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Specific problem arising in course of audit as an organic part of economic practice in the context of application of theoretical aspects of auditing

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Summary

The goal of this article is to point out the importance of audit theoretical aspects, and that mostly by the solution of specifics problems of auditing practice. The purpose of the audit is to express the auditor's opinion on the financial statements deals with whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework. In our article we fixated on the analysis of the chosen specifics problems of auditing practice and in this case we provided the proposal to solution these problems in accordance with theoretical aspects of auditing.

Key words

audit, auditor, financial statements

Introduction

As with any other economic branch, also within the area of auditing there often occur specific problems resulting from imperfections of legislative rules, but mainly from the practice itself. It is not possible for legislative regulations to be absolutely perfect and generally applicable for every accounting unit regardless of its size, kind of business activity, business environment etc.. Similarly, the theory as the fundamental stone of a particular economic branch is rather general and often insufficient. A question therefore arises in relation to the theory of auditing whether the theory itself is exhaustive and whether it is sufficiently applied (mainly in course of preparing for the profession of auditor). It is necessary to understand that legal and guiding regulations are not a theory. In our opinion the audit theory is elaborated insufficiently (or it is not sufficiently available) and most of available literature contains instructions to perform an audit whereby theory is partially ignored and this results in failure to solve specific problems related to this branch.

In our article we aim to outline specific selected problems of auditing and to propose their solutions based on theoretical information. It has not been our aim to evaluate perfection of legislative rules and look for legislative gaps, but rather solve the problems resulting from the audit target, or problems brought about by the application of auditing procedures in practice. The list of these problems is not exhaustive (which is even impossible with regard to the prescribed range); it is rather an outline of the most fundamental problems that an auditor may encounter in course of verification of the financial statements which we have intended to point out.

1. Problems resulting from the application of the requirements of the Ethical Code of Auditors

Auditor's profession is a profession which acts in the public interest. Giving opinion of a particular financial statement by an auditor increases reliability of such a financial statement as a result of which major economic decisions are taken. Consequently, the auditor's opinion directly influences users of that financial statement (these may include internal users, e.g. shareholders, but also external users, e.g. banks, suppliers, consumers, etc.). Based on it, the auditor is bound to observe the rules and principles of the profession, beside the basic moral rules. These are entrenched in the Ethical Code of Auditors. Fundamental principles relating to the auditor's profession in compliance with the Ethical Code of Auditors include:

- integrity,
- objectiveness,
- professional competence and due diligence,
- confidentiality of information,

- professional behaviour,
- professional standards,
- independence.

Observance of the Ethical Code (and hence also the above principles) is embodied in the Act on Auditors and we therefore may refer to it as to **legal duty.** In our opinion, application of objectiveness and independence in the form that is represented by the Ethical Code, standards, but also the Act itself, is actually impossible in practice.

2. Auditor's objectiveness

The requirement of **objectiveness** expects that the auditor should be fair and should not admit prejudice or bias, conflict of interests or influence of other persons. The auditor is therefore supposed to be objective under any circumstances. The principle of objectiveness requires that auditors should not fail to submit their true expert or commercial opinion as a result of bias, conflict of interest or inadmissible influence exerted by other entities. In practice, auditors may face situations that may diminish a degree of their objectiveness. The Ethical Code, however, does not define such situations, nor does it provide for their listing. It allows that practice should evaluate these situations. In our concept we abstract from the fact that it is a general human nature to preserve certain unexplainable friendly or unfriendly attitudes toward particular persons. In this respect, it is not our aim to evaluate innate human features that could interfere with the professional ethical principles. It is more a requirement (contained in the ISA auditing standards) to perform an audit applying **professional scepticism**, i.e. professional doubt, that interferes with the principle of objectiveness. The application of professional scepticism expects a possibility of the existence of certain circumstances that may cause significant incorrectness (intentional or unintentional) in the financial statements. We assume that it is exactly this requirement that creates a bias toward a particular financial statement, and as a result also toward a particular accounting unit. It is really inevitable to approach a financial statement as an incorrect one? The audit is not aimed to **prove** that the financial statement is correct, but it should rather **confirm** that the financial statement is correct. In our opinion it is not necessary to apply professional scepticism in course of an audit as auditing evidence itself confirms or reverses the correct value of the financial statement. Should we refrain from employing professional scepticism, it would be possible to comply with the requirement of objectiveness.

