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Metamorphosis of Risks of Material Misstatement in Statutory Audit, from Identification to Canon, in the Context of Globalization

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Abstract

In a context marked by the intensification of concerns for sustainable practices and transparency in corporate communication, the analysis of the factors influencing companies' decision to publish sustainability reports becomes relevant. The study analyzes to what extent the organizational size, expressed by the number of employees, influences the probability that a company will prepare a sustainability report, in the context of the new reporting obligations introduced by the applicable European regulations from 2024. The analysis is based on a sample of the top 50 companies listed on the Bucharest Stock Exchange, providing a relevant perspective on their degree of compliance with the requirements imposed on companies with more than 500 employees. Also, a complementary direction of the research aims to identify a possible association between the sector of activity and the presence of sustainability reports in 2023, an analysis carried out by applying the Chi-square statistical test.

The authors focus their analysis on a period when sustainability reporting was not mandated by mandatory regulations, thus providing relevant context for investigating companies' voluntary behavior. The study compares companies that have chosen to publish sustainability reports with those that have not taken this step, aiming to identify the motivations and internal factors that influence the adoption of these practices. The results provide valuable insights into how organisations react in the absence of legislative pressures, contributing to understanding the mechanisms underpinning the transition to more transparent and accountable sustainable reporting.

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The study shows that large firms, especially those in sectors exposed to ESG risks, are more inclined to adopt sustainable reporting practices. It is also noted that Romania registers a growing interest in sustainability, reflected in the increase in the number of published reports, although this trend remains uneven.

The paper is relevant both for researchers, providing an up-to-date empirical basis for exploring the phenomenon of non-financial reporting in Eastern Europe and for practitioners, providing useful benchmarks in the development of ESG compliance strategies.

Key words: *ESG (Environmental, Social, Governance); sustainability report; Bucharest Stock Exchange; transparency; non-financial performance; internal factors; globalization;*

JEL Classification: *M42, M48*

Introduction

Economic globalization and the increasing complexity of the business environment have brought significant changes in the field of statutory audit. This article explores the metamorphosis of risks of material misstatement, from their identification to their implementation as standards (canon) within audit processes. Their applicability in practice will be a canon for audit firms both technically and financially.

The challenges associated with globalization, emerging technologies and the pressures of international regulations are analyzed, providing a comprehensive perspective on the adaptation of auditors to an ever-changing environment. The research addresses the topic of risks of material misstatement in statutory audit, given the impact of globalization and developments in ESG (Environmental, Social, and Governance).

Convergence between regulatory structures can serve the interests of global investment decision-making. However, it may also be important to raise the question of whether statutory audit regulation is in fact effective in protecting the broader public interest (C. Richard Baker, Jean Bédard, Christian Prat dit Hauret, 2014).

While sustainability reporting remains a voluntary act in the United States, the European Union has mandated that publicly traded companies, financial institutions, and public-interest entities comply with non-financial reporting standards (Stephen N. Hamilton and Richard D. Waters, 2022).

According to national and European law, certain large entities must meet non-financial reporting requirements, including information related to their environmental impact, human rights and corporate governance. "We are witnessing a profound change in the corporate reporting landscape, with ESG reporting evolving from a niche segment to a new valence, in which sustainability aspects are measured and reported with the same rigor as financial information. The independent assurance report issued by the financial auditor on sustainability reporting plays an essential role in building confidence on the robustness of non-financial information" (KPMG Romania).

Literature review

Sustainability reports play an increasingly important role in managing risks of material misstatement in audit, as they provide essential information about an entity's performance in areas that are not necessarily reflected in traditional financial statements, but which can have a material impact on the entity's risks and financial image. In the context of auditing, they can influence the identification and assessment of risks of material misstatement, and auditors need to integrate them into their audit process to get a full picture of the risks.

The importance of the sustainability report stems from the need for transparency and accountability towards stakeholders, including investors, customers, employees and local communities. The principles that underpin an effective sustainability report include integrity, accuracy, comparability and clarity (Rusu, T.M.; Odagiu, A.; Pop, H.; Paulette, L., 2024).

