

PILLARS OF THE AUDIT ACTIVITY: MATERIALITY AND AUDIT RISK

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ABSTRACT: *The purpose of this article is to present the issues of materiality and audit risk within the activity of financial audit. The concepts of materiality and audit risk are described from a theoretical perspective, providing approaches found within the national and international literature and within the specific legislation. A case study on the calculation of materiality and audit risk for an entity is presented in the last part of the article. Through the theoretical approach and the case study, it was concluded that materiality has an important role in determining the type of report to be issued, that is why it can be considered helpful for those involved in the audit process.*

KEY WORDS: *audit; statutory audit; materiality; audit risk; opinion; audit report; financial statements*

JEL CLASIFICATION: *M20, N40*

1. INTRODUCTION

In the stage of getting to know the audited entity and in the stage of running analytical procedures, the information gathered by the financial auditor must be sufficient to define materiality and assess risks. Materiality plays an important role in determining the appropriate type of audit report that should be issued. In the audit report, the financial auditor must refer to two important issues regarding the area covered by the financial audit, which highlight the materiality and the risk. These two issues refer to: the auditor's liability is limited to significant information established through the materiality determined by the auditor on the basis of his professional reasoning and supplies a *reasonable* and *not absolute* assurance regarding the accuracy of the financial statements. The determined materiality has a relative feature. A certain

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value established as being the materiality value may be significant for a certain entity, while for a different entity it may not be significant. Certain levels of materiality can't be defined or pre-established, not even as a rough guide for all the entities that are subject to financial auditing. Given the importance of calculating audit risk, no audit standard describes a determining method, the audit risk being determined in accordance to the experience of each auditor, professional reasoning being used the most often in auditing. Materiality is in inverse ratio to the audit risk. Following high audit risk calculation, it is possible that the audited financial statements to material misstatement, materiality is determined slow.

2. RESEARCH METHODOLOGY

Methodology is a complex word (concept). Etymologically, it is formed from *methods* and *logos*, which mean "method" and "science" in Greek, and in free translation it means "the method's science", meaning the science of conceiving, choosing and using the method in the investigation of the economic phenomenon. The research methodology represents the theory and the practice of the methods, namely an activity that is studying the essence, nature, status, definition, classification, etc. in order to build explanatory models. Scientific research is necessary for seeking and finding solutions or answers to immediate problems, as well as for composing reasonable theories for the problems related to materiality, audit risk and their relationship. Any research that wants to be scientific should have a purpose. The purpose of this research is to present, first, the theoretical aspects related to the importance of calculating materiality in financial auditing, as well as to establish the relationships between materiality and the audit risk, and, second, to provide a practical example regarding the calculus of materiality and of the audit risk within an entity.

The scientific approach is based on information from literature and from domestic, European and international practice regarding materiality and the audit risk. In this article, we turned to research methods like documentation, comparison, analysis, synthesis and a case study in order to achieve objectives. The main goals taken into account when writing this article were: contributions to the theoretical foundation of the notions related to materiality and the audit risk, defining materiality and the audit risk; identifying the reference basis of materiality, identifying the main audit risk categories. The research methodology that we turned to for this paper was to study the International Standards on Auditing, the Minimal audit norms, papers on financial audit written by Romanian and foreign authors, we accessed international databases, as well as factual documentation of an entity, namely the Romanian legal person SC Everest SA for the case study.

3. MATERIALITY - IMPORTANT INDICATOR FOR AUDITING AND FOR ISSUING AUDIT OPINIONS WITHIN THE AUDIT REPORT

Materiality means: "the amount or amounts set by the auditor as an error, an inaccuracy or an omission that may lead to annual misstatements, as well as the fairness of the results, of the financial statements and of the enterprise's patrimony"

(ISA 320). Materiality is defined within the “General framework for preparing and presenting financial statements” of the International Accounting Standards Committee as follows: Information is material if its omission or misstatement could influence the economic decisions of users taken on the basis of the financial statements. Materiality depends on the size of the item or error judged in particular circumstances of its omission or misstatement. Thus, materiality provides a threshold or cut-off point rather than being a primary qualitative characteristic which information must have if it is to be useful”. According to FASB (Financial Accounting Standards Board), materiality shows: “The magnitude (gravity) of an omission or misstatement of accounting information that, in the light of surrounding circumstances, makes it *probable* that the judgement of a reasonable person relying on the information would have been changed or influenced by that omission or misstatement”. We may use various reference elements to determine materiality, such as: equity capitals, net result, and turnover. These elements are known as benchmarks, against which materiality is determined in absolute or relative values. The elements noticed by the author could have two influences:

- *Over the outcome of the exercise.* The net result of the financial year is used as benchmark. If its size is less important, it could be changed with a different benchmark, such as: the operating result or the self-financing capacity of the entity. A greater importance is given to the exceptional elements that will regroup so that they refer only to the current financial year. In addition, the auditor should document on the previous net results in order to avoid using as benchmark an abnormal net result.