3. Auditor's independence

The requirement of independence, or auditor's independence represents the fundamental stone of the auditor's profession. This requirement derives mainly from the nature of the audit itself as the objective opinion of a financial statement may be expressed only by a person who is independent of the accounting unit concerned in every respect. It is also provided for in Section 19 of the Act on Auditors, in ISA Auditing Standards, and also the Ethical Code, Audit Directive, and Sarbanes – Oxley Law[1] are largely concerned with it, too. By failing to comply with the requirement of independence, auditing would basically lose any grounds.

Independence of the auditor means that nothing prevents the auditor from submitting a free, complete and exclusively material opinion in its auditor's report. This presupposes that the auditor is not subject to instructions or significant influence of other persons, the result of verification does not concern the auditor's own interests or interests of persons whom they have take into account in some respect, and it must be unbiased toward the entity examined. It must also be stated that independence must be treated in this sense rather wide and it must be evaluated in the economic and personal respect. The auditor's independence may be threatened in various ways (intentionally and unintentionally).

Next table summarized the risks that threaten the auditor's independence and their consequences:

The requirement of independence must be complied with by the auditor him/herself as well as by every member of the auditor's team, and the auditing company as a whole. It is a duty of every auditing company and auditor to ensure, prior accepting a job, whether any circumstances exist

[1] Sarbanes – Oxley Law is one of the most influential and controversial laws in the USA, it was issued in 2002 after the bankruptcy scandal of Enron and other American companies. It is primarily aimed to protect investors. The said law imposes strict duties upon company directors, executives, lawyers, accountants and auditors. The requirements of this law are also a pillar for the law-making in the European Union. The key pillars of Sarbanes – Oxley Law include: committee for the verification of accountancy, independence of audit, company liability, provision for released financial data, information sources of a commission and its powers, company and criminal liability for fraud, stricter penalties for offences committed by administrative employees, company fraud and liability for it, conflict of interests and the like.

that would threaten the requirement of independence. If independence has been interfered with, the particular audit job should not be accepted, or a member of the audit team should be excluded from that particular job.

Table 1 Summary of risks threatening independence (Kaszasová & Paule, 2005, p. 31)

Threat as a result of	Private interest	Self-verification	Defence	Friendship	Intimidation
Financial interest	X				
Loans and guarantees	X				
Close business relations with clients	X				
Family and personal relations	X				
Employment with the client	X			X	X
Lately provided services to the client	X	X		X	
Being in the position of an officer or a member of the client's board of directors	X	X			
Rewards	X				
Gifts and hospitality	X			X	
Provision of other services to client	X	X			
Trading or supporting the trading with the client's shares or securities			X		
Operating as an attorney on behalf of the client			X		
Long-term connections between the top management and clients				X	
Pending or threatening court actions	X				X

In practice, it is really very hard to determine the line which represents endangering of independence. A few examples follow to clarify the above:

1. The auditor or auditing company have been granted a loan or a loan guaranty by their client under ordinary business conditions, i.e. after having duly satisfied all the criteria for the grant of a loan or guaranty and will obtain a standard interest. This situation will not be treated as endangering of independence. If, on the other hand, a loan or a loan guaranty has been granted under other than ordinary business conditions or their amount has been significant, this would be treated as a breach of independence. In our opinion, however, even the first situation may represent a threat to independence, despite of it being difficult to prove such an intent, and a breach of independence may not occur at all. In this case, however, an opinion may still be influenced, although indirectly and unintentionally.

2. A member of the audit team is in a family relationship with the employee of the audited accounting unit. The audit company excluded the member concerned from the audit team. This means that it has eliminated a threat of a breach of independence and has provided for independence of all members of the audit team. Despite of it, in our opinion there occurs a breach of independence as the excluded member may influence the remaining members of the audit team who participate in the job and may attain his/her goal through them.