In Romania the legislative framework on sustainability ("ESG reporting") is represented by the Order of the Minister of Finance no. 85/2024 for the regulation of sustainability reporting aspects which entered into force in 2024 and partially transposes into national law Directive (EU) 2022/2464 of the European Parliament and of the

Council with regard to corporate sustainability reporting (CSRD Directive – Corporate Sustainability Reporting Directive).

Rule no. 4 of the FSA requires listed companies, except for micro-entities, to include in the directors' report information on the impact of the activity on sustainability, as well as the way in which sustainability aspects influence the performance and evolution of the company. The NBR issued Order no. 1/2024 which establishes the reporting requirements for credit institutions and insurance companies.

Romania is among the few countries in Europe that have a Sustainability Code.

The new sustainability reporting rules will start to apply gradually between 2024 and 2028, as follows:

- From January 1, 2024, for public interest companies with more than 500 employees, the reports being issued in 2025;
- From January 1, 2025, for large companies (exceeding two of the size criteria: over 250 employees and/or 40 million euros turnover and/or 20 million euros total assets), the reports being issued in 2026;
- From January 1, 2026, for listed SMEs, the reports being issued in 2027 (KPMG, 2024).

Statutory audit is an essential component of the global financial system, with the role of ensuring transparency and credibility of financial information. In a globalised context, auditors face increasingly complex risks of material misstatement, influenced by factors such as digitalisation, the diversity of national regulations and cross-border economic interactions.

In Romania, statutory auditing is regulated by a legislative framework that ensures compliance with European Union directives and regulations, adapting them to national specificity. Law no. 162/2017 on the statutory audit of the annual financial statements and the consolidated annual financial statements establishes the main rules in this area.

At the level of a regulated capital market, the reporting of a complete set of financial statements that include quality financial information is the desire of the main users for the purpose of making strategic or operational decisions (Grosu, M., Robu, I-B., Istrate, C., 2020).

The public interest role of statutory audit means that a broad community of individuals and institutions relies on the quality of the work of a statutory auditor or audit firm. A good quality audit contributes to the orderly functioning of markets by improving the integrity and efficiency of financial statements. As such, statutory auditors perform a particularly important social function (European Parliament, Council of the European Union, 2014).

The statutory audit is an important legal tool for controlling the legality of a company's registrations. The fundamental purpose of a statutory audit is to ensure objective, impartial, and expert oversight of the company's operations and its management to determine whether the company's operations were in compliance with the company's law, bylaws, and other acts (Aksamovic, Dubravka, 2024).

Methodology

Until 2024 Romanian legislation has not imposed a legal obligation on the submission of sustainability reports, leaving it up to companies to adopt such practices.

Analyzing the behavior of large companies in relation to sustainability reporting provides valuable insights into the relationship between organizational size and commitment to transparency. Sustainability reporting helps to identify and manage risks, both for companies and stakeholders, and for the general public, it increases confidence that companies comply with ethical, social and environmental principles, and for investors the reports reduce the risks of misrepresentation of financial and non-financial information. In the absence of a sustainability report, certain environmental, social or governance risks may not be reported or even underestimated. Example: Checking a company's carbon footprint can show the real level of engagement in the green transition.

The metamorphosis of risks of material misstatement involves an essential process within the audit, which starts with identifying them and continues with the implementation of appropriate standards to manage them effectively. This transformation represents a complex and strategic approach, with significant technical and financial implications for companies. As globalization continues to redefine the business environment, firms are facing new and diverse risks, which raises the question: is sustainability reporting an effective way to manage these risks?

Sustainability reporting facilitates effective risk management, starting with risk identification. The increase in international interdependencies amplifies vulnerabilities related to supply and logistics, the environmental impact can influence the operations and reputation of companies, adapting to international standards and legislation imposes new compliance requirements.

The sustainability report allows companies to identify and monitor these risks, providing a structured framework for collecting and analysing relevant data. For example, indicators such as greenhouse gas emissions (GHG Scope 1, 2 and 3) or renewable energy consumption can be used to assess environmental performance.