- *Over the presentation of the balance sheet.* The findings result from an inaccurate bordering of the accounts or from an unjustified compensation between a debit balance and a credit balance. If two bank accounts, one debit and one credit, are compensated, the compensation’s importance is established by comparing it with the total of those posts.

In preparing the audit plan, the auditor requires an acceptable level of materiality so that it may detect the significant distortions from a quantitative perspective. Nevertheless, both the value (quantity) and the nature (quality) of the distortions must be taken into account. Examples of qualitative distortions could be the inadequate or improper description of an accounting policy, when is possible that a user of the financial statements be mislead into the description error, or the failure of the presentation of the regulations’ breach, when it’s possible that the further restrictions given by regulations will significantly deteriorate the operating capacity. The auditor must consider the possibility of distortions occurring at the level of relatively small values, which, cumulated, and could have a significant effect over financial statements. For example, an error occurred in the monthly closing procedure could be a clue for a potential significant distortion if that error repeats every month. The auditor considers materiality in terms of the global level of the financial statements and also in terms of the account balances, with transaction classes and information presentations. Materiality could be influenced by considerations like legal and regulating requirements, as well as by transaction classes, account balances, presentations of information and the relationships between them. The result of this

process may be different levels of materiality, depending on the aspect of the financial statements taken into consideration.

The audit risk and assessing initial materiality in the planning phase of the commitment may be changed in comparison to the moment of assessing the current results of the financial operations and position, which differ significantly from the initial stage of planning the audit. When the total number of inaccurate information that weren't corrected approaches the materiality level, the auditor considers reducing risk by implementing additional procedures or by requesting management to make the corrections in the financial statements associated with the detected erroneous information (Morariu A., & Țurlea E., 2001).

A *foreseen level of materiality* that will be revised during the commitment is determined in the planning stage of the audit commitment depending on new information. *The foreseen level of materiality* is the maximum amount of distortions that the auditor assesses it could influence the decisions of rational users (Oprean I., et al., 2007). If the auditor establishes a reduced foreseen level of materiality, the trust level in the content of financial statements increases, but additional audit evidences must be collected.

Minimum audit standards (Section F0) recommend the following materiality levels:

- between 1% and 2% in regard to total assets;
- between 0.5% and 1% in regard to the turnover;
- between 5% and 10% in regard to the gross result.

Materiality and audit risk are considered throughout the audit, in particular, when: identifying and assessing the risks of material misstatement, determining the nature, timing and extent of further audit procedures and evaluating the effect of uncorrected misstatements, if any, on the financial statements and in forming the opinion in the auditor's report (Socol Adela, 2008)

4. RISKS IN AUDITING

In the analysis of the audit process, risk assessment holds an extremely important role. According to Gray and Manson (2000), the audit risk assessment should be the main concern of the auditor. The International Standard on Auditing 400 "Risk Assessment and Internal Control" defines the audit risk as being "the risk that the auditor will express an inadequate audit opinion when financial statements are significantly distorted". The auditor must plan and conduct the audit commitment so that it reduces the audit risk to an acceptably low level that will be consistent with the audit objective. Reducing the audit risk can be done by creating and running audit procedures that will obtain sufficient and adequate audit evidences in order to be able to shape reasonable conclusions that base an audit opinion. Reasonable certification is obtained when the auditor considers the aspects that could make financial statements to be significantly distorted. The understanding of the auditor regarding the entity and its environment helps establish a reference framework inside which the auditor plans the audit and exercises professional reasoning regarding the assessment of the risks that significant distortions of the financial statements will occur and regarding the reactions

to these risks during auditing. At the same time, it is also useful for the auditor in determining materiality and in assessing if the reasoning regarding materiality remains valid as auditing progresses. The auditor's assessment of materiality in relation to the account balances, the transaction classes and the presentations of information helps him decide on aspects like those regarding the elements that should be examined and whether to use analytical and sampling procedures. They allow the auditor to select audit procedures, which combined are estimated to reduce the audit risk to an acceptably low level.