3. Receiving gifts and hospitality are generally treated as threatening independence. How can we determine what exceeds the frame of acceptability and causes a breach of independence, indeed? The answer to this question is not provided for in the Ethical Code nor in any other guidance. There is a general recommendation that gifts and hospitality should not be accepted. In such a case we recommend that it should be detailed what amount of a gift and hospitality threatens independence. The Ethical Code states that if the gift or hospitality is insignificant, independence is not threatened. What is or is not significant, however, may be interpreted by different persons differently.

4. Rewards represent a problem par excellence. It is a very sensitive issue as it is the reward for the audit services performed that defines the relationship between the auditor and the audited accounting unit as a commercial relationship (provider – client). It is true that auditor will never provide their services free of charge as a result of which they will always be affected by the amount of the reward. In relation to rewarding, the risk factors generally include the fact that if the reward obtained represents a high share in the amount of all rewards of the auditing company, or, contrary to it, if the reward obtained is too low, or if it is conditioned somehow, or is received after a maturity date.

5. In practice, there often operate companies which, apart from auditing, also provide other services, e.g. valuation, services related to IT systems, services of internal audit, legal services and the like. On the one hand, provision of other than auditing services to their clients endangers independence (self-verification may occur), but on

the other hand, provision of other services increases the knowledge of a particular accounting unit which contributes to a higher quality of auditing services. In some cases it is possible to provide such services to one's clients without threatening independence by, for example, separating the auditing team from the team providing other services, etc.. In our opinion, however, independence may not be ensured in the case of providing other services. This may also be explained by the fear of the fact that expressing a modified opinion may influence further retention of the provision of other services.

We assume that the examples above sufficiently justify an opinion that the requirement of independence **may not be** definitely ensured in practice. Independence is first interfered with by the fact that in the case of an auditor and a client it is a commercial relationship (i.e. provision of a service for a reward). In this connection we think that it would be suitable to specify the borderlines which threaten independence and in compliance with the audit target (to express opinion whether the financial statement provides a true and fair picture of the accounting unit in all **major** aspects), **to define independence only in relation to significant facts.**

Significant facts shall include mainly financial interest (with the exception of reward), close business relations, gifts of a high value, employment with the client, executing management offices of the client etc..

4. Problems resulting from the observance of the rules of true and fair reporting of facts

The rule of **true and fair reporting** of facts that are the subject-matter of accounting and reporting of financial situation of the accounting unit is the fundamental accountancy rule. This rule is the highest principle and is superordinate to all other accountancy rules. Other generally recognized rules include the following:

- rule of balance continuity,
- continuity in the use of accountancy rules and accountancy methods,
- priority of substance before form,
- prohibition of compensating assets and liabilities, costs and yield, income and expenses,
- taking into account of all costs and yield in the accounting period in which they occurred, regardless of the date of their payment, income or date of another settlement,
- continuity of operation,
- valuation rules,
- rule of due diligence,
- material and time allocation of costs and yield,
- rule of explaining values (Šlosárová, 2006, p. 59).

In the case where the employed accountancy rules and methods contradict the rule of true and fair reporting of facts that are a subject-matter of the accounting, the accounting unit is bound to prepare its financial statements so that it may provide a true and fair picture of facts.

The rule of true and fair reporting of facts that are a subject-matter of the accounting is included in every national accountancy legislation. Due to different local conditions its application differs. In the common-law conditions (Great Britain, U.S.A.) this rule requires respect of generally recognized accountancy rules and principles. On the other hand, in the conditions of Continental Europe (Germany, France, Slovak Republic) the observance of the rule of true and fair reporting of facts requires observance of legal rules.

The Accountancy Act provides in Section 7 that the accounting unit is bound to keep its accounts so that its **financial statement could provide for a true and fair picture of the facts that are a subject-matter of the accountancy and financial situation of the accounting unit.** Reporting of financial statements is considered as **true**, if the content of particular entries of financial statements corresponds to the facts and is in compliance with imposed accountancy rules and methods. Reporting of financial statements is considered as **fair** if during their preparation there are employed accountancy rules and accounting methods that result in true reporting of facts in financial statements.