GHG Scope 1 includes direct emissions resulting from the company's activities, such as burning fuels in its own equipment.

GHG Scope 2 refers to indirect emissions from the consumption of electricity, heat or steam purchased.

GHG Scope 3 encompasses other indirect emissions in the value chain, such as transport or product use. Also, the consumption of energy from renewable sources is measured as a percentage of the total energy used, providing a clear perspective on the transition to sustainability.

The sustainability report is not only a transparency tool, but also a strategic mechanism for managing the risks generated by globalization. By adopting international standards and adapting to the demands of the global environment, firms can proactively address risks, thus ensuring long-term stability and growth.

Observing and analyzing the behavior of companies in Romania regarding sustainability reporting are essential for understanding their degree of preparedness in adopting responsible practices. In addition, promoting sustainability reporting, even in the absence of legal obligation, offers significant benefits both at the organizational level and for the Romanian economy and society. This practice contributes to the creation of a more responsible business environment, capable of meeting global demands and supporting the transition to a sustainable future.

It is interesting to note to what extent the number of employees of a company influences the probability that a company will submit the sustainability report, using as a case study the top 50 companies listed on the Bucharest Stock Exchange.

In particular, the research focuses on the period leading up to 2024, when sustainability reporting regulations were not yet mandatory. This period provides relevant context to understand factors such as corporate voluntarism and the social or economic pressures that drive the adoption of such initiatives. Data on the size of companies, measured by the number of employees, and the comparative analysis between companies that have submitted and those that have not submitted the sustainability report will be used to identify behavioral patterns and possible motivations.

Through this approach the study contributes to the literature on sustainability reporting, bringing empirical evidence on the influence of the organizational dimension on the adoption of this practice. The results obtained can provide valuable information for policymakers, private sector managers and researchers interested in corporate sustainability.

The sustainability report plays a key role in the audit process, contributing to a clearer and more detailed assessment of the organization's performance. The report provides auditors with an in-depth understanding of the environmental, social and governance (ESG) risks associated with the firm's business. The sustainability report helps to assess the correlation between financial performance and sustainability. For example, reducing costs through energy efficiency or resource management. The auditors verify the correctness and transparency of the information in the report, assuring the public and investors that the data is accurate and complete, this facilitates the identification of areas of vulnerability and possible opportunities for improvement.

A thorough understanding of environmental, social and governance (ESG) risks is essential for companies, investors and other stakeholders, having a direct impact on long-term sustainability and financial performance (**Chart no. 1**).

These risks refer to the critical aspects that can affect organizations in various and complex ways.

1. **Environmental risks (E - Environmental):** refers to the impact of the company's activities on the environment, as well as how environmental changes affect the company.

   Examples: climate change, natural resources, environmental regulations, biodiversity degradation, etc.

   A robust environmental risk assessment helps companies develop mitigation strategies, such as investing in green technologies or adopting the circular economy.

Chart no. 1. ESG risks

Source: authors' processing

2. **Social Risks (S – Social):** These focus on the company's relationships with employees, communities, customers, and other stakeholders.

   Examples: employee rights, community relations, health and safety, diversity and inclusion.

   Responsible management of social risks can improve the company's reputation, boost customer loyalty and attract quality workforce.

3. **Governance (G) risks refer to the way an organization is run and managed, with transparency, ethics and accountability in mind**.

   Examples: corruption and fraud, transparency, governance structure.

