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# Justifications for the Modified Opinions and for Other Observations in the Audit Reports

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## Abstract

*The purpose of this paper is to identify and to comment the main justifications of modified audit opinions and the main observations included in the emphasis of matter paragraphs from the audit reports of Romanian companies listed on the regulated market of Bucharest Stock Exchange (BSE). The authors analyze a sample of more than 1,000 observations-year for the 2007-2019 period. They found that 25% of these reports contain a modified opinion and the main explanations relate to the revaluations of fixed tangible assets, to the provisions, to the impairment of the fixed assets, to some legal issues, to items concerning the closing inventory and, to a lesser extent, to the going concern matters. In 30% of the reports analyzed, there was identified emphasis of matter paragraphs; the main observation is by far related to the going concern, followed by the financial and operating difficulties of companies and by the effects of different global crisis (financial or others).*

**Keywords:** *audit reports, (un)modified opinion, justifications, emphasis of matter paragraphs, Romanian listed companies*

**JEL Classification:** *M41, M42*

### To cite this article:

Istrate, C., Bunget, O.C., Popa, I.E. (2020), Justifications for the Modified Opinions and for Other Observations in the Audit Reports, *Audit Financiar*, vol. XVIII, no. 4(160)/2020, pp. 785-800, DOI: 10.20869/AUDITF/2020/160/026

### To link this article:

<http://dx.doi.org/10.20869/AUDITF/2020/160/026>

Received: 7.07.2020

Revised: 9.07.2020

Accepted: 28.09.2020

## Introduction

The accounting/financial reporting quality depends on several variables and it translates into several dimensions: earnings management, timely loss recognition, and value relevance. In order to diminish certain risks connected to companies' intentions to manipulate accounting data, the way in which companies produce and report such data is subject to external control, performed by an independent professional – the financial auditor. Even if the auditor cannot make accounting decisions for their clients, the opinion they produce offer advices and recommendations to correct the material errors and, thus, have a direct impact on the accounting quality (Knechel et al., 2020).

Thus, to the quality of the financial reporting we must add quality of auditing, these two terms being intrinsically linked (DeFond & Zhang, 2014). The literature on auditing-connected topics is very rich; it is the result of various methodologies, and it is of an increasing impact (Andrikopoulos and al., 2016). As far as articles on audit reports are concerned, the research questions often tackle the audit opinion (with many authors who focus on potential explanations of the modified opinions, most often on the going concern matters). We also find other justifications for the modified opinions, and a lot of other matters that the mention, without, however, modifying the opinion. If an auditor issues a modified opinion, he sends an alert to the users of the financial statements about the compliance with the financial reporting standards (Chen et al., 2017).

Our study is essentially descriptive and our goal is to supply an overview of the explanations given by the auditors who issue modified opinions on the financial statements of Romanian companies listed on the regulated market. At the same time, we found that, in a large number of cases, auditors' opinion is not modified, but the audit report contains observations in the emphasis of matter paragraph on how economic entities produced and presented their financial statements.

To the best of our knowledge, this study is the first which analyses the justifications of modified audit opinions and observations made by auditors of Romanian companies listed on the regulated market of the Bucharest Stock Exchange (BSE), for such a long period (2007-2019) and for more than 1,000 observations.

The main results of our study demonstrate that – under the circumstances where the Big 4 represent 37% of the auditors of the Romanian companies listed on the regulated market – modified opinions in all their forms (qualified opinions, adverse opinion, and disclaimer of opinion), represent 25%. We found an important list of explanations, but the main ones concern the revaluation of fixed assets and problems connected to closing of the financial year matters. As far as observations made in an emphasis of matter paragraph are concerned, 30% of the reports contain such a paragraph and the main explanation are about going concern assumption. These observations, to which explanations of modified opinions are added, turn going concern into the most sensitive and most frequently present topic in the auditors' reports on Romanian listed companies.

In what follows, our study includes a literature review of the audit opinion and its main forms – modified and unmodified, materials and method, the main results and discussions and conclusions.

## 1. Literature review

We have chosen to present the literature review by approaching two aspects: on the one hand, audit reports and audit opinion in the context of auditing quality, in relation to the type of auditor and the type of opinion – markedly modified, and, on the other hand, research on audit reports of Romanian companies.

### 1.1. Audit opinion and audit quality

Literature has established that the main factors which determine auditing quality are the independence of the auditor and his competence (DeAngelo, 1981; DeFond & Zhang, 2014). The most frequently used proxy to measure an auditor's independence is the audit opinion (Garcia-Blandon and Argiles, 2015), to which audit fees are added (DeFond & Zhang, 2014). In fact, it is precisely a modified opinion which suggests such independence. Garcia-Blandon and Argiles (2015) find that the long tenure of the same auditor can damage the latter's independence.

As for the results of the auditing mission, DeFond & Zhang (2014) identify four elements in the literature, which can be used when measuring audit quality:

- the highlighting of significant anomalies in the auditor's work;

- elements connected to the audit's communicative power (especially a going concern opinion);
- the quality of the financial presentation and of measurement indicators (discretionary accruals, quality of accruals, prudence);
- the elements connected to how users perceive the quality of financial information, including its confirmation by auditors (capital cost, the evolution of market price).

A modified opinion delivered by the auditor sends a signal to the users of the financial statements, that the financial reporting is unreliable (Chen et al., 2017). In fact, the possibility of the auditor to issue a modified audit opinion is a strong leverage in the negotiation between the auditor and the client, in the sense that the client accepts to resolve the detected audit adjustments (Ruhnke & Schmidt, 2019).

Conducting a research for the 1994 – 2012 period, and on companies audited by Big N auditors, Chen et al. (2017) found that the average of the modified opinions (including opinions with an explanatory paragraph) is about 17%, but there are significant differences between countries. For the period 2007-2015, the auditors of the companies listed on Shanghai and Shenzhen Stock Exchanges (more than 15,000 observations) provide only 2.65% of modified opinions.

