FINANCIAL REPORTING BY FRAUD - AN ONGOING CHALLENGE FOR INTERNAL AUDITORS

Emilia VASILE, PhD Prof.
„Athenaeum" University of Bucharest
rector@univath.ro

Mariana MAN, PhD. Prof.
University of Petrosani Faculty of Sciences
man_mariana2006@yahoo.com

Abstract

In difficult economic times, such as the one we go through the risk of fraud increases mainly due to weak internal control, conjugated with uncontrolled access to the financial resources available to the entity.

Opportunity to commit fraud perpetrator leaves allowed that can do this without being caught or identified, as well as the existence of incentives, which are mostly financial.

Pressure is reflected by the financial needs of the offender; performance reporting superior results obtained; obtaining additional incentive or desire to achieve some professional aspirations as well. The risk of fraud increases and therefore the pressure on management to achieve the objectives and indicators set so that its position within the entity won't be affected.

The alarm signals are represented by limiting access to economic transactions carried out within the entity environment control inadequate, intimidation and inappropriate attitudes of the leadership; providing incomplete information; false documentation or lack of implementation of appropriate control measures.

In these contexts, the internal auditors have the responsibility to reassess the risk of fraud and guide the activity for detecting the most common forms of fraud; to monitor and to evaluate the quality of managerial leadership; examine the functionality of the internal control system in place and propose measures for implementation of control devices to prevent or detect fraud and to correct and eliminate existing dysfunctions.

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Fraud - control and prevention

Fraud involves an intentional action performed by one or more persons, the driving duties and / or workmanship, done by deception in order to gain an advantage illegal or unlawful. In this context one can distinguish the following: character deliberate and intentional fraud is accomplished, the unlawful nature of fraud and concealment character that of concealment of facts made.

The classical theory developed by Donald Cressey, since the middle of last century and recognized by most experts in the field identify fraud by three factors, namely: opportunity, motive and attitude.

The opportunity is identified by the idea perceived by some employees or management of an organization that can commit fraud without being caught. This perception is due knowledge of internal control weaknesses and the availability of incentives, which are mostly financial.

The reason is identified by the immediate need of a person to gain an advantage that can not be made known and communicated to others. This factor plays a role in a person's intention to defraud and may materialize through: the financial needs of the offender's intention to report higher than actual results achieved by an organization, the desire professional results quickly, getting additional bonuses, competitive environment the person who carries out the fraud operates. Pressure to distort financial statements determined in many situations and managers need to achieve organization goals and achieve indicators so that their position is not affected.

Attitude, belief implies that the person has not committed any act done irregularity. This factor is related to the pressure on managers to achieve planned results at least as well as the opportunity identified by a person that can gain an advantage. People involved justify their actions in these situations, the fact that what they do is good organization, with no other choice at that time.

The existence of effective systems of internal control and accounting records and reduce the likelihood of erroneous transactions and therefore providing misleading financial statements. However, there is a risk of downtime internal control in relation to the parameters established by the management of the organization.

Fraud related to financial statements involves making illegal actions that contribute to the distortion unregulated, as follows:

a) intentional omission of values or information presented in financial statements to deceive users , which involves : acts of deceit , misrepresentation or intentional omission of events, illegal financial transactions that are not related to reality.

b) unlawfully acquiring and personally the assets of the organization by using various ways characterized by records or documents false or misleading facts.

c) manipulation or alteration of financial records or documents , theft of assets .

d) recording of transactions without substance so embellishment financial statements ;

e) misapplication intentionally , accounting policies for presentation of financial statements that could mislead users.

The examination of the internal auditors of financial statements in view of the risk of material misstatements on recorded transactions and operations. Internal auditor, following tests carried out and specific audit methods and techniques applied, plan and perform internal audits and is responsible for identifying and preventing potential for fraud risk.

The fraud risk assessment takes into account aspects related to the honesty of the management, internal or external circumstances that can influence the activities audited, unusual transactions, content and sufficiency tests accomplished, and the quality and sufficiency of audit evidence supporting the findings internal auditors.

In carrying out the responsibilities, there are certain limitations due to the fact that the intervention of the internal auditor periodically, usually every three years, and checks are carried out on a sample basis.

Also, please note that the accounting system and internal control system implemented effective as it can only reduce the risk of error or distortion by fraud because the risk associated with a transaction or financial accounting operations can not be removed, but only minimized.

Depending on the audit procedures applied, obtaining statements from management or employees, and the findings and conclusions of the internal auditors have a responsibility to inform management entity on research results and present evidence to support these findings. The involvement of internal audit in fraud prevention and detection consider investigating all elements and circumstances related to pressure, encourage or perception of committing fraud. Audit procedures applied to take into account both the characteristics of specific operations or transactions or account balance and stretching area checks on records and other financial records.

Factors for the development of fraud

In an organization responsible for the management of the fraud identification, establishing a good working environment to prevent fraud, create and maintain a culture of honesty based on standards of ethics and establish an adequate system of internal control to prevent and detect fraud.

