

Ioan Alexandru Szabo\*

## THE EVALUATION OF THE RISKS INVOLVED IN THE PUBLIC-PRIVATE PARTNERSHIPS, IN THE CONTEXT OF THE AUDIT OF THE PUBLIC ENTITIES MANAGEMENT PERFORMANCE

**Abstract:** Accomplishing the financial audit objective, expressing an opinion concerning the making of the financial reports, in comparison with the general background of the financial report, it assumes underlining some important aspects about the information provided in the financial statements.

In this context, the work treats the level of significance (the materiality level) and its role in the decisive process of the financial audit.

The role of the level of significance is examined, on one hand, in the context of establishing the nature, the moment and the extent of the audit procedures, and on the other hand, evaluating the effect of the inexact presentations.

In the end the work, the author concludes that the level of significance represents an essential element in the decisive process of the financial audit, in the planning stage, in the stage about performing the provisions of the approved audit plan and in the part about reporting the conclusions of the financial audit.

## PROCENE RIZIKA KOJI SADRŽE JAVNO-PRIVATNA PARTNERSTVA, U KONTEKSTU REVIZIJE JAVNIH TELA RUKOVOĐENJA

**Sažetak:** Ostvarivanje cilja finansijske revizije, izražavanje mišljenja o izradi finansijskih izveštaja, u poređenju sa opštom pozadinom finansijskog izveštaja, podrazumeva isticanje nekih važnih aspekata o informacijama koje su date u finansijskim izveštajima.

U tom kontekstu, rad tretira nivo značaja (materijalni nivo) i njegovu ulogu u procesu odlučivanja u finansijskoj reviziji.

Uloga nivoa značaja je ispitana, s jedne strane, u kontekstu utvrđivanja prirode, trenutka i širine revizijskih postupaka, a sa druge strane, vrednovanje učinka netačnih prezentacija.

Na kraju rada, autor zaključuje da nivo značaja predstavlja bitan elemenat u procesu odlučivanja u finansijskoj reviziji, u fazi planiranja, u fazi vršenja ispravki u odobrenom planu revizije, kao i u delu o izveštavanju zaključaka finansijske revizije.

---

\* dr Ioan Alexandru Szabo, Vasile Goldiș University, Faculty of Economics, Arad, Romania

## **1. Preliminary Aspects**

The objective of the financial audit lies in providing an insurance that the examined financial reports are complete and drawn up accurately, and the economic operations have been performed according to the existing regulations. In everyday practice, this objective is impossible to achieve under performance conditions, so the financial audit missions, carried out as tests, assures, in a reasonable way (not absolutely), that the financial reports are complete, true, accurate, and have been drawn up according to a general report plan.

Moreover, the limited character of the insurances supplied by the financial audit results from the total Audit 320 Standard <sup>1</sup> which states that " the audit objective of the financial statements is to offer the auditors the possibility to express an opinion about carrying out the financial statements, from all points of view, according to the general background of the financial report."

Accomplishing this desideratum implies the knowledge and evaluation of everything that is important about the information provided by the financial statements, process which presumes adopting the level of significance ( the materiality level).

The level of significance is defined by the Council for the Accounts International Standards, in the work "General background for the performance and presentation of the financial statements", in the following terms:

"The information is significant if its omission or mistaken presentation could influence the economic decisions of the users, according to the financial statements. The threshold of significance depends on the dimension of the element, the error. So, the threshold of significance is rather a borderline threshold or a limited point and not a main, qualitative characteristic that the information has to contain in order to be useful".

In other words, the adopted level of significance will represent the value according to which it can be determined whether the errors, omissions, identified errors in accounts, individual or cumulated, indicate if those accounts provide an accurate, complete image of the financial position and performance of an entity.

In the same context, the level of significance, on one hand, represents what is called in the Anglo-Saxon Accounts-materiality -the error level which indicates that the comprehension and interpretation of the financial statements won't be significantly affected and on the other hand, the admitted level of error accepted in order to decide if the accounts are accurate or not.

## **2. Materiality Determination**

The auditors, in order to project the audit plan, determine an acceptable level of significance, so as the significant inexact presentations to be detected according to its value (quantity) and nature (quality).

Expressing the level of significance according to its value, can be performed directly or indirectly. The direct part consists of determining an absolute value, while the indirect part implies using a percent from a certain indicator, in order to calculate such a value.

In the case of public entities financed from budget resources, the total level of public expenses is the basis for determining materiality. For public entities with tasks in collecting public resources, the indicator for determining materiality, used through the indirect method, is the level of income. In the case of private entities, the auditors determine the materiality by applying a certain percent to gross and clear assets, profit or turnover.