## 1.2. Researches on the audit opinions in the Romanian context

Given the relatively short period of operation of the Romanian financial market (since 1995) and the fact that since 1995 accounting regulations and auditing standards have evolved quite significantly – just like the organisation of the financial auditor profession in Romania – literature on audit quality in Romania, including on the contents of audit reports and the justification of the auditor's opinion, is not very rich. The organisation which manages the financial auditor profession is the Romanian Chamber of Financial Auditors (CAFR), created in 1999, which adopted the international auditing standards as early as its inception. The literature warns us that, adopting high quality standards is not necessarily sufficient to achieve high quality in financial reporting and in financial auditing: the proper legal enforcement of the standards is also very important (Simunic et al., 2017).

The evolution of the number of financial auditors has been very fast, from about 400 in 2000 to approximately 4,000 currently (Fülöp, 2014). One first appreciation made by a member of the council of the Romania Chamber of Financial Auditors is that in audit reports published for Romanian listed companies, there are errors connected specially to form, which should not be present at this level (Botez, 2015). In another register, Păunescu (2015) demonstrates that it is likely that a small local auditor would not fully comply with ISA requirements, but this situation does not have a high impact on the quality of financial statements.

As far as the choice of the auditor is concerned, after analysing data from the financial year 2013, Jaba and al. (2015) found that for the Romanian listed companies there is a significant correlation between the field of activity, territorial distribution, financial performance and the choice of an auditor belonging to the Big 4. Robu & Robu (2015) report that the net income of companies that received an unmodified audit opinion has a significant and positive influence on investors' decisions and that the auditor's belonging to the Big 4 does not count in this context (the study is based on the 2012-2013 financial years for the Romanian listed companies). In their turn, Dobre & Brad (2015) notice (for 2010-2014) that the auditor's belonging to the Big 4 has a positive and significant impact on the value relevance of the Romanian listed companies.

The impact of the 2008 financial crisis on the activity of Romanian auditors is analysed by Bunget & al. (2014) who find that some consequences of the crisis were: an increase in the auditors' efforts during auditing missions, a significant decrease of audit fees, and an increase in the number of modified going concern opinions.

Robu et al. (2016) analyse the effects of auditors' rotation on the relevance of the financial information supplied to users; they find that the rotation of auditors, as it was practiced by Romanian listed companies from 2006 to 2014, influenced the global relevance of financial information, but taken individually, this influence on indicators is not significant. Toma & Robu (2014) measure the auditor's impact on how Romanian listed companies apply the accounting principle of prudence, and find that this influence can be observed at the level of equity and liabilities, and that companies whose auditor belongs to the Big 4 are much more prudent than the others. Cordoş & Fülöp (2013) conclude that for the 25 most important capitalisations of the Bucharest Stock

Exchange, the auditor rotation has rather negative effects, in terms of independence. The role of the financial audit in mitigating the effects of the real and accrual earnings management is analysed by Carp & Georgescu (2019).

Some explanations for the modified audit opinions issued for the Romanian listed companies are presented by Dănescu & Spătăcean (2018) for the period 2008-2016 (217 audit reports); they conclude that the modification of the audit report is mainly justified by the absence of sufficient audit evidence on the recognition and measurement as assets. Analysing another category of public interest entities, Istrate (2018) found that, in the case of big Romania state owned companies who had to apply IFRS in their financial statements, the proportion of modified opinions in the audit report was 71%. However, taking into consideration all the Romanian state-owned companies, the Romanian Ministry of Public Finance found only 14.43% of modified opinions for the 2019 financial year (MFP, 2019).

For a period of three years (2016-2018), and only for the biggest companies listed on BSE, Tache (2020) found that the opinion shopping hypothesis is not confirmed.

## 2. Methodology and population

In our analysis, we focused on audit reports that accompany the financial statements of Romanian listed companies on the BSE, on the regulated market. The period for which we have available reports is 2007 – 2019. The year 2007 represents the first year for Romania as a full member of the EU. We divided this period in two sub-period: 2007-2011 – five years of mandatory application, in the individual financial statements of the listed companies, of the Romanian Accounting Standards (RAS), based on the EU directives, and 2012-2019 – eight years with the mandatory application of the IFRS in the statutory accounts of the listed companies. These two sub-periods could allow us to observe the effects of the application of the IFRS on the audit reports, if any. In this respect, we present sub-totals and averages for the two sub-periods for some of our data. In the case of the companies listed after 2012, we eliminated the observations with an application of RAS, in order to have two homogenous sub-sample: only RAS for the 2007-2011 and only IFRS for 2012-2019. We choose to not eliminate financial companies from our analysis.

**Table no. 1. Composition of the sample and auditor category**

Year	Companies with available audit reports	Auditor category					
		Big 4		Non Big 4i		Local non Big 4	
		N	%	N	%	N	%
2019 IFRS	78	27	34.62	21	26.92	30	38.46
2018 IFRS	80	30	37.50	18	22.50	32	40.00
2017 IFRS	82	33	40.24	13	15.85	36	43.90
2016 IFRS	82	33	40.24	13	15.85	36	43.90
2015 IFRS	81	33	40.74	10	12.35	38	46.91
2014 IFRS	81	32	39.51	13	16.05	36	44.44
2013 IFRS	82	34	41.46	12	14.63	36	43.90
2012 IFRS	77	29	37.66	12	15.58	36	46.75
<b>Total IFRS sub-period</b>	<b>643</b>	<b>251</b>	<b>39.04</b>	<b>112</b>	<b>17.42</b>	<b>280</b>	<b>43.55</b>
2011 RAS	89	34	38.20	8	8.99	47	52.81
2010 RAS	88	31	35.23	7	7.95	50	56.82
2009 RAS	87	29	33.33	6	6.90	52	59.77
2008 RAS	89	28	31.46	5	5.62	56	62.92
2007 RAS	88	28	31.82	6	6.82	54	61.36
<b>Total RAS sub-period</b>	<b>441</b>	<b>150</b>	<b>34.01</b>	<b>32</b>	<b>7.26</b>	<b>259</b>	<b>58.73</b>
<b>Total</b>	<b>1,084</b>	<b>401</b>	<b>36.99</b>	<b>144</b>	<b>13.28</b>	<b>539</b>	<b>49.72</b>

