Background to Auditing and Role of Auditor

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Abstract

Financial markets crisis since 2007 has unfolded many issues regarding the supervision of financial institutions, financial reporting and auditing as of core importance to many regulatory bodies in order to ensure proper-functioning framework in the internal market. An audit, along with both adequate supervision and corporate governance, can contribute towards the financial health of the companies by providing assurance in terms of bringing financial stability into their reports (European Commission [EC], 2010, p. 3). The assurance provided by the auditors reduces the risk of misstatements and ultimately the cost of failure to be suffered by the firm's stakeholders' also reduces. Market trust and confidence is restored by the audit as it contributes to the protection of investors' investments and reduces the cost of capital for companies. Therefore, the auditors have been entrusted by the law to conduct statutory audits and that their role is of importance towards financial health.

Auditors in the capital market provide their services for a valuable function of lending their credibility over the financial statements of public listed companies in an attempt to reduce the information risk. The fairness and credibility of the audit depends upon the nature of the attestation provided by the auditors (Lu & Sivaramakrishnan, 2009, p. 71). For audit quality the size of the city-based audit office can be a crucial determinant to be taken into consideration along with the size of the national-level audit firm, due to the fact that the city-based offices of audit-firms serve to be semi-autonomous with their own client base.

In early years the quality may be impaired in auditor-client relationship. Carcello and Nagy (2004, p. 57) found that generally there is no evidence which proves that if auditor tenure is long, audit quality is impaired. There are certain reasons to why audit quality is supposed to be lower in the early year. One reason could be that in early years, the auditor is new to the client and doesn't possess much knowledge about the client's business, operations, controls, accounting policies and systems. Another reason could be that the new auditor is unaware of the industry error patterns. A relationship between both financial statement error patterns and fraudulent financial reporting, and, industry group has been revealed by previous studies. Fraudulent financial reporting prevails more to an extent where you have a fresh auditor having less knowledge about the client's industry.

Keywords: Audit quality, auditor-client relationship, auditing in SMEs, auditing in Kosovo, International Standards on Auditing (IAS), role of auditor, auditor size, auditor rotation, non-audit services, and auditor independence.

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