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THE ROLE OF THE FINANCIAL AUDITOR FOR THE PARTICIPATION OF FORESTRY ENTERPRISES IN GLOBAL VALUE CHAINS

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Abstract: The independent external financial audit is of fundamental importance in the management of any sector, including forestry. Economic theories argue that evidence from external sources is considered more reliable. In addition, external financial auditors have an important role in terms of the strategic development of the entity, the disclosure of data in the financial statements, and managerial decisions. However, the forestry sector in Bulgaria is very conservative and closed to effective collaboration with foreign partners. In this respect, the financial auditors can have an important role as a factor for forestry enterprises' participation in global value chains (GVC). The paper's main goal is to outline the role of external financial auditors in the participation of Bulgarian forestry enterprises in GVCs. For this purpose, the authors present summarized data from interviews conducted with representatives of the financial audit sector in the Republic of Bulgaria. In conclusion, it can be stated that auditors do not have the right to influence management decisions and processes related to GVCs, but at the same time, part of the analysis of risk factors such as foreign suppliers and customers are taken into account by the management who directly or indirectly relays on auditors' opinions and even seeks consultations and advice from them. In addition, based on the procedures the financial auditors perform, they analyze and evaluate the business as a whole, with which they consciously or unconsciously evaluate the influence of global chains on the activities of their clients.

Keywords: external auditor, forestry, global value chains

1. INTRODUCTION

World trade and production are increasingly structured around global value chains (GVCs). GVCs are a systematic process, representing a series of stages, including all the main activities related to the production, distribution and after-sales service of a product or service, where each stage is adding value. Value chains become 'global' when at least two of the stages take place in different countries (World Bank, 2020). GVCs include functionally and geographically fragmented productions, which are usually coordinated and controlled by leading firms (Mayer et al., 2017). Micro-level benefits are related to the transfer of activities to other countries and cost reduction, importation of foreign products of lower cost or better quality, creation of competitive effects in domestic markets, and the diffusion of knowledge by multinational companies (Crisuolo & Timmis, 2017).

Scholars (Constantinescu et al., 2017); Constantinescu et al., 2019) argue that the participation of enterprises in GVCs increases labor productivity. Kummritz, Taglioni, and Winkler (2017) argues that it even leads to an increase in sectoral added value, especially in

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the phases of development and design, marketing and customer service. The main advantages that can be pointed out from the participation of enterprises in GVCs are (Strange, 2020):

- Cost reduction based on the use of cheaper raw materials and cheaper labor in the country where a given stage of the process is outsourced;
- Improvement of the production capacity in the quantities desired or required quality by the management;
- Reducing the company's risks from unforeseen circumstances, such as epidemics, strikes, hurricanes, floods, terrorist threats, etc.

The participation of enterprises in such chains is a complex process, tied to a lot of preliminary research and analysis. Studies on Bulgaria, however, report little or even no participation of enterprises in GVCs (Georgieva et al., 2022; Georgieva, 2023). In the wood processing value chain, forest certification as a voluntary verification tool has been gaining importance worldwide (Paluš et al., 2018). However, less importance is given to financial auditing and its relation to the problem.

In the knowledge-based economy, the creation of value through intensive knowledge or professional services is subject to extensive analysis (Nguyen et al, 2014). The independent external financial auditors are helping the management by increasing the quality control of the company. Financial auditors' main functions are related to the review, assessment and monitoring of the adequacy, effectiveness and efficiency of the control and accuracy of the financial statements. Research by Paul Verbruggen (2022) emphasizes the role of the auditor in GVCs. The importance of auditors' professional judgment in assessing the risk that is related to key customers and suppliers, reviewing strategic plans and decisions made by companies as well as the audit function itself are also discussed. However, it is necessary to distinguish between different types of audits to better understand the impact of the audit's function on the GVCs. For example, the audit of financial statements is based on IFRS and concerns the information in the financial statements and the correctness of the application of accounting policies by the audited company. When it comes to assessing the risk of key customers or suppliers, financial auditors are not entitled to express opinions. The reason is that this is a consultation that would affect the financial result of the report and is in breach of International Auditing Standards. Therefore, the audit function is expanded based on the systematic methodology of the Compliance Audit. It is an additional audit dedicated to how specific standards are applied.

Even though the independent financial auditor has no right to influence managerial decisions, the auditor is a "role model" in the decision-making process and is often consulted by managers. In this respect, we agree with the statement of Nguyen et al (2014), that in audit services, the client's stakeholders are an important aspect to be considered in value creation processes. The financial audit should express an opinion on the reliability of the information in the financial statements to the external data users that are making informed economic decisions, whose attitude and interest in the audit service may affect the creation of asymmetric information and the indirect impact on managerial decisions. Hence, the auditor may have a direct or indirect role in the participation of enterprises in the GVCs, based on the expressed opinion on matters regarding specific customers or suppliers.