Source: Own projection, based on data analyzed

In **Table no. 1** we have described the structure of the sample by year and by category of auditors. In the analysed audit reports, we identified several variables:

- the category of auditors (Big 4 vs others auditors): it is frequent in literature to make this distinction; DeFond & Zhang (2014) cite many articles which argue that

the Big 4 ensure better audit quality (through the Big 4's size and attraction for candidates, as well as through their possibilities to train auditors and follow-up their work); for the non-Big 4 auditors, we adapt a proposal of Păunescu (2015) and separate another two categories: those internationally affiliated (non-Big 4i) separated from the local non-Big 4; similar classification are used, in the Romanian context, by Levanti (2019) and Istrate (2018);

- the type of opinion: unmodified vs modified (qualified, adverse opinion, disclaimer of opinion) and the justifications for these opinions;
- the presence in the report of an emphasis of matters paragraph, and the observations provided in these paragraphs.

„All data were manually collected from the individual annual reports of the Romanian listed companies (there are very few companies that consolidate); these reports are available, in general, on the site of the BSE, but we complete some data by searching on the companies' websites.

In **Table no. 1** we notice, first of all, that the proportion of the Big 4 among the auditors of Romanian listed companies is quite limited when compared to developed countries: an average of 36.99% for a minimum of 31.46% (in 2008) and a maximum of 41.46% (in 2013). However, we could notice a relatively constant increase

in the weight of Big 4 auditors and a very important increase in the number of non-Big 4 internationally affiliated (non-Big 4i), from a minimum of 5.62% in 2008 to 26.92% in 2019. Together, these two auditors' categories have, in 2019, more than 60% of the audit market for the listed companies – a very important increase, compared to the 2007 situation. In Spain, Garcia-Blandon and Argiles (2015) find 92% of the Big 4 among the auditors of listed companies, for the period 2002-2009. In a group of 5 developing countries – from MENA region (Middle East and North Africa) – Sarhan et al. (2019) found 59% of Big 4 for some non-financial listed companies. In the case of another emerging ex-communist country, Slovenia, Štager (2018) found that all Slovenian listed companies are audited by Big 4 auditors.

We must notice that the clients of Big 4 auditors are bigger in size than the client of non-Big 4i and of local non-Big4 (according to the average of the natural logarithm of total assets).

### 3. Results and discussions

First, we highlighted modified opinions vs. unmodified opinions identified in the audit reports of Romanian listed companies. The unmodified opinions, by category of auditor are presented in **Table no. 2**.

**Table no. 2. Unmodified opinion for the Romanian listed companies, by auditor category**

Year	Total available observations	Unmodified opinions		From which					
				Big 4		Non-Big 4i		Local non-Big4	
		N	%	N	%	N	%	N	%
2019 IFRS	78	62	79.49	25	40.32	13	20.97	24	38.71
2018 IFRS	80	67	83.75	28	41.79	11	16.42	28	41.79
2017 IFRS	82	66	80.49	28	42.42	9	13.64	29	43.94
2016 IFRS	82	67	81.71	28	41.79	8	11.94	31	46.27
2015 IFRS	81	63	77.78	26	41.27	6	9.52	31	49.21
2014 IFRS	81	61	75.31	25	40.98	7	11.48	29	47.54
2013 IFRS	82	61	74.39	25	40.98	7	11.48	29	47.54
2012 IFRS	77	53	68.83	20	37.74	5	9.43	28	52.83
<b>Total IFRS sub-period</b>	<b>643</b>	<b>500</b>	<b>77.76</b>	<b>205</b>	<b>41.00</b>	<b>66</b>	<b>13.20</b>	<b>229</b>	<b>45.80</b>
2011 RAS	89	68	76.40	22	32.35	8	11.76	38	55.88
2010 RAS	88	61	69.32	21	34.43	3	4.92	37	60.66
2009 RAS	87	60	68.97	19	31.67	2	3.33	39	65.00
2008 RAS	89	56	62.92	17	30.36	3	5.36	36	64.29
2007 RAS	88	63	71.59	17	26.98	4	6.35	42	66.67
<b>Total RAS sub-period</b>	<b>441</b>	<b>308</b>	<b>69.84</b>	<b>96</b>	<b>31.17</b>	<b>20</b>	<b>6.49</b>	<b>192</b>	<b>62.34</b>
<b>Total</b>	<b>1,084</b>	<b>808</b>	<b>74.54</b>	<b>301</b>	<b>37.25</b>	<b>86</b>	<b>10.64</b>	<b>421</b>	<b>52.10</b>

Source: Own projection, based on data analyzed

We can compare these figures with the situation in other countries. In Spain, for instance, Garcia-Blandon and Argiles (2015) found an increase in the percentage of unmodified opinions during the period 2002-2006 (from 80% to 90%), followed by a decrease due to the crisis (towards 82% in 2008 and 84% in 2009). The same authors identified, for 2008 and 2009, a justifiable incidence of more modified opinions, accounted for by the risks connected to the going concern matters. Still in connection to the crisis, Chen and al. (2016) noticed that for American banks, auditors became much more prudent for the fiscal years 2008-2009, to the extent that they took lower risks at giving an unmodified opinion for banks which were going to go bankrupt, by comparison to the post-crisis period. For an emergent country like Iran, MohammadRezaei et al. (2016) noticed a radical evolution of the proportions of modified opinions: from approximately 96% in 1999 to 64% in 2010, in the context of the liberalisation of the auditing market; the percentage is 61% for the period 2006-2015 (MohammadRezaei and al., 2018). In Portugal, for the fiscal years 2006-2012, Heliodoro et al. (2016) find 43.57% modified opinions. In Turkey, between 2010 and 2013, Yaşar et al. (2015) found 10.6% modified opinions.

Lennox (2000) analysed the audit reports of companies listed on London Stock Exchange and found 161 reports with a modified opinion in a sample of 5,441 observations (2.96%, out of which 96 were qualified opinions) and 65 with unmodified opinion but with an emphasis of matters paragraph, explained by some accounting issues or on important uncertainties (among these reports, there are 103 with a going concern opinion).