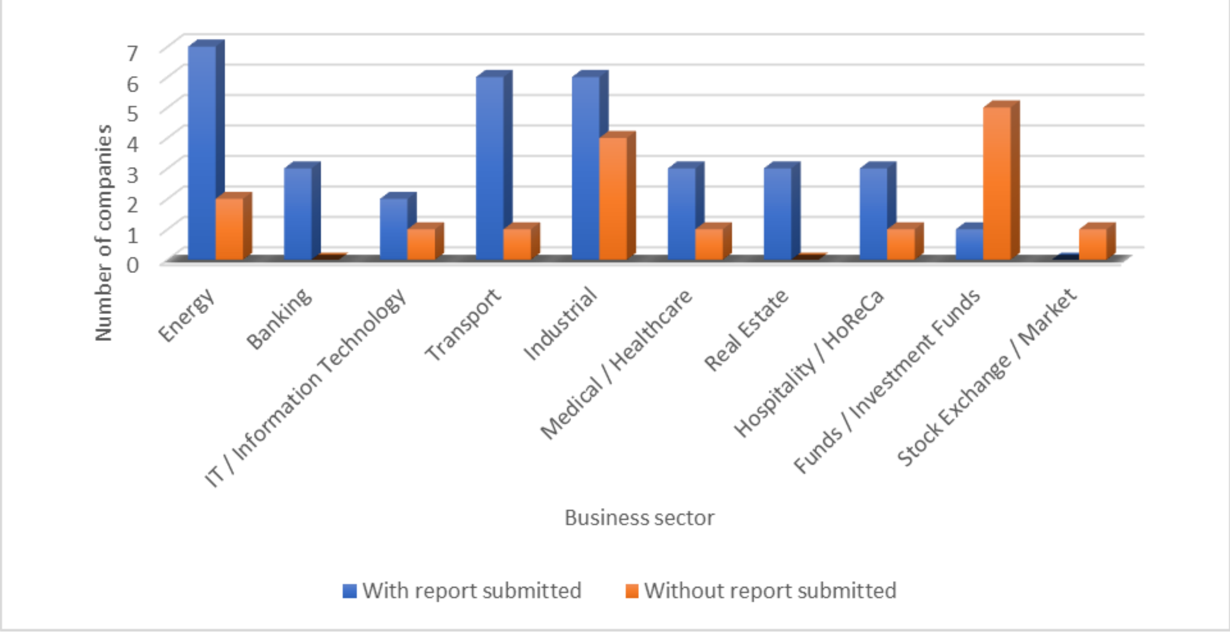
Failure to comply with local or international regulations can expose the organization to penalties and reputational losses.

We analyzed the top 50 companies listed on the BVB on the regulated market, in order of capitalization. The data was collected from the official websites of the companies (sustainability reports), the BVB website, the Trade Register (number of employees).

This last criterion was essential in the context of the new European requirements on sustainability reporting: as of January 1, 2024, public-interest companies with more than 500 employees are required to publish such reports, starting with the 2025 financial year. Therefore, the inclusion of this indicator allowed us to more accurately assess the compliance and readiness of the entities concerned in relation to the new regulations.

1. The objective of the research: to analyze the relationship between the sector of activity of companies and the existence of sustainability reports in 2023, using the Chi-square test.
2. Data collection: the data was taken from an excel file, containing information about the companies, the sector of activity, the existence of sustainability reports and the number of employees.
3. Quantitative analysis: creating a contingency table between the sector of activity and the existence of sustainability reports. Application of the Chi-square test to determine if there is a statistically significant association between the two variables.
4. Interpretation of results: evaluation of observed and expected frequencies to identify specific patterns, as well as interpretation of the p-value to establish statistical significance.

Chart no. 2. Distribution of the existence of sustainability reports by sectors of activity



Source: authors' processing based on data collected from www.bvb.ro

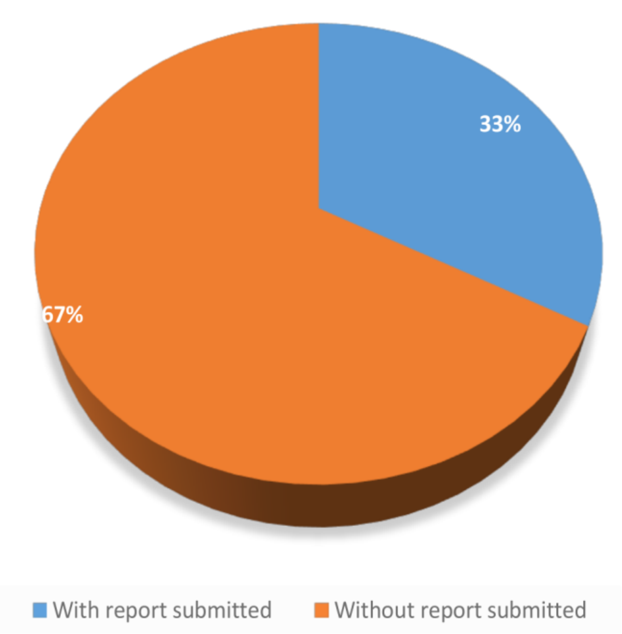
Chart no. 2 shows how companies in different sectors of activity, listed on the Bucharest Stock Exchange, were involved in sustainability reporting in 2023.