For the sake of comparison, IFRS are not directly concerned with defining what a true and fair picture is, but they provide that a true and fair picture may be achieved by respecting basic quality characteristics and relevant accountancy standards in preparing and presenting financial statements. This fact is demonstrated in next scheme:

The rule of true and fair reporting of facts that are a subject-matter of the accounting has been long subject to discussions and it still has not been sufficiently specified how a true and fair picture may be possibly achieved. We assume that by observing the rules and methods and employing all requirements of a particular legislation **it is not possible to achieve an absolutely true and fair picture**. This is supported by a well-known assertion that there is no perfect legislation and it almost certainly contains "black holes".

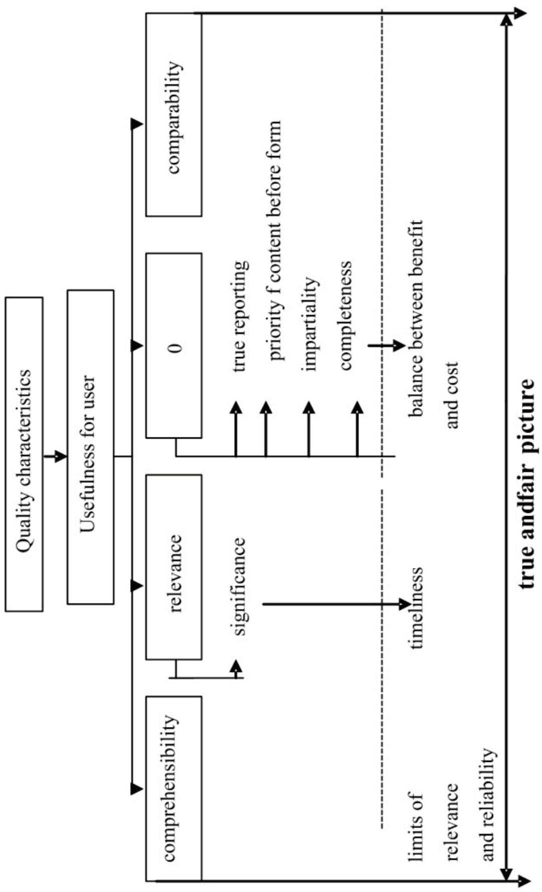

Figure 1 Achievement of true and fair picture (Soukupová, 2008, p. 35)

If we look at the issue of a true and fair picture of facts as the superordinate accountancy rule from the point of the auditor, then it is their task to express the opinion whether the financial statement provides a true and fair picture of the assets, resources, costs, yield, income, expenditure, economic result and other assets and the auditor must solve the question of what is a true and fair picture and what should be the basis for its determination. In the conditions of the Slovak Republic (as a part of the Continental Europe), the financial statement provides a true and fair picture of facts that are a subject-matter of the accounting if it respects all the accountancy rules and methods and it has been prepared in compliance with the requirements of legislative rules. This definition relates to a general audit target according to which the auditor aims to express an opinion whether the financial statements are in compliance with the effective framework of accountancy reporting in all the significant aspects.

On the ground of the above it may be definitely stated that it is not the purpose of an audit to confirm to correctness of book-keeping, or evaluation of observance of legislative rules or confirmation of the correctness of a tax return. Its task is to consider whether the financial statement actually provides a true and fair picture of facts in relation to the addressees of the financial statements who create their opinions of that accounting unit on the ground of the data reported in the financial statements and adopt their economic decisions.

According to our understanding of the facts above, the auditor should first concentrate on the attainment of **reasonable assumption that financial statements provide a true and fair picture of facts that are a subject-matter of the accounting** and that it does not contain significant deviations from the relevant frame for accountancy reporting.

A particular example that confirms these facts is an employment of the rule of due diligence which allows of re-valuation of property only downwards (e.g. via adjustment entries), but never upwards. There exist assets, however, (buildings, land, but also specific kinds of supplies etc.), in respect of which as a result of market conditions (e.g. growing prices of real estates etc.), the original price may rise (in value). In compliance with this rule of due diligence it is not possible to re-value the assets upwards. This means that the accounting unit will not take such a measure, within the effective legislation, and this fact will not be reported in their financial statement (or directly in their balance sheet). Will financial statements provide a true and fair picture of facts in such a case, however? Is it fair that the auditor will issue a report on the fact that the financial statement provides a true and fair picture of facts?