The conditions that determine the implementation of actions to evade financial accounting activities generally are:

a) working environment - employee and management fraud increases under a permissive climate and organizational work;
b) pressure on employees - employees may have debts to third parties outside the entity and they can exert influence on them in order to obtain information or other benefits to the detriment of the entity , management may exploit situations of restructuring and downsizing and pressure on staff to take actions that are not consistent with the regulatory and procedural;
c) uncontrolled access to assets - fraud can occur under conditions of weak internal controls or lack of responsibilities and limits on access to information and documents;
d) personality traits that work against personal integrity - some employees are impressed by obtaining income or immediate and unfair advantage and therefore tend to choose the wrong path .

Individuals performing its fraud attempt, through various ways or operations, to hide the traces of irregularity committed. However, all their efforts to make undetectable traces of fraud, there are many signs that those responsible, namely the entity's management and internal audit should identify and take into account to prevent or detect fraud.

Occurrence of risk factors associated distortions in financial reporting fraud can enclose the following:

a) factors associated with leadership , identify the capacities , pressures , management style and attitude toward internal control and financial reporting process . Issue conditions include: the existence of motivation, poor attitude regarding internal control, management involvement in selecting accounting principles used and significant estimates determination, high mobility among management, strained relations between management and audit, previous trends security breaches and specific legislation; ;

b) factors associated industry specific conditions , involving organizational environment in which the organization operates and can be identified by legislative changes that may affect financial stability; ;

c) factors associated operational characteristics depend on the nature and complexity of the organization and its transactions, financial position and how to provide the resources to finance expenditure. These factors are identified by the organization's inability to generate cash flows , the need for funds to finance expenditures, assets, liabilities, income and expenses based on significant estimates, financial transactions not related activity performed or complex organizational structure of debt addiction;

d) factors associated misappropriation of assets are represented by high exposure to asset misappropriation and inadequate controls may not prevent or detect misappropriation or lack thereof.

In this context we can say that the detection of fraud by the internal auditor is influenced by a number of factors related to the skills of internal auditors, the frequency of acts of fraud and size, the association that these actions involved only personal running or engaged and leadership. Also, management has the ability to have employees to achieve something, which may involve the commission of a fraud, with or without their will.

Alarm signals that internal auditors should consider in the prevention and detection of fraud contain:

a) access internal auditors economic transactions carried out within the organization;
b) the provision of various facilities staff and others;
c) lack of cooperation during the course of audit and attempts to intimidate the internal auditors;
d) providing incomplete, inaccurate, delayed or can not be verified from other sources;
e) inability to provide original documents;
f) lack of access to electronic programs used to perform test operations recorded;
g) inadequate control environment, the implementation of internal control failures or limited supervision exercised by management levels;
h) internal auditors limiting communication with those responsible for corporate governance or management of activities.

Determinants of the risk of fraud can be established as a result of checks ordered by management, internal auditors performed tests or analysis of information within or outside the entity.

The involvement of internal audit in the event of fraud

Standard 1210.A2 "*The internal auditor should have sufficient knowledge to identify fraud, but it is not necessary to have experience of a person whose primary responsibility is to detect and investigate fraud.*" Taking into account that the main mechanism for detecting fraud is control, responsibility of internal auditors is to examine and evaluate the efficiency and effectiveness of the internal control system.

To provide reasonable assurance that the financial statements reflect the reality and reliability, the internal auditor should obtain sufficient appropriate audit evidence regarding the risks of misstatement of financial statements due to fraud and propose tools to limit their control.

Considering the fact that the main means of fraud in financial reporting are recording correctly recognized income overstatement of assets or understatement of expenses unlawful alienation of assets, internal audit procedures applied should follow:

a) examining the contractual requirements and income;
b) fixed assets accounting analysis and verification of any kind;
c) verification purchases, licensing, registration and payment;
d) analysis of the existence of supporting documents regarding expenditure incurred and recorded, endorsement and approval;
e) perform verification of inventory and registration of its property;
f) analyzing the governance of accounting records, the reality and legality of the takeover made and how the information in the records and summary.

Collection of detailed set of information from various sources, verification and corroboration shall allow the internal auditor to express an opinion on financial statements prepared credibility and reality, and to highlight any signals of fraud.

Knowing how financial statements are subject to distortions due to fraud actions and awareness by staff to alert management about fraud signals related to internal auditors' professional skepticism, for which they must proceed to:

a) orientation of the audit on identifying fraud risk;
b) knowledge of organizational culture and leadership concerns the organization of staff training in fraud prevention and reporting any indications of fraud;
c) analyze actions and limit fraud detection promoted within the organization, knowledge work environment and the organization's financial status;
d) analyze the complexity of the organizational structure and the internal control environment;
e) reviewing the applicable accounting policies and how they are met;
f) management system analysis and organizational behavior applied for understanding the factors that enable the emergence of elements of fraud.

We believe that, in any action performed internal auditors should express assurance on the quality of business operations and asset recorded in the public entity, including the financial statements.

