

THE NECESSITY FOR AUDITING THE FINANCIAL-ACCOUNTING ACTIVITY

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Abstract: Many financial-accounting information users mistake internal audit and accounting. These confusion has, at is basis, the fact that most internal audit activities regard financial-accounting information and the fact that most internal auditors have a significant background in fields regarding accounting. Although the origins of accounting and audit are not clearly defined they have different application domains. The practice has imposed the abandonment of the entity's internal audit correlated with the financial-accounting function significance and the growth of its importance by including the internal audit function in the direct subordination of the general management.

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Many financial-accounting information users mistake internal audit and accounting. These confusion has, at is basis, on one side the fact that most internal audit activities regard financial-accounting information and, on the other side, the fact that most internal auditors have a significant background in fields regarding accounting.

Although the origins of accounting and audit are not clearly defined they have different application domains.

Thus, accounting represents the logical process through which we register, classify and synthesize economical events with a purpose in providing financial information for the decision making while internal audit check and analyses the accuracy and compliance of transactions, the functionality of systems and evaluates the efficiency and efficacy of methods and operational procedures within an entity.

The practice has imposed the abandonment of the entity's internal audit correlated with the financial-accounting function significance and the growth of its importance by including the internal audit function in the direct subordination of the general management thus, becoming an instrument in identifying, analyzing and monitoring risks.

Generally, the management it is responsible with the entity's continuing regarding its shareholders and any other parties interested in its activity and, thus, it is the management's responsibility for informing with regards to the entity's actions, administration and results.

Precisely, the main objective of the management process consists in obtaining:

- a pertinent and reliable financial-accounting information obtained by reflecting in accounting all patrimonial operations in accordance with legal and contractual stipulations and also with good practice in the field;
- an efficient and effective usage of the organization's resources;
- the safeguard of the organization's assets;
- the identification of all existent risks and the usage of effective strategies for controlling them;
- the established objectives for operations or projects.

1. Internal audit's role in obtaining relevant and reliable financial-accounting information

Because of the fact that the financial-accounting activity represents the main source of information for the management it emerges the necessity for the internal auditor to evaluate if, at the financial-accounting department's level, there are procedures, rules or specific regulations that are regarded. The objective of the compliance programs consists in preventing the production of errors by the personnel, identifying illegal acts and to discourage any malpractice committed voluntarily by the employed personnel. The importance of these programs has risen following the manifestation of a new trend in the evolution of accounting – the apparition of the concept of creative accounting.

In order to present the notion of creative accounting we consider as being relevant the opinion of K. Naser, assumed within the Romanian specialized literature¹, under which creative accounting represents:

- “the process through which, given the break of rules, the accounting numbers are manipulated and, given its flexibility, there are chosen those measuring and informing practices that allow the transformation of synthesis of documents from what they should be into what managers want to be.
- the process through which transactions are structured in such a way that allow the “realization” of the desired accounting result.”

The main techniques of creative accounting can be classified as it follows:

- the normative frame and the recognized good practice in the field allow the usage of alternative accounting techniques and methods that lead to the realization of different results and, implicitly, the obtaining of different images of the financial situations. For example, in Romania, in accordance with the legal stipulations², the entities absorb tangible assets by using the following depreciation regimes: linear depreciation, digressive depreciation, accelerated depreciation.

- some operations that affect the patrimony require appraisals or forecasts before being registered in accounting. For example, the normal use of an asset, established in order to calculate the depreciation, represents a group appraisal realized by a group of persons (reception committee) entrusted to manage the entity. This

¹ Feleaga N., Malciu L. – Accounting policies and options, Economic Publishing House, Bucharest 2002, page

² Order of the Minister of Public Finance No. 1752 of 17 November 2005 for the approval of the accounting regulations complying with the European directives, The Official Gazette of Romania No. 1080 and 1080 bis of 30 November 2005; Law no 571 of 22 December 2003 – Fiscal Code, The Official Gazette of Romania No. 927 of 23 December 2003, Part I, modified and completed.

appraisal has a subjective character, allows an “optimistic or pessimistic” approach that can lead to different representations for the financial situations.