Still in Spain, between 2001 and 2008, Abad and al. (2015) noticed 12.63% modified opinions (for listed companies). In Italy, for the financial year 2009, there were 87% unmodified opinions, to which were added 8% of other unmodified opinions, but emphasis of matter; in 2012, the total amounted to 92% (Provasi & Riva, 2014).

The situation in Romania, with an average percentage of almost 75% of non-modified opinions, is quite far from the developed countries for which figures are available, but we can suppose that it is close to certain emergent countries. Unfortunately, it has been impossible for us to find figures for the other ex-communist countries in Central and Eastern Europe.

The type of auditor (the auditor's size) and the opinion represent two categories of variables that are much frequently used to measure auditing quality (DeFond & Zhang, 2014). In the case of Romanian listed companies, the proportion of modified opinions issued by the Big 4 is a little bit greater than the weight of the Big 4 in the total number of auditors who work for these companies.

For Australia, Carson et al. (2016) analysed the audit reports of listed companies between 2005 and 2013, and noticed a decrease of unmodified opinions from 84.8% (in 2005) towards 64.3% (in 2003), but this decrease is accompanied by an equivalent increase of unmodified opinions accompanied by an emphasis of matter paragraph, from 13% in 2005 to 32.3 % in 2013. Thus, the total of the two is relatively constant, at 96% – 97%, and modified opinions range only between 2% and 4%.

### 3.1. Modified opinions in the audit reports of Romanian listed companies

According to IAS 705 *Modifications to the opinion in the independent auditor's report* (ISA 705 on <http://www.ifac.org/system/files/downloads/a038-2010-iaasb-handbook-isa-706.pdf>, accessed on 15.12.2016), "the auditor will clearly express a proper modified opinion on financial statements in the following cases:

- (a) the auditor concludes that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement;

or

- (b) the auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatements."

Among the audit reports that we were interested in, there are 276 (more than 25%) which contain modified opinions (**Table no. 3**).

In order to be more precise, we should complete the figures provided in **Table no. 3** and add that we found all three types of modified opinions: qualified opinions (244), adverse opinions (13, of which 10 for the same company, from 2010 to 2019) and the disclaimer of opinion (19, for 9 different companies). In fact, a modified opinion for a financial year is often followed by another modified opinion, during the following year. This

confirms the conclusion of Lennox (2000), who states that a modified opinion is more likely to be expressed for a company which has already received this type of opinion the previous year, especially in the case when the auditor has been maintained.

In the case of modified opinions, the weight of the Big 4 and non-Big 4 is more important (36%, respectively 21%) than their respective proportion in the total audit opinions that accompany the annual financial statement of the Romanian listed companies (35%, respectively 13%). The concentration of modified opinions for these two categories of auditor is, probably, justified by the increased independence associated with this type of auditor.

The weight of modified opinions before the application of IFRS (30.16%) is more important than

after the mandatory application of IFRS (22.12%), even if we do notice a significant increase of modified opinions in 2012 (the first IFRS year), in comparison with 2011 (the last year when the RAS were in force); there was a passage from 21 to 24 modified opinions, paralleled by a slight decrease in the number of companies (from 89 to 77). This situation can be explained precisely through the transition to the IFRS, for which Romanian companies had very little time to prepare. The obligation to adopt the IFRS was made public in June 2012, for the financial year 2012! The average of the modified opinions is high comparing to other European countries: Garcia-Blandon et al. (2020) found 16% of modified opinions for the 2006-2013 period in the case of Spanish listed companies.

**Table no. 3. Modified opinions in the auditors' reports – Romanian listed companies**

Year	Total available observations	Modified opinions		From which					
				Big 4		non Big 4i		Local non-Big4	
		N	%	N	%	N	%	N	%
2019 IFRS	78	16	20.78	2	12.50	8	50.00	6	37.50
2018 IFRS	80	13	16.25	2	15.38	7	53.85	4	30.77
2017 IFRS	82	16	19.51	5	31.25	4	25.00	7	43.75
2016 IFRS	82	15	18.29	5	33.33	5	33.33	5	33.33
2015 IFRS	81	18	22.22	7	38.89	4	22.22	7	38.89
2014 IFRS	81	20	24.69	7	35.00	6	30.00	7	35.00
2013 IFRS	82	21	25.61	9	42.86	5	23.81	7	33.33
2012 IFRS	77	24	31.17	9	37.50	7	29.17	8	33.33
<b>Total IFRS sub-period</b>	<b>643</b>	<b>143</b>	<b>22.27</b>	<b>46</b>	<b>32.17</b>	<b>46</b>	<b>32.17</b>	<b>51</b>	<b>35.66</b>
2011 RAS	89	21	23.60	12	57.14	0	0.00	9	42.86
2010 RAS	88	27	30.68	10	37.04	4	14.81	13	48.15
2009 RAS	87	27	31.03	10	37.04	4	14.81	13	48.15
2008 RAS	89	33	37.08	11	33.33	2	6.06	20	60.61
2007 RAS	88	25	28.41	11	44.00	2	8.00	12	48.00
<b>Total RAS sub-period</b>	<b>441</b>	<b>133</b>	<b>30.16</b>	<b>54</b>	<b>40.60</b>	<b>12</b>	<b>9.02</b>	<b>67</b>	<b>50.38</b>
<b>Total</b>	<b>1,084</b>	<b>276</b>	<b>25.48</b>	<b>100</b>	<b>36.23</b>	<b>58</b>	<b>21.02</b>	<b>118</b>	<b>42.75</b>

Source: Own projection, based on data analyzed

**3.1.1. Main justifications of the modified audit opinions**

Bunget & Dumitrescu (2012), in a study on opinions given by a local audit company for its clients (approximately 50 entities), found that the main observations written by auditors in their reports are concerned with the compliance with the accounting

principle of prudence, followed by the principle of permanence of methods, while observations about the going concern are at a quite limited level (approximately 6.5% of the total observations). Bendovski (2014) identifies 10 main errors noticed by auditors in the accounting of 30 Romanian companies (without specifying if the companies are listed or not and without

specifying the frequency of the apparition of these errors): treatment of the revaluation reserve, spreading of certain charges/revenues over a larger time-span, deferred recognition of certain acquisitions /sales of stocks, compensation of advance payments with supplier liabilities, presentation of some provisions, non-disclosure of transactions with related parties, erroneous cancellation of provisions, inappropriate recognition of discounts, buy-backs, delayed update of debts/liabilities in foreign currencies, omission of recognize impairment of some assets (especially receivables).