In achieving these requirements internal auditor complies with the Code of Ethics of the internal auditor, audit methodology applicable best practices. It also aims to reduce the risk of internal audit transactions and operations conducted in primary and accounting records of the entity, lead to significant distortions of financial results.

Conclusions

From the analysis presented it can be concluded that the internal audit activity should be oriented towards assessing the observance of the conceptual framework of accounting, the reality and source documents and accounting compliance, legality economic operations conducted internal compliance procedures and fidelity, clarity and completeness of the information contained in the financial statements.

In this regard, the contribution of internal audit to limit fraud linked to misstate the financial statements should be viewed and investigated the following aspects:

A. Contribution to improving the accounting system. Audit , in his approach, applying the necessary procedures to obtain audit evidence and forming an opinion on the content of each accounting or financial operations examined and express reasonable assurance. In this respect shall:

a) review the regulatory framework for accounting and record imperfections communicating results to management. In this regard, it notes that the audit may make proposals to limit the risk of fraud, however, together with the management entity in the field inform regulators on existing imperfections and argue how they can lead to errors or fraud;

b) analyze the applicability of the procedural framework identifies inconsistencies and propose their revision . In this respect conducts tests on the knowledge and application by employees of the procedural framework , identify areas where internal control is inoperative, and together with management determines appropriate measures to correct inconsistencies;

The internal auditors determines the level of achievement of the objectives of the entity’s management, identify possible shortcomings in the regulatory framework applicable to the field and deviations from the financial statements and establishes control tools need to be implemented in order to eliminate errors or limit fraud.

B. Contributing to the improvement of internal control. In assessing the accounting system internal audit mainly aims knowledge of its internal control system, since a system of internal control and appropriate scope prevents or detects any omissions, inaccuracies, errors or fraudulent activities conducted within the accounting system.

Internal auditor in his approach, test all components of the control system which they consider likely existence of uncontrolled risks, so that after the implementation of appropriate control devices that can prevent, detect and correct fraud and errors associated accounting system default situations financial. Test results will enable the formulation of an opinion on the level of functioning of the internal control and financial operations and accounting consequences if that were the basis for the financial statements comply accordance with the regulations and procedures developed and carried out in conditions of economy, efficiency and effectiveness.

C. Contribution to reducing risks related to financial reporting. By internal audit risk assessment is a complex process that involves assessment procedures applied by management in managing risk. The risk assessment involves identifying activities / operations auditable identify risks associated activities/operations, risk assessment, weights and their levels, achievement testing and analytical procedures and risk control.

Tests examine the existence and functionality of internal controls and cover:

- control tests are performed to determine the operation of the accounting and internal control;

- background procedures are performed to detect errors with significant impact on the financial statements. These may include tests of detail on transactions, which seeks to obtain evidence about the items reflected in the debit or credit accounts to assess how the recording of transactions; detailed tests on balances aimed at gathering reliable information on balances and the whole analytical procedure which examines the relationships between various types of accounting information in the financial statements.

Minimizing the risk of fraud is achieved through the Internal Control Standards as well as financial reporting standards implementation, internal audit and information systems security.

D. Involvement in research fraud. The objective of internal audit on the assessment of the distortion of financial statements is to express an assurance about the quality of property transactions recorded, the quality and accuracy of their registration documents in the accounts and accounting documents and summary. In this regard, within each audit action is performed as follows:

a) Consider the fraud. During the audit plan development, selection procedures, conducting tests and reporting the results of the internal auditor, in addition to compliance or performance analysis tests they perform, consider the risk of fraud, of the existence of significant abnormalities in primary documents and accounting records or erroneous entries in the accounts or financial reports.

b) Examine the organizational entity and its environment. In preparation for the audit mission is collect data and information on the organizational context and functioning of the organization and the environment in which it operates , including the quality and adequacy of internal control and whether it can identify and assess significant risks may result if their manifestation, distort financial statements.

c) Realize that management discussions. Internal audit obtain statements from management confirming its responsibilities regarding the implementation and monitoring of the accounting and internal control necessary to prevent and detect fraud and errors.

d) Plan and perform tests. Audit procedures applied them into account both the specific characteristics of each class of transactions, account balance or transaction record and the fact that the risk assessment takes account of internal controls implemented.

The application of control allows to obtain audit evidence about the quality of the supporting documents, accuracy of accounting operations carried reality accounting balances of accounts, including information from the financial statements prepared. The area of investigation of testing is determined in relation to the sampling method used.

e) Communicate the results of the fraud detected. After establishing that a fraud has been committed, the internal auditor has a responsibility to inform the entity management on issues identified. The reports must contain information on the findings and conclusions of the internal auditors on fraud identified the need for thorough investigation of the phenomenon, and recommendations that can help make the right decisions by the management entity to limit fraud.

Please note that the objective of internal audit is to give assurance of asset integrity, reliability of financial statements and reality results. To provide this assurance internal audit monitors whether recorded transactions and operations correctly reflect the nature of the events that took place and whether they are likely to be skewed.

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