- there is a possibility for realizing artificial transactions in order to influence the value of patrimonial elements within the balance and to obtain a certain result for the financial year. For example, specifically for the entities within the transportation domain, at the end of the N time management it is proceeded to registering within the accounting the “remaining tank” through the cancellation of unused fuel expenses and, at the same time, to the immediate retrieval of the sum for the beginning of the N+1 period, by resuming the fuel expenses. The value of the cancelled fuel usage can be greater or lower than the real value of the “remaining tank”.

- the moment for realizing some transactions it is carefully chosen in order to give a certain image within the accounts. For example, an entity owns a tangible asset with a value that hasn't been updated of 300 square meters, but has a fair market value of 400 square meters. The entity's management will decide to sell the property in the year in which it will increase the result.

Regarding the possible malfunctions that an auditor can encounter in practice following the usage of creative accounting techniques, we present, as it follows, some examples identified initially by O. Amat and J. Blake and published in the paperwork “Contabilidad creativa” and that later have been assumed in the Romanian specialized literature³:

- the increase or diminish of expenses. The accounting norms leave a certain margin of maneuver in quantifying the expenses that emerge following a financial year. For example, for certain assets we point only the maximum number of years in which these assets must be depreciated. O larger or smaller rate of depreciation affects the size of the exercise. Similarly, we can analyze the provisions and the possibility of activating certain expenses.

- the increase or diminish of revenues. In certain cases, we can accelerate or not the recognition of revenues by applying the prudence principle or the matching principle regarding the connection of expenses and revenues.

- the increase or diminish of assets. The existence of flexibility with regards to the depreciation and provisions calculation creates the possibility for increasing or diminishing the assets' net value. Also, stocks can be evaluated through different methods and, as follows, their value can be different with effects in the profit/loss account.

- the increase or diminish of the owners' equity. The modification of revenues and expenses affects the size of the exercise and, in consequence, the size of reserves. It modifies, also, the value of the owners' equity and all the rates calculated on it.

- the increase or diminish of liabilities. In some countries, the accounting norms allow the possibility to regularize certain liabilities such as those regarding compensatory salaries under the conditions in which employment relationship ends before fulfilling the retirement conditions (length of service and/or age) in a period of time. As follows, an enterprise interested in increasing the result of the financial year will proceed to the distribution of liabilities within the maximum period allowed.

- reclassification of assets and liabilities. In some cases, there are certain doubts regarding the localization within a certain accounting element or another. This is the

³ Feleaga N., Malciu L. – Accounting policies and options, Economic Publishing House, Bucharest 2002.

case, for example, for shares that, with respect to the enterprise's intentions, must be enlisted in current assets or non-current assets.

- manipulation of information within the annexes of the financial situations.

Lack of relevant information can affect the external users' decisions.

- the presentation of information. The criteria used in presenting accounting information can represent a way to exhibit creativity.

Often, the entities take advantage of the breaches within the existing norms and their flexibility in order to manipulate published information. Even if, in reality, there is a clear delimitation between creative accounting and breaking the law intentionally, both phenomena are present under the conditions in which most economic entities are dealing with financial difficulties.

Analyzing the data presented above we can extract the idea that the necessity for evaluating the financial-accounting activity by the internal auditor has, as a basis, the management's need to obtain a reasonable assurance with regards to the patrimonial entity's compliance with the following principles:

- the systematic and chronological registration of the patrimonial operations;
- the completion of accounting registers;
- the existence of assets and liabilities and the confirmation that they belong to the entity;
- the compliance with the legal stipulations with respect to the accomplishment of the patrimonial inventory;
- the pursuit of the patrimonial entity's debts, obligations, revenues and expenses;
- abiding the professional codes;
- preparation and publication of financial statements in accordance with the National and International Accounting Standards.

2. The necessity for evaluating the financial-accounting system

If in the previous chapter we presented the importance of the financial-accounting information auditing seen in terms of final goal, respectively the relevance and reliability of financial-accounting information, this chapter wants to be the promoter for the aspects regarding the need to analyze the financial-accounting activity as a whole, organized and integrated by elements and sequences of events that are combined with the purpose for obtaining the predefined objectives and to realize the necessary results. Considering those previously found, the financial-accounting activity represents a system. Although in the specialized literature, the notion of a financial-accounting system has gained different definitions, we consider relevant the opinion by which it represents the overall of methods, procedures, human resources and technical means of governance, registration-processing, transmitting and preserving data and information regarding the activity and the environment in which the system functions.