The data show that the ENERGY sector stands out for the highest number of companies that publish sustainability reports (7 companies), reflecting both the pressure of regulations in the field and the high exposure to environmental, social and governance risks. Also, the BANKING and TRANSPORT sectors register high reporting rates (over 75%), signaling an increased concern for transparency and compliance with ESG standards.

On the other hand, the BURSA and FUNDS sectors have a low number of companies reporting, and the BURSA sector did not register any companies with a published report, which may indicate a lack of prioritisation of reporting in these areas or a reduced perception of the relevance of sustainability for their respective activities.

This unequal distribution highlights the differences in ESG maturity and engagement between sectors, highlighting the need for incentives, legislative clarifications or support for less active sectors, so that reporting becomes a standardised and relevant practice across the market (**Chart no. 2**).

Chart no. 3. Proportion of reporting listed companies vs. non-reporting companies (2023)

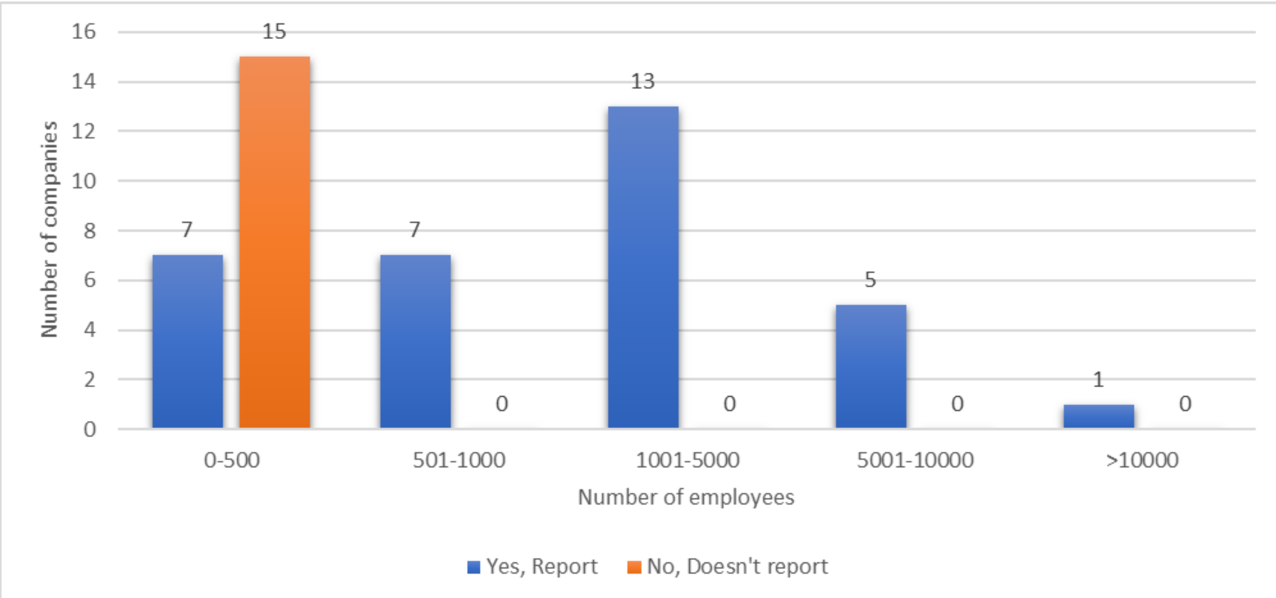


Source: authors' processing, based on data collected from www.bvb.ro

Chart no. 3 highlights the fact that in 2023 approximately 67% of companies listed on the Bucharest Stock Exchange (BVB) chose to publish sustainability reports, while 33% did not.