In order to establish the nature of the level of significance, the auditor has to decide whether a non-material element as value, can be considered material, due to its inherent nature or its features. Furthermore, it is necessary to examine the audit transactions according to the regulations which concern the entity and the field to which it belongs, the dimensions of the entity and different associated factors, for example the date

---

<sup>1</sup> See the Manual for Audit International Standards, Certification and Ethics, issued by the Accounts International Federation, 2007 Edition.

of its establishment. The examples of incorrect presentations, according to their nature (quality), are the inexact and inadequate description of an accounting policy, in cases when there is the possibility that through these drawbacks, the user of the financial statements to be misled; also, not mentioning breaking some rules, in the situation when there possible that imposing further restrictions, the normal function of the entity could suffer.

Apart from the possibility of determining materiality according to the value, nature and the characteristics of some elements or group of elements, the level of significance can be determined through context. An error or an omission can be considered material due to the context or the circumstances in which it comes up. In the same time, an element can be material because of its effects upon some key factors in the financial statements, such as: changing a budget excess into a budget deficit and reverse, changing the profit into a loss and reverse, etc.

The auditors determine the level of significance at a general point of view and also those in connection with the dealings, the balance of account and information presentations. If the users of the financial statements demand more accuracy for certain accounts, the auditors may establish a lower level of significance. It must also be pointed out that when first planning the audit task, its level may differ from the moment of evaluation of the audit proceedings. These changes may occur because of new circumstances or because of new auditor information stored during the audit task. For example, if the audit is planned before the closing of the financial exercise, the auditor will make a projection of the performance and financial position of the entity. If the current facts differ significantly from the presumed ones, focusing the performance and financial position of the entity, the evaluation of the level of significance may be changed. So, the auditor, when planning the audit task, may determine a lower level of significance than the one which he intends to use for the evaluation of the audit results. This has the purpose to reduce the possibility of not discovering the wrong information and offers the auditor a safety reserve when he evaluates the effect of wrong information. Choosing the basis for materiality establishment and the way of determining its level (the level of significance), must be mentioned in the work documents. These documents are meant to reflect the professional argument of the auditor, for example, the case when he determines a different level of materiality for more sensitive elements through their nature and context.

### **3. The role of the level of significance in the context of determining the nature, moment and the extent of the audit procedures**

As we already know, between the level of significance and the audit risk level, there is a reverse proportional report, so as the higher the level of significance is, the less the audit risk is and reverse. During audit tasks, the auditors take into account this relation, in order to establish the nature, moment and the extent of the audit procedures.

Actually, if the author determines that the acceptable level of significance is higher after the audit procedures, than the audit risk is greater. In order to diminish the audit risk, the author intends, on one hand, to reduce the evaluated risk of inaccurate presentations and sustaining the reduced level through carrying out additional or extended tests of the control and, on the other hand, reducing the risk of external indetermination, through modifying the nature, moment and the extent control of the planned fund.

### **4. The role of the level of significance in the context of evaluating the inaccurate presentations effect**

The level of significance is taken into consideration by the auditor when expressing his point of view. Basically, in order to evaluate whether the financial statements are drawn up, from all significant points of view, according to the general setting applicable to the financial report, the auditor has to examine if the total amount of inaccurate non-rectified presentations that have been found during the audit task, is significant.

These inaccurate presentations include those identified by the auditor, including the clear effect of the inaccurate non-rectified presentations identified during a previous audit and, on the other hand, other inaccurate presentations that cannot be identified exactly.

In order to draw up a conclusion concerning the identified inaccurate non-rectified presentations effect, the auditor compares their total with the level of significance, so that if the total of the non-rectified

presentations approaches the level of significance, he proceeds in reducing the risk by carrying out audit additional procedures or by demanding the manager to adjust the financial statements for the identified inaccurate presentations.

If the auditor can't draw up a conclusion after finalizing the audit extended tasks, if the total amount of inaccurate presentations is significant or not, or if the manager refuses to adjust the financial statements, he may take into consideration modifying the audit report, according to I.S.A. 701 " Modifications of the independent auditor's report."

## **5. Conclusion**

The level of significance represents the expression of materiality and expresses the maximum approved level accepted for reported information in the financial statements, in order to avoid the possibility of affecting the users' decisions.

Being a maximum level of materiality- importance concept, the level of significance (the level of materiality) represents an essential element in the decisive process of the financial audit, in the planning stage, in the stage of carrying out the provisions of the approved audit plan, as well as in the reporting part of the financial audit conclusions. No matter how many times the auditors perform a financial audit, they have to take into account the level of significance and the relation with the audit risk.

Last but not least, when reporting the conclusions, the auditors have to take into consideration the result of correlating the total inaccurate identified presentations with the established and approved level of significance.

## **Literature**

- [1] Loebbecke, Arens, The Audit, An Integrated Approach, the 8 th Edition, Arc Edition, Chisinau, Moldavian Rep.,2006;
- [2] The International Federation of Accountants, The Manual for International Standards of the Audit, Certification and Ethics, 2007, Edition;