

## ECONOMIC AND SOCIAL RESPONSIBILITY OF FINANCIAL AUDITING: A NEW DIMENSION

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### ABSTRACT

*The current financial crisis has a classic three-dimensional structure of responsibility. Creditor banks must ensure the money supply, aggregate demand for loans to households in debt, and monetary authorities (supervisors, governments). We consider it essential that the auditors' and any operator's responsibility extend not only to the economics of profits and losses but also to society, be it local, national, or global. As many banks are global operators, financial auditing must also have a global dimension. In the fourth year of the sub-prime crisis, auditors' responsibilities have shifted to a new dimension. In light of this, our presentation is mainly focused in the European Union's Green Paper titled, "The Audit Policy: Lessons from the Crisis." This report recommends more transparency and encourages a return to substantial survey. In it, auditors are exhorted to professional scepticism. It is necessary to enhance dialogue between auditors and banking regulatory authorities. Audit of European reform, however, may not be adequately effective in global markets, since international companies and global operators are not subject to it while outside the EU. As such, we will present examples of related legislation from overseas, particularly the now-completed inquiry report of the U.S. Congress. There is no doubt that responsibility for auditing companies has exceeded the corporate economic area and national boundaries. International economic performance and confidence in the wide international markets has begun to show the effects of new auditing policies. This presentation is about the content and quality challenges involved in changing auditors. The global economy is a global challenge to which all auditors must adjust if they are to do their job of strengthening and securing global markets.*

Keywords: CSR of banks, subprime crisis, auditing, EU Green Paper, overseas practice

### INTRODUCTION

The undertaking responsibility is in a classic sense the mixture of such business behavior as well as comprehensions, which integrates not only the inside undertaking economic factors in the spirit of sustainable development and business ethics, but also environmental, social and human rights considerations. The undertaking responsibility includes the comprehension of the operation of the company, its ethics and taking the interests of the stakeholders into comprehensive consideration. Special enterprises are the institutional participants of the money-, capital-, and currency markets. Until the existence of the Bretton Woods system, the spending of the public funds was more comprehensive. Today the possibility of the control of the global

financial profit centres is remarkably restricted. In the economic policy authority of the Washington Consensus System the globalization and the financial standing of the financial markets has grown to considerable size. The free movement of the capital and the overshadowing of the control processes have made the financial institution sector into individual sphere of power. In addition to incurring debts of the governments, the credit dependence of the local governments and even after the millennium of the households has become a significant factor. At the same time, the economic power of the financial aggregates in creditor position would show larger responsibility. It is desirable for the future that the social welfare factors should strengthen in the business policy and in responsibility taking of the enterprises, in particular banks. According to our judgment, in the process of world-wide growing economic crisis of the American mortgage market, there is a new requirement from the banks that they should not cause any loss with their operation for the society and the budget as well as they ought to maintain their classic social role (environment protection, support of the poor and the sport).

#### **The specific perspectives of the social responsibility of the financial institutions**

General public interest surrounds the stability of the system of the financial institution. It is indispensable for the stable operation of the economy that the banks are admitted to the inhabitants' and the national and local government's confidence, their operation and their safety level should be known for the society and the participants of the economy, according to the Directive 8. of the European Union and the definition of the Article 1 (13) of /22/EGK Council Directive. For this reason it is not possible to compare the situation of banks with other enterprises, so it has very stressed significance in the way the banks treat their financial stability, and the supervisions control the financial stability of the banks. To the extent the activity of the financial institutions has been becoming more and more combined in relation to both domestic and international aspects, the supervision and the external auditor has to face with higher requirements. The auditing of the financial companies were regulated by the attitudes of the International Auditing Practices Committee (*IAPC*) working under the International Federation of Accountants (*IFAC*) in order to increase the unification of the auditing methods and its relating services. Besides determining the physical safety of the monetary instruments, it is an essential task to control the different types of banking transactions as well as electronic data processing. The decentralization of the eligibility for decision making of the branches and subsidiaries because of the geographical problems, in many cases the location of the regions of the world, the separation of the accountancy and the supervision functions make difficult to prepare the financial and the accountancy reports of the banks. In the last decade the so-called items out of the statement have become widespread considerably, in other words those commitments of banks, which are not considered with money circulation at the time of their emerging, by all means no entry can contribute to them (in general short-term and not in all cases), so their auditing examination and judgment is also complicated. At the same time their financial influence effects the statement of the banks negatively in general if it appears. The investor's expectations focus on minimizing the risk and maximizing the

income. Taking into consideration that the taken risk and the required profit are in ratio, those divisions have been established moreover, they have become independent components, whose business activity relates to transferring as well as undertaking risk. The unrestricted multiplication of money, the unlimited transferring of the loss of the banks and the general establishment of the workout companies cleaning the statement of the parent company finally precipitate into crisis the North-American mortgage markets, the banks and the economy, which has given rise to economic crisis all over the world. The recession gives good chance to think over the tasks and the responsibility taking of the participants of the financial market.