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The main goal of the paper is to outline the role of the external financial auditor in the decision-making process by enterprises in the forest sector whether to participate or not in the GVCs. The object of analysis is independent external financial auditors that are auditing forestry enterprises. The used scientific methodology is based on the methods of analysis and synthesis, induction and deduction. To collect primary data, the in-depth interview method with the target group was used.

2. RESEARCH METHODOLOGY AND RESULTS

In-depth interviews were carried out to identify the role of the external financial auditors in the forestry GVC participation. The goal is to identify the attitude of the interviewees to:

- the benefits and added value for forest industry enterprises from their participation in GVCs;

- the added value from the performed audit procedures about the assessment of risk areas in the financial statements of companies and assessment of external impacts (COVID-19, the war with Ukraine);

- the added value from the performed audit procedures about the assessment of dependence on customers and suppliers, as well as the sustainability of the company, more specifically, the Bulgarian market is experiencing currency risk related to the accession of the country to the Eurozone and acceptance of the euro as the official currency.

A total of 7 in-depth interviews were held in the period April-May 2023. The target group are independent financial auditors with experience in auditing furniture manufacturing enterprises. The interviews were conducted by telephone or via online call with an average duration of 25 minutes. The interviewees were mostly female (86%) with experience in the field over 10 years (71.43%).

Nearly 29% of the interviewees share the opinion that the financial auditor should not participate in any form or influence anyway of their clients to participate in global value chains, as it conflicts with the auditor's activities and duties. For 43%, however, the auditor performs procedures for assessing the impact of environmental risks on the company's activity. This information can even indirectly influence the management staff and the decision-making process. The entire financial audit process, starting with the examination of the enterprise processes, corrections, and communication with management, contributes both to the improvement of financial reporting and to the understanding of management to build and eliminate weaknesses in the internal control environment and business management. The financial auditor's added value can be related to the fact that they point out weaknesses in the internal control environment, correct errors and increase the level of disclosure in the financial statement, hence focusing on compliance with regulatory requirements, including non-financial information.

The literature supports the idea that if a company is international or dependent on external investment, more disclosure pressure is applied to that entity (Oliveira et al., 2006; Gerpott et al., 2008). However, nearly 29% of the interviewed auditors believe that the disclosure of non-financial information should be in line with regulatory requirements and should not influence managerial decisions to participate in global value chains. On the opposite aspect, the rest of

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the auditors indicate that the identification of weaknesses in the internal control environment (including environmental risk, credit risk, etc.) is a reason for management to change one or more processes in the enterprise. The formation of an understanding of sustainable business development is a process that should gradually cover a large part of business and society. Financial auditors gain knowledge of the many aspects of reporting and the impact of sustainable development on business. Discussion between the financial auditor and its client of the individual manifestations both at the level of financial statement and at the level of reporting of non-financial information helps speed up the process of understanding and applying the needed standard's requirements. In this respect, regardless of the requirement not to provide consultations to their clients, the majority of interviewees admit that they do so and that this directly or indirectly affects managerial decisions. It often happens that managers ignore the opinion of their accountants in favour of the auditor, therefore auditors are often "consultants" in cases and questions that arise.

3. CONCLUSIONS

GVCs are a channel for the dissemination of technological knowledge, entrepreneurial culture and innovation capacity. In this way, they change the profile of the related economic sectors and regions in which the activity of the companies is concentrated. In cases where an independent financial auditor also offers consulting services, the auditor's dependence on the client may increase, but vice versa as well. This can significantly affect the quality of the auditor's work and his independent opinion. It could lead to the expression of an incorrect opinion by the auditor which can mislead the users of the reports. Regardless of this fact, financial auditors are often treated as consultants on issues and cases that arise.

Based on the in-depth individual interviews of financial auditors of forestry enterprises, the following conclusions can be drawn:

- auditors who are hired to carry out an independent financial audit of the financial statements of enterprises should not participate in clients' consultations, as the standards do not allow such a circumstance due to the risk of auditors checking their own work;
- auditors do not have the right to influence management decisions and processes related to GVCs, but at the same time part of the analysis of risk factors such as foreign suppliers and customers are taken into account by the management;
- the auditors do not realize that, based on the procedures they perform, they analyze and evaluate the business as a whole, with which they consciously or unconsciously evaluate the influence of global chains on the activities of their clients.

Management's attitude and vision for the audit work require that the audit function expands to meet the needs of users. New types of audit are emerging - CSR audit (Application of the International Federation of Accountants Standards of Assurance on Corporate Social Responsibility) (Peycheva et al, 2016) and ESG (an audit that is fully specialized in environmental, social and governance issues, key areas – Climate Change and Sustainability,

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Diversity, Equity, and Inclusion, Supply Chain Issues, International Conflict). In this respect, the management of a forest industry enterprise can arrange an audit based on a special area, such as an audit of key customers and suppliers in GVCs. However, it is necessary to carefully describe the goals and responsibilities of both parties in a contract. Accordingly, the professional competence of the financial auditors can be affected – the risk profile of the audited objects, dependence on the client, study of the legislative framework, and reflection of specifics when trading with third parties. Because of that, there is a need to be developed specific standards for auditing global value chains.

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