brief analysis of the table above shows that the audit firm Arthur Andersen was most involved in the financial scandals. As a result, in 2001, after the collapse of Enron, something difficult to imagine happened for the accounting profession: the international audit and consulting firm, a member of Big Five, Arthur Andersen went bankrupt. Accused of accounting fraud and obstruction of justice, it has been shown that the consulting firm has allowed the use of accounting practices by which Enron managed to hide billions of dollars in debt to investors (Comândaru, Horaicu, 2021).

However, the bankruptcy of such an important audit firm did not discourage either creative accounting practices or the accounting profession in covering the handling of financial statements. The crisis of 2007 once again highlighted the fact that there were companies that benefited from unqualified audit opinions and subsequently reported financial difficulties. How this happened remains a question that is especially asked by users of financial-accounting information. In this context, it remains important for the auditor to establish objectives and procedures that adequately assess the principle of business continuity. A solution in this regard comes from ISA 570 "Going concern" which establishes as the responsibility of the auditor the collection of adequate and sufficient evidence regarding the verification of the management's compliance with the business continuity principle in preparing and presenting the position and financial performance of the entity.

The uncertainty that characterizes the economic environment requires the financial auditor to check more closely the entity's ability to continue its business. The rehabilitation of the auditing profession in front of users of financial information also largely depends on this aspect.

5. CONCLUSIONS

International financial scandals have adversely affected the accounting profession, as users of financial-accounting information have lost confidence in financial reporting, which has often concealed manipulation and fraud.

The auditor's responsibility is limited to identifying significant errors and omissions that may change the decisions made by those interested in the entity's business. Reasonable, not absolute, assurance that financial statements are not materially affected by manipulation and misstatement provides the auditor with the legal framework to avoid the obligation to record the use of creative accounting techniques in the audit report.

The auditor's need for independence derives from the auditor's ethical responsibility, which must be impartial, objective, fair and honest in the conduct of the audit engagement. The fulfillment of the role of protection of the public interest is achieved if the services provided by the auditor comply with the highest standards of performance.

The reality of recent decades has shown that restoring public confidence in the accounting profession is a long process that is further affected by the financial scandals in which less scrupulous auditors are involved. However, the approach that all professional accountants are guilty of bankruptcy of the audited companies is wrong. In support of the above, the following conclusion is outlined: sometimes auditors are accused of things that do not fall within their sphere of responsibility and blamed on generalizations unjustified by "uncommitted" facts.

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