This distribution reveals a clear trend of increasing transparency among companies, reflecting a progressive adaptation to the requirements of the market, investors and the European legislative framework on sustainable development (Chart no. 3).

Chart no. 4. Sustainability reporting by average number of employees: reporting vs. non-reporting companies (2023)



Source: authors' processing, based on data collected from www.bvb.ro

Chart no. 4 highlights a significant difference between companies that report sustainability and those that do not, depending on the average number of employees. According to the data, companies that publish sustainability reports have on average a much higher number of employees, which suggests that the size of the company is a determining factor in the adoption of non-financial reporting.

This trend is correlated with European and national regulations in the field, in particular with the entry into force, starting with 2024, of the new sustainability reporting requirements for companies with more than 500 employees, according to the CSRD (Corporate Sustainability Reporting Directive). Thus, large companies are either already subject to these obligations or are actively preparing to comply, which partly explains the high level of reporting among them.

On the other hand, firms with a smaller number of employees – often in the SME category – are less represented in the reporting area, either due to a lack of legal obligations to date, or due to limited resources or a lower level of awareness (Chart no. 4).

Results and discussions

The Chi-square test is used to check if there is a statistically significant association between two categorical variables. In this case, the variables analyzed are:

a) **Existence of the sustainability report (2023):** Categorical variable with two values: "Yes" and "No".

b) **Number of employees (grouped into categories):** Categorical variable divided into employee ranges:

- 0-500
- 501-1000
- 1001-5000
- 5001-10000
- >10000

1. Data preparation

- The data in the column (number of employees) has been divided into **categories** to turn this numeric variable into a categorical one.
- A contingency table **has been created** showing the frequencies of each combination of the two variables. The table shows, for example, how many companies that report sustainability have between 0-500 employees and how many do not (**Table no. 1**).

Table no. 1. Contingency table

Employee category	Yes (Report)	Not (Does not report)
0-500	7	15
501-1000	7	0
1001-5000	13	0
5001-10000	5	0
>10000	1	0

Source: authors' processing, based on data collected from www.bvb.ro

2. Expected frequencies (Eij)

For each cell in the table, the expected frequencies (Eij) are calculated as follows:

$$Eij = \frac{(\text{Row Sum i})x\ (Column\ Sum\ j)}{\text{Total Observations}}$$

Total observations: Total amount = 48

Amounts per row:

"Yes" (Report): 7+7+13+5+1 = 33

"No" (Does not report): 15+0+0+0+0=15

Amounts per column (Categories of employees):

- 0−500 ⟶ 7+15=22
- 501−1000 ⟶ 7+0=7
- 1001−5000 ⟶ 13 +0=13
- 5001−10000 ⟶ 5+0=5
- >10000 ⟶ 1+0=1

Now we calculate each Eij:

For cell $E_{Yes,0\text{-}500} = \frac{33x22}{48}$=15.13

For cell $E_{No,0\text{-}500} = \frac{15x22}{48}$=6.88

We continue this process for all cells. The results can be found in **Table no. 2**.

Table no. 2. Expected frequencies obtained

Employee category	Yes (Expected)	No (Expected)
0-500	15.13	6.88
501-1000	4.81	2.19
1001-5000	8.94	4.06
5001-10000	3.44	1.56
>10000	0.69	0.31

Source: authors' processing based on data collected from www.bvb.ro

3. Calculating the Chi-square value

The formula for the Chi-square value is:

$$x^2 = \sum \frac{(\text{Oij} - \text{Eij})^2}{Eij}$$

For each cell, we calculate:

- Oij: the observed frequency,
- Eij: the expected frequency.
- Formula: (Oij – Eij)²/Eij

Example for *Yes,0-500:*

$x^2_{Yes,0\text{-}500} = \frac{(7-15{,}13)^2}{15{,}13} = \frac{(-8{,}13)^2}{15{,}13} = \frac{66{,}09}{15{,}13}$ = 4,37

Repeat for all cells and sum the values:

x^2 = 4.37 +.....= 25.79

4. Degrees of Freedom (DOF):

DOF = (Number of rows - 1) x (Number of columns - 1)

Number of rows: 2 (Yes, No)

Number of columns: 5 (Employee categories)

DOF = (2-1) x (5-1) = 4

5. P-Value

Using the value x^2 = 25.79 and DOF = 4, the p-value is determined from a Chi-square table or with a statistical function.