### **Crisis and Responsibility**

One of the main conclusions of the crisis originating from the Anglo-Saxon markets is that the financial markets can not be left themselves. The self-regulating ability of the markets, as an axiom, obviously failed. In addition, as a consequence of market liberalization and deregulation dating back to 1970s, they have become serious destabilizing factors.

In professional circles, three responsibility groups appear typically relating to the crisis (*Lentner et al.*, 2010):

- banks as well as financial institutions representing the supply side of the financial markets,
- borrower companies, especially households representing the demand side of the financial markets,
- the government creating the rules and determining the institutional background of the financial markets, supervision and central bank as the monetary and fiscal authority.

The liability is common, however, it is essential to emphasize the banking sector, owing to the fact that in the first place, the responsibility of the banks and financial institutions is to maintain the financial stability. The responsibility inside the bank is restricted to the owners and the managers commissioning by the owners as the main aim of the bank is to raise as high profit as possible. The decisions made in the financial institutions influence the society and the environment since the financial processes help the flow of products and services.

The economic companies, especially the financial enterprises are such institutions, which with their own business activity and individual path is forced to take determine the surrounding people's life. The company has legal authorization to run their business solely in its own interest in every case without taking into consideration that it can cause harmful consequences for others. It means that the economic companies have legal authorization to protect their own interests without taking into account the damage causing to others.

The conglomerates with their power over the society and the people have become serious danger (*Bakan*, 2005). The rules laid down by the government are followed, depending on the governmental power and the clout power of the company. The weakening of the government and the strengthening of the international companies, mainly the banks characterized the last decade.

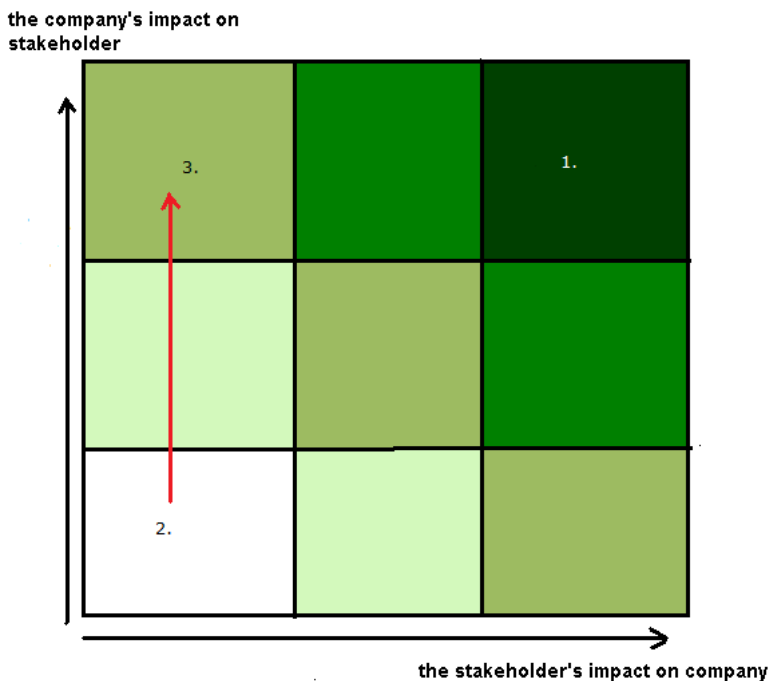
The crisis beginning from the mortgage markets brings the problems to the surface with thunderous applause. Not only the traditional support of the environmental protection, family-supporting workplaces, and flexible workplace providing for parents should be taken into account in case of social taking responsibility, but also we need to see the establishment of the future society, protecting democracy and finally, we should avoid the collapse of market economy system. In the sustainable economic system the social responsibility of a bank is not only to support the sport clubs, socially disadvantaged pupils, but also it needs to help financing green technologies, and it also should assist in providing careful credit for households as bank clients, small-and medium sized enterprises, for the national budget with these bank clients the institutions of the economic system, democracy and the life chances of the future generation can be modified.

The circle of stakeholders provides little information about the responsibility taking of the banks. The relationship of stakeholders is necessary to examine from two points of view:

- how much is the influence of the interested individual on the company (*Figure 1* horizontal axis) and
- how much is the influence of the bank on the interested individual (*Figure 1* vertical axis).