Dănescu T (2007) says that financial auditors, in the un-fulfilment of the audit commitment, follow especially the audit risks in accordance to which audit procedures and their extent are established. The higher the risk, the more time the auditor will give to checks. These risks are common to all economic units. *Potential risks* are those possible risks against which the economic unit has no means to limit them. During his mission, the auditor seeks to identify these risks with the purpose to assess the impact of errors on annual accounts. The auditor must use professional reasoning in assessing the audit risk and in establishing the audit procedures in order to ensure the risk is reduced to a minimum accepted level.

The audit risk has three components: inherent risk; control risk and detection risk. The International Standard on Auditing 400 "Risk Assessment and Internal Control" defines the three audit risk components as follows:

↳ *inherent risk* represents the susceptibility of an account balance or a transaction category to inaccurate information that could be significant individually or cumulated with erroneous information from other balances or transactions, assuming there were no additional internal controls.

↳ *control risk* represents the risk that an inaccurate statement, which could be found in an account balance or in a category of transactions that could be significant individually or cumulated with erroneous information from other balances or transactions, can't be prevented or detected and researched in due time by the accounting system and the internal control.

↳ *detection risk* represents risk that a procedure will not detect an inaccurate information that exists in an account balance or in a category of transactions that could be significant individually or cumulated with erroneous information from other balances or transactions.

Literature presents a classification of the audit risk components depending on the intervention capacity of the auditor over them, as follows:

- the risk that financial statements contain errors
- the risk that the auditor will not detect these errors.

From this perspective, the first risk category (composed of inherent and control risks) is not under the control of the auditor; he assesses the risks associated with the audited entity, but he can't control them in any manner. The last risk category (detection risk) is under the control of the auditor; he exercises this control by selecting and implementing control tests for certain statements he wishes to evaluate (Dobroţeanu L., & Dobroţeanu C.L., 2002). The audit risk (including its components) can be established in terms of quantity (as percentage), as well as in terms of quality (low, moderate or high level). In order to assess the audit risk, one of the usual

methods is the individual calculus of the values attributed to the audit risk components, followed by their aggregation based on the following formula:

$$\begin{array}{ccccccc} \text{Audit.risk} & = & \text{Inherent.risk} & * & \text{Control.risk} & * & \text{Detection.risk} \\ (\text{AR}) & & (\text{IR}) & & (\text{CR}) & & (\text{DR}) \end{array}$$

$$\text{TR} = 100 - \text{DR}$$

The trust level (TR) of the auditor is defined as the difference between 100% and the detection risk. Therefore, the lower the detection risk, the higher the trust level of the auditor. Similarly, the audit assurance (AA) level corresponds to the difference between 100% and the audit risk: $\text{AA} = 100 - \text{AR}$.

Minimum audit standards require that the audit risk accepted by auditors does not exceed 5%, resulting in an assurance level of 95%. Professor Oprean I. (2007) recommended that in order to reduce audit risk and implicitly increase assurance level regarding the fact that financial statements are not significantly distorted, the auditors must collect a large quantity of adequate evidence, must implement extended procedures, allot the audit commitment to the most competent and experienced collaborators and assistants and must monitor the activity of the audit team.

5. RESEARCH ANALYSIS

To support the theoretical base of this article, we try to facilitate the understanding of the procedure through an actual analysis of the entity, in this case: Everest company. In the preliminary stage of the research analysis we establish *materiality* depending on one of the three reference elements: equity capitals, net result and turnover; after which, in the next stage, consisting of determining the *audit risk*, we'll determine in two consecutive stages: the general inherent risk and the specific inherent risk, the control risk and the detection risk.

The three indicators were compared for the years 2007, 2008 and 2009 at the beginning of the analysis in order to determine the materiality level in the planning stage (work sheets regulated by the minimum audit standards written by the Chamber of Financial Auditors of Romania).

Although the total assets indicator was the most constant throughout the three financial exercises, as can be seen from the chart above, professional reasoning led us to choosing turnover as being the most relevant indicator for the shareholder. Materiality was chosen at the value of 0.5% of turnover because it was decided that by knowing the client, more detailed tests may be done. This level must be used to see if areas of incertitude or disagreement in the financial statements are significant enough to impose a reserved opinion in case incertitude or disagreement can't be resolved. The materiality established in the planning stage is mainly used to determine the size of the samples; at least for the expression stage - in order to determine if final adjustments are needed. Once materiality was established, our research analysis can go to the next phase, namely determining the audit risk through the three stages.