D=3.5 x 10^{-5}

6. Interpretation

- **x^2=25.79:** The statistics indicate a significant difference between the observations and the expected frequencies.
- **p-value = 3.5 x** 10^{-5}**:** Being well below the threshold of 0.05, the results are statistically significant.
- **DOF =4:** Reflects the complexity of the contingency table.

Conclusions

The distribution of sustainability reports by sector is not significantly different from a random distribution. However, certain sectors such as ENERGY and TRANSPORT seem to have a greater involvement in reporting, while others, such as BURSA and FUNDS, are less involved.

A positive trend in sustainability reporting, most sectors demonstrate an increased commitment to reporting.

Clear sectorization: sectors such as ENERGY and TRANSPORT are leaders in reporting, while sectors such as BURSA and FUNDS lag behind.

Correlation with the size of the organization: There is a link between the size of the company (measured by the number of employees) and the probability of publishing reports.

These observations could guide policies or initiatives that encourage sustainability reporting in less involved sectors.

Conclusions on the application of the Chi-square test

1) **There is a statistically significant association between the number of employees and sustainability reporting:**
   - The p-value (3.5×10^{-5}) is well below the standard significance threshold (0.05). This indicates that the variable "number of employees" significantly influences the likelihood that a company will report sustainability.
2) **Companies with a large number of employees are more likely to report sustainability:**
   - In the 501-1000, 1001-5000, 5001-10000 and >10000 categories, all companies reported sustainability.
   - The 0-500 employee category is the only one where most companies did not report (15 out of 22).
3) **According to the expected frequencies:**
   - Small companies (0-500 employees) should have reported more often according to the general distribution, but they did not.
   - Larger companies significantly exceeded reporting expectations.
4) **Practical involvement of results:**
   - Large companies may have more resources (financial, human) to prepare sustainability reports.
   - Small firms may require additional support to comply with future reporting regulations, especially in the context of the legal obligation that will apply from 2024.
5) **Limitations of the analysis:**
   - The contingency table includes a few cells with low expected frequencies (<5), which may affect the validity of the Chi-square test.
   - The sample includes only the top 50 listed companies, which limits generalization to other organizations.

The study highlights a growing interest in sustainability reporting among Romanian companies, especially large, listed ones. This positive trend is encouraging and aligns with the pressures exerted by investors, business partners and recent European regulations, particularly the CSRD (Corporate Sustainability Reporting Directive), applicable from 2024 to companies with more than 500 employees.

However, the distribution of sustainable reporting remains uneven. Sectors such as ENERGY and TRANSPORT demonstrate greater involvement in reporting, while others – such as STOCK EXCHANGE and FUNDS – are significantly less active. In addition, the analysis highlights a statistically significant association between the size of the company and the probability of reporting, which suggests that large companies have more resources (financial, human, technical) necessary for compliance. Small companies, on the other hand, require additional support to meet the new requirements, including methodological assistance and accessible digital infrastructure.

The limitations of the research include the small sample size – only 50 companies listed on the Bucharest Stock Exchange being analyzed – and the presence of low frequencies in the contingency table, which may affect the robustness of the Chi-square test. Also, the exclusive focus on the Romanian market limits the degree of generalization of conclusions at regional or international level.

Directions for future research aims to expand the database at European level, by including companies listed on other EU stock exchanges, in order to carry out a comparative analysis on the adoption of sustainable reporting.

In conclusion, sustainable reporting is becoming an essential tool for transparency and governance in the Romanian economy. The transition to a responsible economy, aligned with the principles of sustainable development, depends not only on legal obligations, but also on building an organizational culture oriented towards responsibility, performance and trust.

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