**Figure 1**

**Matrix 2 of Stakeholder**



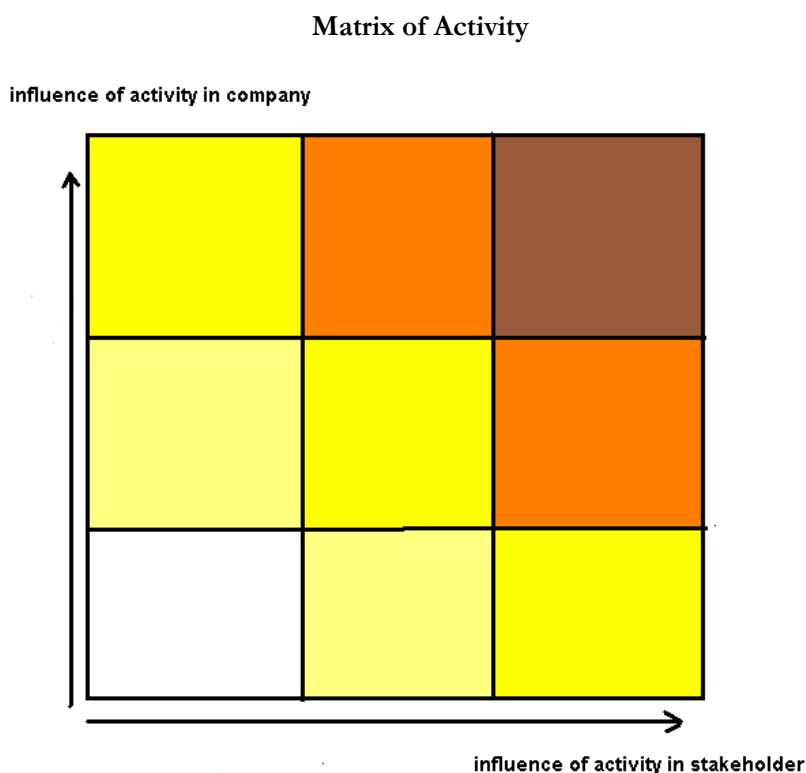
According to our judgment, the banks make good decision if they are on the point of making a more responsible activity with the stakeholders, who are in the most highlighted part, namely in the darker square on the graph. The clients (1.) claiming loans for flat and house make significant effect on the banks and the bank also makes essential influence on the families interested in real estate development, for this reason the social responsibility of the banks is more expedient and efficient if they focus on them. Thus, it has higher values as if, for instance talented socially disadvantaged pupils would be supported by the banks, where the common dependence is much lower, in other words, the stakeholder is located near the origin (2.). Of course, this question should be treated shaded since in case of families with low budget, the further studies of talented children would be failed therefore, the stakeholder is placed higher on the vertical axis, into the darker field (3.).

The responsible business activity of a financial institution can be varied. It can focus on internal or external clients, it can connect directly to the business activity of the bank and it can be independent from it. The CSR transaction relating directly to the activity of the bank means ensuring financial-banking knowledge according to the borrower's level of knowledge, which can decrease the proportion of the non-refunding credits and it establishes stability in the client's management. At the same time, it is not so associating with the activity of the bank, for instance providing food ticket. It makes difference on whom the responsibility of the bank focuses, however it is also determining that how much is the importance of the activity in the life of bank and the interested individual. Generally speaking, the more valuable the activity is the higher influence it has on the company and the stakeholders. In the case of a bank, responsible activity means also if the bank takes the responsibility for copying the certificates in two-sided, however, its significance is basically less than organizing course for its clients about the development of the financial culture. By the assessment of the activity, we need to be careful owing to the fact that a CRS activity with common content can have different effect in a financial institution and in a cement-plant. The company makes the right decision if it chooses the activity that can be seen in the darker square on the graph, in other words, the work of CSR stands closer to its basic activity and its clients (*Figure 2*).

The "best practice" means that the most common operative perspective of banking responsibility taking. Getting to know and accepting the practice of the top-ranking can provide possibility to develop and close up for institutions with little theoretical knowledge. It provides excellent occasions for different tenders, charges, conferences and international musters. The particular interested individuals and fields are placed in various points of the map of the stakeholders, so the responsible activity can not be adapted automatically. What is natural by one type of financial institution, it suits well the activity as well as strategy of the company; it has no sense in other type of institution. The real estate market counselling for the clients matches into the CSR activity of a mortgage bank, at the same time, it seems to be not expedient by financial institutions experienced in leasing cars. The other factor that we need to consider is that if the bank arranges everything as the others, it can reach the same results in the best case. If the banks copy the best practices, they can stabilize their position at most. The adaptation of good practice can be successful only after

through theoretical foundation. The owner of the enterprise, the management employed by the owner, the supervision and the auditor play emphasized role in the establishment of the practice of responsibility taking of the bank.