Audit client Written by: JA 17.01.2010			
Audited period: Revised by: SI 19.01.2010			
01.01.09/31.12.09			
Financial statements	Current year -required-	Previous years n-1 -required-	Previous years n-2 -required-
Total assets (before debt relief)	28.454.257	28.321.834	25.311.200
1%	284.543	283.218	253.112
2%	569.085	566.437	506.224
Turnover	35.414.242	27.364.523	25.414.132
0.5%	177.071	136.823	127.071
1%	354.142	273.645	254.141
Profit before tax	12.730.444	8.954.222	8.715.426
5%	636.522	447.711	435.771
10%	1.273.044	895.422	871.543
Materiality	177.071		
Planning stage	177.071		
Opinion expression stage	-		

Stage I - Determining general inherent risk. At the base of determining the inherent risk lays a so-called “checking list of the inherent risk” that is used to assess the inherent risk of the environment and to make a classification of the clients in entities with a high, average, low and very low risk. This list must be filled for all the audit commitments, regardless of the testing techniques (work sheets regulated by the minimum audit standards written by the Chamber of Financial Auditors of Romania).

Explanations: There are efficient managerial computer systems following the activity of managers, as well as the results of the company in recent years; their experience and qualifications can't be questioned.

<i>Initials:</i>		<i>Date:</i>	
Client: SC EVEREST SA		Written by: JA	
Audited period: 01.01.2009-31.12.2009		Revised by: SI	
		25.01.2009	
		27.01.2009	
		Yes	No
1. Management			
Are the managers lacking the necessary knowledge and experience to lead the company?			✓
Do the managers have the tendency to engage the company in associations with a high risk level?			✓
Have there been replacements of the managers in key-positions during the financial year?			✓
Are there certain requirements for maintaining the profitability level or achieving some objectives (for example, to comply with demands from creditors)?			✓
Does the reported result have a personal meaning for managers (for example, bonuses related to profit)?			✓
Are administrative control and the control exercised by the manager weak?			✓
Are efficient managerial computer systems missing?			✓
Are managers actually involved in daily tasks?			✓
MANAGEMENT RISK GENERAL ASSESSMENT			
<u>VERY LOW</u>/LOW/AVERAGE/HIGH			

<i>Initials:</i>		<i>Date:</i>	
Client: SC EVEREST SA		Written by: JAM, SIC	
Audited period: 01.01.2009-31.12.2009		Revised by: Financial auditor	
		25.01.2009	
		27.01.2009	
		Yes	No
2. Accounting			
Is the accounting function decentralized?		✓	
Is the accounting personnel lacking the training and ability to fulfil its tasks?			✓
Are there attitude problems or ethical issues in the accounting department?			✓
Is there a risk for committing errors due to the fact that employees work under pressure?			✓
GENERAL ASSESSMENT OF THE ACCOUNTING RISK			
<u>VERY LOW</u>/LOW/AVERAGE/HIGH			
3. The activity of the audited company			
Is the company running its activity in a high risk industry?			✓
Is there a third party creditor with a significant individual importance?			✓
Is there a concentration of shares of voting rights exceeding 25% belonging to members without executive power in the administrative board?			✓
Is it anticipated that the business (or part of it) could be sold in the future?			✓
Has another person taken over control of the company in the last 12 months?			✓
Is the company insolvent?			✓
GENERAL ASSESSMENT OF THE BUSINESS RISK			
<u>VERY LOW</u>/LOW/AVERAGE/HIGH			

Explanations: The company runs its activity in an industry with limited competition, its extended experience providing an advantage in front of other competitors, the company has contracts with some of the most important clients at national and international level; therefore, the business risk was assessed as being very low.

<i>Initials:</i>		<i>Date:</i>	
Client: SC EVEREST SA	Written by: JA	25.01.2009	
Audited period: 01.01.2009-31.12.2009	Revised by: SI	27.01.2009	
The audit company		Yes	No
Is it the first time when the company will audit this client?			✓
Has an opinion with significant reserves been expressed in the audit report in one of the last two years?			✓
Would you describe the company - client relationship as “conflictual” or “deteriorating”?			✓
Are there pressures regarding fees or time?			✓
Is there a significant number of “difficult to audit” operations?			✓
GENERAL RISK ASSESSMENT			
<i>VERY LOW/LOW/AVERAGE/HIGH</i>			

Explanations: It is the second consecutive financial year audited by our firm, we benefited from the services of a previous auditor, we mention that past audit reports had no reserves.