Theoretical sources state that the rule of true and fair reporting of facts is superordinate to all the rules, hence also to the rule of due diligence. The accounting unit is obliged to take all measures in observing the rule of a true and fair picture of facts that are a subject-matter of the accounting.

In this connection we should like to propose that an auditor's report should be extended by another section that would specify similar cases, along with their numeric specification and consequences. Introduction of such a section would enable that the users could obtain a realistic and reasonable picture of the accounting unit concerned. The fact whether financial statements are prepared in compliance with the effective legal framework of financial reporting is important for users, but what is more important for the purpose of adopting economic decisions is the fact whether financial statements really provide a true and fair picture of facts.

5. Problems arising in relation to the determination of auditor's signification in the context of verification of a true and fair reporting of facts

In auditor's documents for a particular auditing job, the auditor must specify what is, according to them, insignificant and, at the same time, they have determine the threshold from which the incorrectness found will be considered as significant incorrectness in the financial statements. It is important to realize that significance is determined by setting out a threshold point rather than specifying a certain quality characteristics that a particular information must contain so that it could be significant.

An exact definition of significance, however, is not contained in the International Auditing Standards, nor in IFRS. While the International Auditing Standards only define the concept of independence, IFRS define the significance in a sense that the information becomes significant if its deletion or incorrect reporting could influence economic decisions of users of the financial statements. It is very difficult to set out a threshold point from which the information may be considered as significant. This is mainly due to the existence of a significant number of users of the financial statements and their differing targets and preferences. It is therefore a matter of expert opinion of the person preparing the financial statements to evaluate which information is significant in relation to the users, and, on the other hand, it is up to the auditor's expert opinion to evaluate substantiation of reported information, or, on the contrary, failure to report significant information. What should be significant for the auditor is that which is also significant for the user of information from the financial statement.

An inversion relation obtains between significance and risk of an audit, i.e. the higher the level of significance, the lower the risk of audit, and vice versa.

Even ISA themselves do not provide for precise instructions what level should be determined by the auditor to ensure the rule of significance. As stated in the previous part of this thesis, the following starting bases are used in practice to determine the significance:

- total assets (0.5 – 1.5 %),
- profit from ordinary business of the accounting unit prior taxation (5 – 8 %),
- sales income (0.5 – 1.5 %).

For the sake of comparison we may state that the American auditing standards evaluate the threshold of as much as 10% of a taxed profit as significant incorrectness.

Percentage is impossible to be imposed universally as the starting points may vary. Neither is there a consistent opinion of which basis would be the best starting point of the significance threshold. The auditor must view determination of the significance threshold as a complex problem capable of being solved only in particular situations of a particular client, actual time and job.

Applying the above facts to a particular case, differences between the respective starting bases become more conspicuous.

As of December 31, the XYZ accounting unit, a.s., had the following values of particular entries of its financial statements:

Table 2 Balance Sheet

Desig nation	Assets	Line No.	Accounting period		Immediately preceding accounting period
			Brutto– part 1 / Correction– part 2	Netto 2	Netto 3
	Total assets line 002 + line 031 + line 061	001	3 324 000	2 408 000	2 282 000
			916 000		

Hence, if we apply the lowest and the highest threshold to determine significant at the starting basis of total assets, the following indicators will arise:

The lowest threshold: 3 324 000 x 0.5 % = 16 620 eur

The highest threshold: 3 324 000 x 1.5 % = 49 860 eur

Theoretically, if the auditor applies the upper threshold to determine the significance, i.e. 1.5 %, every incorrectness of up to 49 860 eur will be treated as not significant.

The same may be applied to another starting basis such as sales income. If a particular accounting unit reported in its Profit and Loss Statement the overall sales income amounting to 4 120 000 eur, the following level of significance may be calculated by the employment of the percentage thresholds above:

The lowest threshold: 4 120 000 x 0.5 % = 20 600 eur
The highest threshold: 4 120 000 x 1.5 % = 61 800 eur

If we employ the lowest threshold, any incorrectness of up to 20 600 eur is not significant, with the employment of a higher threshold, any incorrectness of up to 61 800 eur is not significant.