**Figure 2**



**The connection between the CSR banking activities and the auditing**

It is questioned in many places whether the banks, security funds, credit certifiers, supervisions and central banks have done through job. At the same time, not enough attention was paid to how the auditing would be able to improve the financial stability. The Green Paper of the European Union aiming at developing the quality of the work of the auditors raises the role of the auditors in the emergence of crises inevitably. So, the responsibility taking of the three in the report mentioned banks, borrowers and regulating authorities are expanded by the fourth, the auditors. It seems to be doubtful if in the last decades the auditors rated the statements of the banks in a real through way. Have the regulating authorities, where several auditors work, really raised the necessary attentions within their professional competence? Between 2007 and 2009 numerous banks showed significant loss in the outside and inside position of their statement. These circumstances raise that not only how the auditors would have been able to provide

opinion about the previous period for their clients, but also it questions the appropriateness and aptitude of the present law. It seems to be practical to think over the general regulation of the money market, the rulings of the auditors as well as the practice of the auditing since the responsible decisions of the banks, the financial reports provided for the participants of the market are certified with the report of the auditors. Thus, the decisions of the bank in the sphere of corporate responsibility taking was provided by the opinion of the auditors for the clients claiming information. The members of the market expect more responsible and more circumspect behavior from the banks and the auditors. It is a requirement that besides supervision and bank leading the auditing should also be the basic element of the financial stability. The auditing placed on new methodological bases plays crucial role in rebuilding the general and market trust and it protects the investors and decreases the capital cost of the companies. With regard to finding the through and losing management, the preventive auditing can decrease cost of the company spent on its loss, the cost of the government budget as well as the social costs. The responsibility taking of the bank means more than the classical stakeholder model, it is also represented in practical form in order not to cause economical problems with fictive economic situation, and not to spend public funds for consolidating the financial institutions. The auditor employed by the owners is practically the supervisor of the trustee management, who assess the regulation employed by the company, the application of requirements, the use of corporate input and its performance. In case of auditing the social responsibility also appears. The auditing companies work in a proper way if they assess the performance and reports of their clients. With the help of this, the receiver of the external information can establish market relationship with the companies and banks controlled by the auditors without economic loss. The global participants of the auditing market (big4) are able to take social responsibility for forming the financial culture, the stability and their responsible management of the controlled enterprises relating the closest to them, international banks, multinational companies. With the help of professional auditing and from this resulting valid corporate information, the auditing company can reach higher social profit as if it would support animal alms-house from the money. See the logics of the matrix of stakeholder and activity. In this globalized world not only the primary, secondary and tertiary branches have been-and in the former we think of the financial institutions-globalized in the last decade, but also the auditing. The International Standards on Auditing have become ready-made product. In the world the unification of auditing practices can be realized. The consultation within the European Union can not be successful in itself if the overseas experienced are not applied. With regard to the financial crisis, there was a process of making clearer the responsibility spheres in order to determine the lack of possible responsible banking behavior in the United States, since it was the origin of the financial crisis.

According to the US Congress Report, the crisis could have been avoided. (*US Congress Report*, 2011). The Congress Report indicates that the cause was the mistakes in the financial regulation as well as in the superstition, which have led to the weakening of the stability and the national financial sectors. The dramatic

failure of corporate management and the risk management have become crucial factors of the crisis. The most varied combination of the exaggerated credit borrowing, the risky investments and the lack of seeing through have drawn the financial system into crisis. The items outside the stock exchange and the banking statement also played significant role in the development of the crisis. The credit rating institutions were indispensable cog-wheels of the financial weakening. Last but not least, in the emergence of the financial crisis the lack of ethics and countability represented determined factor. The causes of the crisis in the Congress Report clearly include the irresponsibility of the banking management, the lack of regulation, however it means indirectly the responsibility of the auditors by the credit rating companies. The main responsibility taking of the banks is to arrange stable, calculable, clear flow of money as well as the transmission role. As these institutions are in the increased interests of the public, the content of their reports are provided for the clients demanding information through the procedure of opinion giving from auditors. It happens that the responsibility of not only the banks but also the auditors appear in the development of financial crisis.

## **CONCLUSIONS**

Besides the traditional corporate responsibility taking, a new liability taking of the banks, financial institutions must be defined because of the financial crisis. Apart from the traditional responsibility taking, the liability for the clients of the financial institutions, enterprises, families and the national budget raises its value. Summing up, the bank determined as the institution ensuring mainly the stability of the national economy and the international financial sector can do its bets with calculable operation and with the application of credit techniques providing long lasting maintaining for its clients and with giving financial experience relating to responsibility taking. So, the partial banking responsibility taking dimension expanding sub-parts replaces the simultaneous assurance of the responsibility for society, national economy even international economy.

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