Table 1. General inherent risk

General inherent risk assessment	Very low	Low	Average	High
RESULT	3	1	0	0

According to the procedures written by the Chamber, certain positive answers carry a higher risk note than other, which indicates the importance attached to each of the considered particular circumstances. The general risk given to the entity comes from the assessment of each section seen as a whole. The number of positive answers will indicate the risk level attached when each question in being considered and the manager of the audit mission must use **professional reasoning** for the general risk level (Table 1). Consequently, based on professional reasoning, as well as on the results obtained after assessing the components of the general inherent risk, it was established that it is very low, subsequently, the process starts with the following stage in this phase.

Stage II - Determining the specific inherent risk, the control risk and the detection risk. In practice, risk analysis involves the following procedures for each audited field: assessing the inherent risk; assessing the detection risk; calculating the global risk factor; establishing the size of the samples. After assessing the general inherent risk, it's important to consider if there is any audit field with an attached specific risk. The specific inherent risk represents the occurrence possibility for a significant inaccurate statement in a filed due to a specific problem in that field; the detecting method is synthesized through the answers given to the following six questions (work sheets regulated by the minimum audit standards written by the Chamber of Financial Auditors of Romania).

1. System exposed to errors/system in ABeCDat /manual, non-computer system?
2. Accountant responsible for this field trained poorly professionally?
3. Complex operations (the nature of the actual operation, not how it is registered)?
4. Risk of loss / embezzlement / fraud?
5. Many professional judgements / calculations?
6. Unusual operations (the nature of the operation or the nature of the process outside the system)?

Once all these factors were considered, as an answer to the six questions, the analysis is continued to assess the risk in the following categories: high, average, low and very low (Tables 2-5).

<i>Initials:</i>								<i>Date:</i>	
Client: SC EVEREST SA				Written by: JA				25.01.2009	
Audited period: 01.01.2009-31.12.2009				Revised by: SI				27.01.2009	
<i>Materiality = 0,5%x turnover=177.071</i>		<i>Specific inherent risk</i>					<i>Ref</i>	Sample size (based on reasoning) / Initial risk fa	
<i>General inherent risk = Low</i>		Questions					Assessment		
		1	2	3	4	5	6		
Tangible and intangible assets		-	-	-	-	-	-	Very low	23%
Accounts of the group and investments		-	-	-	-	-	-	Very low	23%
Inventories and work in progress - quantities		-	-	✓	-	-	-	Very low	23%
Inventories and work in progress - assessment		-	-	-	-	-	-	Very low	23%
Debtors		-	-	✓	-	-	-	Very low	23%
Short-term investments		-	-	-	-	-	-	Very low	23%
Bank accounts and petty cash - payments		-	-	-	-	-	-	Very low	23%
Bank accounts and petty cash - incomings		-	-	-	-	-	-	Very low	23%
Bank accounts - confronted with bank statements		-	-	-	-	-	-	Very low	23%
Creditors		-	-	-	-	-	-	Very low	23%
Long-term creditors		-	-	-	-	-	-	Very low	23%
Sales		-	-	-	-	-	-	Very low	23%
Purchases		-	-	-	-	-	-	Very low	23%
Expenses		-	-	-	-	-	-	Very low	23%
Wages and indemnities		-	-	-	-	-	-	Very low	23%
Other audit sections		-	-	-	-	-	-	Very low	23%
Checking balance and accounting entries		-	-	-	-	-	-	Very low	23%
Preliminary financial statements and entries after the end of the financial year		-	-	-	-	-	-	Very low	23%

Table 2. Specific Inherent Risks And The Size Of The Initial Samples

Number of identified specific inherent risks	INHERENT RISK GENERAL LEVEL			
	Very low	Low	Average	High
0, 1 or 2 risks	23%	50%	70%	100%
3 or 4 risks	50%	70%	100%	100%
5 or 6 risks	70%	100%	100%	100%