It may be said that these are not high amounts in relation to the starting basis, but they can significantly influence the users of the financial statements. It is necessary to realize that users is not familiarized with the significance threshold determined, hence they do not know the limit up to which the auditor has tolerated any incorrectness found.

On the ground of the examples above it is possible to say that if financial statements contains incorrectness of up to a determined threshold, the auditor will give opinion that the financial statements report a true and fair picture of the facts which are a subject-matter of accounting, despite of that.

A question arises in this respect whether the auditor may give an opinion that the financial statements report a true and fair picture of the facts that are a subject-matter of the accounting, despite of the fact that the accounting unit contains incorrectness calculated by employing a significance threshold. We should point out that determination of this threshold is exclusively a matter of an expert opinion of the auditor. Significance thresholds are not universally applicable and the auditor may also set out higher levels.

Hence, if we speak of a true and fair reporting of facts which are a subject-matter of accounting then what we mean by this assertion are absolutely, rather than relatively, correct financial statements. As has been mentioned, it is not possible to define an exact significance threshold clearly as the interests of their users differ, which is also true about the case exemplified above. The said amount will not be significant, and, on the other hand, they may represent a significant threshold.

The statement of the significance threshold determined should be included in the auditor's report so that users could understand whether they agree to such a threshold and whether the incorrectness found up that threshold is not significant for them.

6. Audit in small and medium-sized accounting units

Audit in small and medium-sized accounting units (enterprises) represents a specific area of auditing. Contrary to large enterprises, small and medium-sized enterprises show specific features necessitating the employment of another auditing approach to the conditions typical of such enterprises.

International auditing standards which are employed in the conditions of the Slovak Republic apply generally to all accounting units, regardless of their size (or legal form). Similarly, the law regulating auditing in relation to auditing procedures does not specify the size criteria of accounting units. This is seen as a problem since auditing standards are „tailored" for auditing large enterprises where due division of responsibilities and powers is employed. In such a case the auditor's report is primarily intended for shareholders, since the shareholders as owners are separated from the management (executives) of that accounting unit. Failure to settle this situation causes problems to both interested parties; on the part of enterprises mainly as a result of the fact that small and medium-sized enterprises are primarily aimed at "correctness" of accountancy in relation to their tax duties. Representatives of these enterprises often think twice whether they would incur considerable costs on a good quality "full" audit or whether they had better not risk fines for a breach of applicable provisions of the Accountancy Act. A compromise is available in this respect in form of so called "quasi full audit" performed by an auditor in a short time and for a lower price. This form of audit, however, does not fulfil its aim. On the other hand, for the auditor a problem arises concerning the employment of the approach to auditing financial statements which is different from the one employed in large enterprises in certain aspects. With this type of enterprises there may also occur increasing control risk.

As per size, accounting units may be divided into:

- micro-enterprises,
- small enterprises,
- medium enterprises,
- large enterprises.

In accordance with a definition of the Regulation EC No. 800/2008 on declaration of certain categories to be contrary to a common market pursuant to Articles 87 and 88 of the Treaty (General Regulation on Group Exceptions) (hereinafter referred to as „Regulation on the Categories") a **micro-enterprise** may be defined as an enterprise which employs less than 10 persons and its yearly turnover does not exceed 2 mil. eur. This kind of enterprise is not subject to auditing, it is more of a family kind of enterprise.

A small enterprise is defined by the said Regulation on the Categories as an enterprise which employs less than 50 persons and whose yearly turnover does not exceed 10 mil. eur. **A medium-sized enterprise** within the meaning of the Regulation on the Categories represents an enterprise that employs up to 250 persons and its yearly turnover dos not exceed 50 mil. eur and/or a total annual balance sheet does not exceed 43 mil. eur. If an enterprise shows higher parameters, it is a large enterprise.

It follows from the above criteria that a small and medium-sized enterprise as defined by the European Regulation may be subject to auditing in the Slovak Republic on condition that it satisfies other requirements set out in the Accountancy Act.

In the context of the employed auditing approach, small and medium-sized enterprises have the following specific features:

- restricted division of responsibilities,
- strongly dominant position of top management or owner.