In a broader perspective, among the other reasons mentioned in the literature and which justify auditors' modified opinions, we find the following:

- going concern, non-compliance with accounting regulation, impairment of receivables, litigations, uncertainties about the fair value of fixed assets or of other assets (Lennox, 2000);
- going concern, evaluation of assets (including receivables), weaknesses in the internal control system, the first year of mandate, contingencies (Vanstraelen, 2002);
- income tax, non-confirmation of liabilities/receivables, measurement of costs, impairment of receivables, recognition of charges/revenues, contingencies, non-preparation of consolidated financial statements, classification of assets/liabilities, provisions, impairment of inventories, of fixed assets, of financial assets, goodwill, going concern, disclosure on related parties, others (MohammadRezaei et. al, 2016);
- clients' financial difficulties, increasing risks for auditors in case of client's bankruptcy (Bunget et. al, 2014);
- problems connected to the recognition of equity (35%), of assets (23%), liabilities (20%) and other elements (22%) (Heliodoro et al., 2016);
- accounting treatment of goodwill, tax matters (especially connected to criteria of charges deductibility), problems connected to the adjustment of the accounting value of assets and liabilities, the bad accounting recognition of certain charges (Abad and al., 2015).

In **Tables 4** and **7** we report data from the audit reports which contain modified opinions and/or emphasis of matters paragraphs. Our data come from audit reports over a 13-year period, so it seemed useful to us to

supply information for the entire sample as well as for each year and to mention, as well, the number of companies concerned by these opinions, following Lennox (2000). **Table no. 4** shows the main explanations given by auditors when they modify their audit opinion. We only included the explanations which are featured 13 times or more (13 is the number of years of our analyzed period).

The first source of justification for a modified opinion issued by the auditors of Romanian listed companies concerns the revaluation of fixed tangible assets, which confirms the results reported by Bendovski (2014). In our sample, and for the same period, looking in the notes to the financial statements, we found that a majority of Romanian listed companies (82%) use the model of revaluation for property, plant and equipment (PPE), especially for buildings and lands, and that the transition to the IFRS does not significantly changed this situation. Or, revaluation is a technique which should require the intervention of an external evaluator (which is not always the case, for certain companies in our sample); in addition, the rules followed for the recognition of the revaluation according to the IFRS require more attention after 2012 than before, when RAS were in force. The following two explanations (provisions, impairment of fixed assets) are connected precisely to estimations that Romanian listed companies should make, mainly, upon closing. It seems that the procedures applied in this sense by Romanian companies and the implementation of these procedures are not fully aligned to requirements of accounting standards. Identifying assets write-down modified audit opinions is current in the literature (Zhao & Zhang, 2008). As far as the number of companies to which explanations apply, one can easily notice that it is often twice lower than the frequency of the apparition of explanations, which suggests that the same explanation is valid at least for two financial years, sometimes for three or more consecutive financial years, for the same company. In the case of going concern, this can be easily explained by the length of the reorganisation process which seeks to improve companies' performance, in the case of companies in insolvency. On the contrary, for the other explanations, beyond two financial years, this observation evinces certain inertia in the application of accounting procedures, a certain reluctance, on the companies' part, to correct data according to auditors' observations. The annual



distribution of explanations of modified opinions is quite constant (for the total number of explanations, as well as for each individual one), reaching, however, a maximum in 2008 – the year of the beginning of the

global financial crisis. We can therefore conclude that the impact of the change of accounting standards (transition to IFRS in 2012) was not really significant in terms of the justification of modified opinions.

**Table no. 4. Main justifications for the modified opinions in the audit reports of Romanian listed companies**

Justification	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Total	Number of different companies
1. Fixed assets revaluation	8	9	11	4	6	5	7	6	4	5	6	5	4	80	34
2. Provisions	4	9	5	6	4	4	2	4	3	3	4	3	1	52	17
3. Fixed assets' impairment	3	3	3	3	3	2	4	5	5	4	6	4	3	48	18
4. Legal issues	2	4	5	4	3	1	3	4	4	3	5	4	4	46	19
5. Closing issues	6	4	2	8	5	4	2	4	2	2	3	1	1	44	22
6. Going concern	0	2	2	2	2	4	6	4	4	5	3	4	5	43	14
7. Receivables' impairment	3	5	3	3	2	4	5	5	3	2	1	1	4	41	24
8. Recognition of revenues and charges	5	5	3	5	3	0	2	4	1	3	3	1	3	38	18
9. Recognition and classification of assets and liabilities	2	1	2	4	2	3	4	3	4	2	2	2	3	34	11
10. Cost measurement	2	3	1	3	1	2	4	5	2	1	2	2	2	30	9
11. Weaknesses in internal procedures	3	6	5	1	2	1	0	1	2	4	2	1	1	29	12
12. Inventories impairment	2	2	1	4	3	1	3	1	2	2	2	2	2	27	11
13. Impairment of financial assets	1	3	3	4	2	1	1	0	0	2	3	2	4	26	15
14. Accounting recognition of some transactions	4	3	1	1	1	3	1	1	1	2	1	1	2	22	12
15. Comparability issues	1	1	0	2	0	1	3	4	2	1	3	1	2	21	12
16. Related parties	1	1	2	3	3	3	1	0	0	1	2	2	1	20	9
17. Non confirmation of the receivables /liabilities	1	3	2	2	1	1	2	0	2	1	1	2	2	20	11
18. Fixed assets depreciation	1	2	3	3	1	1	2	0	0	0	0	0	0	13	6
19. ERP matters	2	1	1	0	0	2	2	1	1	0	1	1	1	13	3
20. Others*	0	2	2	4	2	2	7	9	4	5	9	6	3	55	-
<b>Total</b>	<b>51</b>	<b>69</b>	<b>57</b>	<b>66</b>	<b>46</b>	<b>45</b>	<b>61</b>	<b>61</b>	<b>46</b>	<b>48</b>	<b>59</b>	<b>45</b>	<b>48</b>	<b>702</b>	<b>-</b>

\* These other elements are: fiscal issues, deferred taxation, IFRS 5 application, difficulties in the relationship with the management of the company, application of the IFRS, incomplete disclosure in notes, current income tax, exposure on a single client or activity, environment matters.