Initials:					Date:
Client: SC EVEREST SA			Written by: JA		25.01.2009
Audited period: 01.01.2009-31.12.2009			Revised by: SI		27.01.2009
	Inherent risk (R1): source	RNNE	Control risk (CR)	Calculation of risk band $R1 \times RNNE \times CR$	Size of the sample
Tangible and intangible assets	23%	56%	100%	12,88%	20
Accounts of the group and investments	23%	100%	100%	23%	30
Inventories and work in progress - quantities	23%	56%	100%	12,88%	20
Inventories and work in progress - assessment	23%	56%	100%	12,88%	20
Debtors	23%	56%	100%	12,88%	20
Short-term investments	23%	100%	100%	23%	30
Bank accounts and petty cash - payments	23%	56%	100%	12,88%	20
Bank accounts and petty cash - incomings	23%	56%	100%	12,88%	20
Bank accounts - confronted with bank statements	23%	56%	100%	12,88%	20
Creditors	23%	100%	100%	23%	30
Long-term creditors	23%	100%	100%	23%	30
Sales	23%	56%	100%	12,88%	20
Purchases	23%	100%	100%	23%	30
Expenses	23%	100%	100%	23%	30
Wages and indemnities	23%	56%	100%	12,88%	20
Other audit sections	23%	100%	100%	23%	30
Checking balance and accounting entries	23%	100%	100%	23%	30
Preliminary financial statements and entries after the end of the financial year	23%	100%	100%	23%	30

Table 3. Detection Risk Factors Not Associated With Sampling

SAFETY IN ANALYTICAL EXAMINATION	Inexistent	100%
	Moderate	56%
	High	31%

Table 4. Control Risk Factors

SAFETY	CRITERIA	RISK
Significant	Failure rate up to 2%	13.5%
Moderate	Failure rate up to 5%	23%
Limited	Failure rate up to 10%	56%
Inexistent	Failure rate higher than 10%	100%

Table 5. The Sample Size For A Population > 400

RISK BAND	SAMPLE SIZE
72.1% TO 100%	59
58.7% TO 72.0%	52
47.8% TO 58.6%	48
39.0% TO 47.7%	44
30.2% TO 38.9%	40
23.4% TO 30.1%	35
18.1% TO 23.3%	30
14.0% TO 18.0%	25
10.9% TO 13.9%	20
8.4% TO 10.8%	15
6.5% TO 8.3%	10
UP TO 6.4%	5

After doing the tests by using sampling methods, it's necessary to evaluate the obtained results. It's essential to determine if there are errors in a different part of the population and, if there are, if they are significant for the financial statements. If that's the case, depending on the nature of the error, alternative tests can be designed in order to provide additional information regarding the occurrence probability of other errors. If this is not possible, then it will be necessary to project the known error in the sample in order to get the projected error for the population. Because the high value elements and the key elements would have already been tested, the projection will be made only for the residual population (procedures elaborated by CAFR).

Once the errors were projected, they must be synthesized so the auditor will see if the accounts present an accurate picture. However, the projected error and the real error won't be the same and that is why it will be necessary once again to make use of professional reasoning to decide if it's probable for an error to be significant or not. If, after deliberation, it's decided that significant errors occurred, then the next step will be: a request to the client to investigate the errors or the potential errors; to extend audit tests in order to have a more accurate conclusion; if possible, to do alternative tests.

6. CONCLUSIONS

In the *audit* of accounting data, the most important thing is to determine if the registered information reflect in an accurate manner the economic events that happened during the accounting year. In the context of a financial statements' audit, in most cases, the applied rules are generally accepted accounting principles. Besides a good understanding of accounting, the auditor must have experience in collecting and interpreting audit evidences.

The conclusions that can be drawn from the study indicate the importance of determining the risk band and the materiality that are at the basis of the entire audit mission. The information supplied with the help of the two calculation methods is significant, but we highlight that the key factor that underlies the entire determining process of the sample, as well as the sampling range, is professional reasoning. No international audit standard describes a technical method to calculate the audit risk, specifying only that it must be set at a low level, with the auditors professional reasoning and experience playing an important role within the audit mission.

It can be said that, although determining significant elements and materiality is important, the determining method is subjective. The audit norms don't establish an absolute level or a percentage or a mathematical formula universally applicable. The elements that will be used will be established by the auditor based on his experience and on numerous factors that must be taken into account and on the relative importance. Considering the consequences of materiality described above, firstly on the nature of the audit report, we can conclude without exaggerating that the nature of the audit report depends also on the accuracy of the financial analysis methods that accompanied the determination of materiality, and the whole process of getting to know the entity.

According to Arens Loebbecke, "*it's much easier to work hard at a complicated audit than justify your decisions and judgements after it's too late to do anything*".

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