A more detailed analysis of the above characteristic features results in the following findings:

- small (but often also medium) enterprises allocate less resources to fund the accounting which results in serious consequences (that also increases a risk of auditing), these consequences include

  - book-keeping may be informal and incorrect,
  - in the conditions of such enterprises a higher responsibility is imposed upon the auditor in relation to the stage of preparing accounting cases and financial statements which may result in an incorrect understanding that the company management has been relieved of liability for exact accounting;

- small and medium-sized enterprises do not have a large number of employees in the area of accounting, and it is therefore impossible to divide the responsibility among various employees as in large enterprises, which may result in that the auditor will not be able to rely on the internal control system; this may be exemplified by the situation when employees in charge of book-keeping have disposal rights toward the property which they may hide or sell;
- the owner is often identical with the management, i.e. there does not occur a division of these functions as in large enterprises,
- due to a dominant position of the management or owners, dominance may occur during the operation of the enterprise in all principal aspects such as internal control system or preparing of financial statements,
- risk of fraud on the part of the management or directly the owner is higher as due to a small number of employees it is possible to avoid prescribed procedures, the owner may, for example, make employees pay the money, which they would not do otherwise without original documentation;
- prevalence of the owners or management in the enterprise may result in serious distortions in financial statements.

As has been stated, specific conditions of pursuing business in small and medium-sized enterprises have great influence on the approach to auditing their financial statements. As with other audits, also in auditing small and medium-sized enterprises the auditor first gets acquainted with the accounting unit and its system of registration, collection and processing of data. At the same time they must evaluate the overall system of book-keeping aiming to understand the economic operations so that an audit may be planned and performed. The auditor evaluates whether it is possible to obtain sufficient amount of reliable evidence from the book-keeping and examination of financial statements to support the auditor's opinion. When auditing small and medium-sized enterprise as a result of insufficient division of responsibilities and possible avoidance of internal controls on the part of the management or owners, the auditor may encounter problems. This is mainly due to the fact that either internal controls are missing or there is insufficient evidence in relation to the incompleteness or lack preciseness of data. When auditing small and medium-sized enterprise it is especially important that the auditor could obtain a declaration of the management, mainly due to a risk of the auditor's work and responsibility linked to a distortion of financial statements, the auditor must therefore remind the management of their responsibility for the assurance of complete and correct book-keeping and for the protection of property.

In connection to the above definitions of small and medium-sized enterprises we may state that a definition of such enterprises is today quite common also in the rules of the European Union, and should therefore be an inseparable part of audit-related regulations. There exist methodological guidance in respect of auditing small and medium-sized enterprises, nevertheless, it does not have legal grounds. We therefore propose to process this issue in a legislative form related to auditing and to enrich theoretical grounds of auditing by auditor's approach to auditing financial statements of small and medium-sized enterprises.

To conclude this issue, it seems suitable to contemplate a question whether an audit is necessary in small accounting units. It may be said that in such entities the management is identical with the owners, so there is no initial user of the auditor's report as in businesses where the management is different from the owners. Performance of audit is financially demanding for such a business and it represents „only" fulfilment of a legal duty. There are accounting units, however, which do not fulfil this duty and prefer taking a risk of possible fine. In relation to this we propose to adjust quantity criteria determining which accounting units are subject to a duty to have their financial statements verified by an auditor so that small accounting units could be taken out of this group.

Conclusion

Results of the article can be divided into the following areas: to identify specific problems within the auditing practice in relation to financial statements, and subsequently, to formulate proposals for the solution of the above-mentioned specific problems within the context of theoretic aspects in the following areas:

- ethical principles of the auditor, in particular the principle of independence and objectivity of the auditor;
- the level of importance set by the auditor in connection with the audit job in question;
- assurance of the provision of a true and fair presentation of facts subject to the accounting;
- size criteria applied to define accounting entities with the obligation of verification of financial statements by an auditor.

Contribution of the article is in the presentation of selected problems within the auditing practice and in the proposal of their solution representing a modification of the requirements for auditors, an extension of the audit report by additional paragraphs, and a change in the size criteria for accounting entities with the obligation of verification of financial statements by an auditor, so that accounting entities small from the size perspective are exempted from such obligation.

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