Source: Own projection, based on data analyzed

### 3.1.2. Going concerns opinions in the audit reports of Romanian listed companies

In the literature, a significant place in the analysis of modified opinions is given to the going concern matters and it can be a sign of high auditing quality (Mande et al., 2017; Tanyi & Litt, 2017; Brocard et al., 2018); but DeFond & Zhang (2014) warn us that this can be due to an excessively prudent behaviour of the auditors, so as to avoid litigations which, in their turn, can damage auditing quality. Garcia-Blandon & Argilés Bosch (2016)

complete the image of the situation in Spain (which we mentioned earlier) by providing a percentage of approximately 10% (13 out of 135) of going concern opinions among all the modified audit opinions received by the Spanish listed companies, between 2002 and 2010.

With reference to the American context, DeFond & Zhang (2014) found that the going concern opinions are relatively rare and they are exclusively connected to clients in a difficult situation. In another study, DeFond &

Lennox (2011) find approximately 17% modified opinions justified by going concern matters, for the case of American companies; the majority of these opinions come from small or medium sized audit companies. The explanation they give consists in the poor financial health (on average) of the clients of small audit companies. On the other hand, Carson and al. (2013) notice – for American companies – that going concern opinions are more frequent for small enterprises – from 20.14% to 42.08%, from 2000 until 2010, for stock-exchange capitalisations lower than \$ 75 m – and they drop significantly in direct correlation with the size of capitalisations (a very stable percentage of 0.33%, for capitalisation higher than \$ 500 m); for the total number of companies included in their sample, Carson and al. (2013) calculated an increase of the weight of this type of opinion from 9.82% in 2000 to 17.01% in 2010.

In what Romanian listed companies are concerned, explanations of modified going concern opinions are present in only 43 out of 1.084 reports (3.97%) and they concern 14 companies, against a yearly average of about 83 companies. 40 of these 43 companies report either negative equity, or important losses for the financial year they receive the going concern opinion. But these figures must be completed by observations on going concern present in unmodified opinion reports containing an emphasis of matter paragraph (Table no. 6). In these paragraphs, explanations based on going concern matters, by far, the most frequent (97 out of 635, which is 15.28%). In certain cases, the going concern observations can look like a modified opinion

(Carson and al., 2013). If we take into account this methodology, for the case of BSE, we arrive at a total of  $43 + 97 = 140$  references to going concern matters in audit reports. This means that there was an average of 10.77 apparitions per year, for an average number of 83 listed companies: almost 13% of the yearly audit reports contain, on average, an observation connected to the going concern.

### 3.1.3. Opinion shopping hypothesis

We know that a firm engages in opinions shopping trying to influence the auditor decision in order to obtain a more favourable decision than supported by the quality of its financial reporting (Xie et al., 2010). We consider that it is interesting test if the switch of the auditors by companies which received a modified opinion, leads to a change towards a clean opinion, and to compare figures with those reported by Lennox (2000). After doing this test, we noticed that for the studied period, there are 150 changes of auditors, and in the case of 103 observations (69%) these changes lead to the same type of opinion. Between the 47 others observations, we found that in 20 cases (13%) the auditor switch is followed, in the first year of the new auditor, by a change from a modified opinion to an unmodified opinion (Table no. 5). In the other 27 cases (18%), there is a change from an unmodified to a modified opinion. These results are consistent with the findings of Tache (2020), but diverge with the proposition put forth by Lennox (2000).

**Table no. 5. Changes in the audit opinions in the case of the rotation of the auditors**

Changes between auditors' categories	Total	No change of the opinion		Changes in the auditor' opinion, after the rotation of the auditor			
				From a modified opinion to an unmodified opinion		From an unmodified opinion to a modified opinion	
		N	%	N	%	N	%
From Big 4 to Big 4	34	28	82.36	3	8.82	3	8.82
From Big 4 to local non-Big 4	4	2	50.00	1	25.00	1	25.00
From Big 4 to non-Big 4i	18	16	88.89	2	11.11	0	0.00
From local non-Big 4 to Big 4	16	8	50.00	0	0.00	8	50.00
From non-Big 4i to Big 4	6	4	66.67	0	0.00	2	33.33
From non-Big 4i to local non-Big 4	5	3	60.00	2	40.00	0	0.00
From non-Big 4i to non-Big 4i	4	2	50.00	2	50.00	0	0.00
From local non-Big 4 to local non-Big 4	52	33	63.46	9	17.31	10	19.23
From local non-Big 4 to non-Big 4i	11	7	63.64	1	9.09	3	27.27
<b>Total</b>	<b>150</b>	<b>103</b>	<b>68.67</b>	<b>20</b>	<b>13.33</b>	<b>27</b>	<b>18.00</b>

Source: Own projection, based on data analyzed

If we consider the modified opinion as a proxy for the audit quality, then the relative increase in the number of modified opinions following the auditor rotation could signal an improvement in the quality of the audit.

### 3.2. Emphasizes of matters paragraphs in the audit reports

ISA 706 *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report* stipulates that "if the auditor considers it necessary to draw users' attention of to a matter presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to the users' understanding of the financial statements, the auditor shall include an Emphasis of Matter paragraph in the auditor's report provided the auditor has obtained sufficient appropriate audit evidence that the matter is not materially misstated in the financial statements". The presence of such a paragraph is very common. Czerney et al. (2019) found an increasing percentage in the reports containing a clean opinion, from 41.5% in 2000 to 85.8% in 2007, and the most frequent explanation provided by the auditors are issues about the application of the accounting principles, supplemental information, audit-related scope limitations.

Thus, in the audit reports which are the object of our study, we identified 328 which contain such an Emphasis of Matter paragraph. In **Table no. 6**, we calculated the weight of these reports and we also presented the type of opinion which they accompany.

One can notice that observations are present in numerous reports with an unmodified opinion, as well as in reports with a modified opinion. However, the tendency goes towards a decreasing presence of such a paragraph in reports with an unmodified opinion. In the literature we found a study by MohammadRezaei and al. (2016) who also identify a large number of auditing reports with an unmodified opinion, but which contain an emphasis of matter paragraphs.

The main types of observations that the auditors of Romanian listed companies consider to be important to present, because they are essential to the comprehension of financial statements, are centralised in **Table no. 7**. In this table we only included observations that appear more than 13 times, regrouping all others on a single line.

The main source of observations is, by far, the going concern assumption. As we could see earlier in this article, references to this topic is present in the explanations of modified opinions and those present in observations are, together, very numerous and the literature notices this presence in a large number of audit reports analysed for different markets and for different periods. Thus, the aspects related to going concern represent the majority of observations, just like in the case of Australia (Carson and al. 2016). In the case of Belgium, for non-listed companies, Hardies and al. report data which allow us to calculate the percentage of going concern opinions, which is around 10% (Hardies and al., 2016).

**Table no. 6. Audit report with an emphasis of matter paragraph**

Year	Total available observations	Audit reports containing an emphasis matters paragraph		Accompanying			
				Unmodified opinions		Modified opinions	
		N	%	N	%	N	%
2019 IFRS	78	29	37.18	18	62.07	11	37.93
2018 IFRS	80	20	25.00	11	55.00	9	45.00
2017 IFRS	82	20	24.39	10	50.00	10	50.00
2016 IFRS	82	19	23.17	11	57.89	8	42.11
2015 IFRS	81	30	37.04	15	50.00	15	50.00
2014 IFRS	81	27	33.33	16	59.26	11	40.74
2013 IFRS	82	23	28.05	14	60.87	9	39.13
2012 IFRS	77	12	15.58	8	66.67	4	33.33
<b>Total IFRS sub-period</b>	<b>643</b>	<b>180</b>	<b>27.99</b>	<b>103</b>	<b>57.22</b>	<b>77</b>	<b>42.78</b>
2011 RAS	89	27	30.34	18	66.67	9	33.33
2010 RAS	88	27	30.68	11	40.74	16	59.26
2009 RAS	87	27	31.03	13	48.15	14	51.85
2008 RAS	89	32	35.96	17	53.13	15	46.88
2007 RAS	88	35	39.77	22	62.86	13	37.14
<b>Total RAS sub-period</b>	<b>441</b>	<b>148</b>	<b>33.56</b>	<b>81</b>	<b>54.73</b>	<b>67</b>	<b>45.27</b>
<b>Total</b>	<b>1,084</b>	<b>328</b>	<b>30.26</b>	<b>184</b>	<b>56.10</b>	<b>144</b>	<b>43.90</b>

Source: Own projection, based on data analyzed

In the second position we find the financial and operating difficulties in the activity of some companies. According to De Fond et al. (2002), the financially distressed firms are more likely to receive modified audit opinion; for the companies in our sample, the auditors prefer to include this explanation in the emphasis of matter paragraph.

As expected, the going concern explanation is issued by the auditors in the case of companies reporting negative net income and/or negative equity. Out of 97 observations with a going concern explanation, 74 report losses, and out of the other 23 observations, 6 report negative equity. The financial crisis beginning in 2008 lead to an increase number of observations in the explanatory paragraph, as well as the 2020 Covid-19 crisis. In the latter case, the crisis was considered as an event after the reporting period, more precisely,

a non-adjusting significant event that are indicative on conditions that arose after the reporting period, and must be disclosed in notes (according to IAS 10).

In **Table no. 8** we present the category of auditors that delivered the modified opinion and emphasis of matter paragraph related to the most important explanations: revaluation of fixed assets, respectively, going concern matters. We follow Chen et al. (2017), in adding the unmodified opinions with an explanatory paragraph to the modified opinions.

The weight of the Big 4 (40.21%) in the total going concern observations is significantly higher than their weight in the total distribution of reports between the two categories of auditors, especially for the RAS period.

**Table no. 7. Justification in the emphasis of matter paragraphs from audit report of Romanian listed companies**

Type of observation	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Total	Number of different companies
1. Going concern	3	7	5	7	6	11	9	10	8	5	9	10	7	97	28
2. Financial and operating difficulties	6	6	7	6	6	6	8	4	5	1	6	6	1	68	28
3. Financial or other global crisis	4	9	5	5	6	4	1	0	0	0	0	0	21	55	34
4. Tax matters	9	7	4	2	4	1	4	5	5	2	4	4	4	55	22
5. Legal issues	4	2	3	2	4	4	4	4	5	5	4	3	4	48	20
6. Insolvency	1	1	1	0	2	3	3	4	4	6	7	5	4	41	12
7. Related parties	4	5	5	2	2	1	2	3	1	2	3	4	2	36	16
8. Provisions	3	2	3	2	5	2	4	2	4	2	2	2	3	36	19
9. Impairment of financial assets	2	4	1	1	1	4	3	2	1	2	1	2	2	26	8
10. Classification and recognition of asset/ liabilities	5	2	3	2	2	0	1	2	2	0	0	1	2	22	12
11. Internal procedures	4	3	0	2	2	0	0	1	3	1	3	2	1	22	14
12. Impairment of receivables	2	2	2	2	0	0	2	1	0	3	2	2	2	20	15
13. Revaluation	3	2	2	2	4	0	0	1	3	0	0	1	1	19	10
14. Comparability	3	2	0	1	1	1	0	1	3	2	1	0	3	18	17
15. Exposure on a single activity or on a limited number of clients/ suppliers	1	2	1	0	1	2	0	1	1	0	1	2	1	13	5
Others*	7	11	5	1	3	10	6	4	3	3	1	4	1	59	n.a
<b>Total</b>	<b>61</b>	<b>67</b>	<b>47</b>	<b>37</b>	<b>49</b>	<b>49</b>	<b>47</b>	<b>45</b>	<b>48</b>	<b>34</b>	<b>44</b>	<b>48</b>	<b>59</b>	<b>635</b>	

\* In decreasing order of occurrence, these other observations concern: non publication of consolidated financial statements, hyperinflation accounting, impairment of inventories, classification and recognition of revenues/charges, closing matters, impairment of fixed assets, application of IFRS, environmental matters, existence of financial and operating risks, recognition of some transactions.

Source: Own projection, based on data analyzed

## Conclusions

The aim of our study has been to describe how auditors of Romanian listed companies justify modified opinions and the emphasis of matter paragraphs they include in their financial audit reports. Therefore, the study is essentially descriptive and its main results show how

auditors evaluated the work of the preparers of the financial statements of Romanian listed companies.

Modified opinions and auditors' observations are often used as a proxy for auditing quality. We compared the results from our study with the results proposed by other papers in order to attempt to situate the case of Romania at an international level.

**Table no. 8. The main justifications in the audit reports, by category of auditor**

Type of observation	Total	Big 4		Non-Big 4i		Local non-Big4	
		N	%	N	%	N	%
<b>a) Explanations of the modified opinion</b>							
1. Revaluation of fixed assets	80	40	50.00	12	15.00	28	35.00
...							
6. Going concern matters	43	6	13.95	12	27.91	25	58.14
<b>b) Explanation in the emphasis of matters paragraphs</b>							
1. Going concern	97	39	40.21	22	22.68	36	37.11
...							
13. Revaluation	19	1	5.26	7	36.84	11	57.90
<b>c) Total going concern opinions and observations</b>							
- for the RAS period (2007-2011)	36	18	50.00	3	8.33	15	41.67
- for the IFRS period (2012-2019)	104	27	25.96	31	29.81	46	44.23
<b>d) Total justifications and observations on the revaluation</b>							
- for the RAS period (2007-2011)	51	21	41.17	8	15.69	22	43.14
- for the IFRS period (2012-2019)	48	20	41.67	11	22.92	17	35.41

Source: Own projection, based on data analyzed

The evolution of auditing and accounting in Romania has been rapid and strongly influenced by the international and regional context: the 2007 adhesion to the European Union and the orientation towards the IFRS and ISA, in the early 2000s.

One first observation which particularises the situation of Romania consists in the proportion of the Big 4 among the auditors who work for the listed companies: on average, the percentage is only 37% during the 13 that we analysed, by comparison to developed countries, where the Big 4 largely dominate the auditing market of listed companies. However, the trend is towards the increase of the role of the Big 4, especially in the IFRS context. The Romanian literature suggest us to identify more than 2 auditors' categories, separating the local auditors from the internationally affiliated ones. In these conditions, we have to add to the Big 4 auditors, the non-Big 4 affiliated to international networks, and we obtain 50%.

The population we studied represent the Romanian companies listed on the regulated market of the BSE: 1,084 observations for 13 years, after having eliminated observations with missing data. In all these reports, we found 74.54% unmodified opinions (with continuously increasing percentages over time), the remaining 25.46% including modified opinions, of all categories: the most numerous are qualified opinions (88.41%), but there are also adverse opinions (4.71%) and disclaimer of opinion (6.88%). The Romanian situation seems far from the average situation on developed financial markets.

In their reports, auditors must supply clear explanations for the modified opinion that they expressed. In the case of Romanian listed companies, the main explanations concern:

- the revaluation of fixed assets, in a context in which most companies revalue their fixed assets,

especially buildings and land, for reasons that are often linked to taxation;

- provisions and impairment of fixed assets, as estimates difficult to operationalize by companies with a short history in the application of a good set of accounting and financial reporting standards;
- legal issues;
- other closing matters;
- going concern matters etc.

The literature on audit reports contains many references to going concern assumption which, often, represent the main explanation for modified opinions. Yet, for Romanian listed companies, going concern is ranked 6<sup>th</sup> in the list of explanations of such opinions (43 observations in 702, that is 6.13%). However, we then noticed that going concern is, by far, the first among the observations presented in the emphasis of matter paragraph by auditors who express unmodified opinions. Together, the explanations of modified opinions and the observations in the emphasis of matter paragraph made that the going concern cover more than 10% of the explanations/observations.

In the analysis that we conducted in order to test the opinion shopping hypothesis, we noticed that this hypothesis is not really confirmed in the case of Romanian companies; on the contrary – there are more companies that changed the auditor and which received modified opinions, instead of unmodified opinions before the change.

Emphasis of matter paragraphs are present in 30.26% of the audit reports that we studied. Such paragraphs also occur in reports with a modified opinion, as well as in

reports with unmodified opinions. We have already stated that the main observation – far before the second (15.28% versus 10.71%) – is related to the going concern matters, just like in other studies. Other explanations highlight elements connected to the financial and operational difficulties in the activity of the company, the financial and other global crisis, tax matters, legal issues, insolvency, related party transactions, provisions etc.

The main limitation of our article is its descriptive character; to this we can add the small size of our sample, and the lack of data for other ex-Communist countries from Central and Eastern Europe. Another limitation of the study, which suggests as many venues for future research – consists in the absence, in our research, of a statistic correlation between the different variables specific to audit reports: length of an auditor's mandate (and, consequently, the rotation of auditors), audit fees, type of activity, size of analysed companies, ownership, financial performances of entities, evolution of prices on the financial market, leverage, earnings management, evolution of the regulation of auditing and accounting, the concentration of audit companies, the analysis of the subsequent situation of companies which went bankrupt and which received or did not receive a modified opinion, the quality control of audit companies, the gender of the audit partner who draws the report.

**Acknowledgments:** An earlier version of this paper was presented to the AMIS 2017 International Conference, at The Bucharest University of Economic Studies, Romania, and the authors would to thanks to the participants whose comments improved the paper.

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  51. The weight of the Big 4 (40.21%) in the total going concern observations is significantly higher than their weight in the total distribution of reports between the two categories of auditors, especially for the RAS period.