At the basis of the financial-accounting system it stands a series of rules, principles that has to be known by both the persons that use the system and auditors:

- the entire activity of the entity represents a system made from many systems and one of these systems it is the financial-accounting system.
- in turn, the financial-accounting system it is made up from smaller systems;
- the systems don't function on an isolated basis, they are connected and interfaced with other systems – it has an environment;

- the results of a system represent inputs for other systems, a reason for which the other systems have interested factors;
- for each level of the system there is designated a person responsible;
- each system will have boundaries and coverage within these boundaries.

In our opinion, the financial-accounting system must comprise the following elements (table no. 1):

- objectives and targets clearly and unitarily defined;
- clear policies, regulations, standards and procedures;
- its own organizational structure made up of numbers, roles, responsibilities, authorities, behaviors, abilities;
- the necessary infrastructure and other resources such as offices, computers, communications, information, budget etc.;
- corresponding processes, correctly controlled;
- corresponding interfaces and the coordination with other systems.

Table no. 1. Filing systems suppliers

The system's objective: The correct payment of suppliers for the services provided/goods delivered at the given date.		
No.	Stage	The stage's objective/objective for control
1.	Setting the objectives and the performance indicators	Assuring the existence of a clearly defined and communicated objective and, also, the existence of the corresponding performance indicators and the fact that they assure the achievement of the entity's objectives.
2.	Setting the laws, policies, regulations, standards and procedures	Assuring the fact that there are sufficient and updated regulations and policies, that they are in accordance and complementary with other regulations and policies within the entity, that the legislation and the good practice in the field are applied and that procedures are adequate and appropriate for the users' needs.
3.	Setting the organizational structure: personnel, infrastructure, training etc	Assuring the fact that the personnel is correctly sized and qualified, with roles, responsibilities and levels of clear authority, that the available infrastructure is adequate and functions on the basis of economy, that there is a budget and it is available.
4.	Identification of suppliers that must be paid	Assuring the fact that payment is made to all suppliers that have provided services and have delivered goods to the entity.
5.	Establishing the entity's debts in accordance with provisions of the contract/Note order	Assuring the fact that all debts are correctly established.
6.	Setting the increases for delays and commercial deductions	Assuring the fact that commercial deductions and increases for delays are in accordance with the law, authorized and correctly completed.
7.	The calculation of the total debt for each supplier	Assuring the fact that the total debt is correctly calculated
8.	Estimation of the entity's total debt and the disposal of money	Assuring the fact that the total debt it is correctly and in good time predicted, that money are turned to account completely and in the right accounts.

Finances - Accounting

The system's objective: The correct payment of suppliers for the services provided/goods delivered at the given date.

No.	Stage	The stage's objective/objective for control
9.	Payment	The payment is complete, correct, realized in good time and safely.
10.	Paying taxes and submitting the statements.	Assuring the fact that all deductions are complete, realized in good time and safely by the proper authorities together with the corresponding documents.
11.	Updating the registrations	Assuring the fact that all registrations are correctly updated, completely, in good time and safely, with all necessary authorizations
12.	Monitoring and revising the completeness and accuracy of the process.	Assuring the fact that the registration process for suppliers it is monitored and revised regularly in order to assure that the processing it is complete and correct and, also, that the suppliers' registration system functions on economy and efficiency principles and that the objectives and indicators are achieved.

The ground that stood at the basis of the audit's orientation in time for this approach resides in the fact that along with the system's audit, the internal audit can form an opinion regarding the good establishment and proper functionality of it. Carrying out an internal audit mission involves, generally, the direct testing of a sample of transactions in order to obtain the necessary objectives. Nevertheless, the magnitude of the test can be diminished when it can be depended on the internal control systems, where it is possible and economic. The audit's approach toward the system starts with a detailed examination and with the testing of the design and functionality of the internal control systems implemented by the audited structure in order to obtain the proof of their functionality.

The internal control systems are systems implemented by the management in order to assure:

- the achievement of their objectives in an efficient and effective manner;
- the adoption of external rules (laws, regulations) and governance policies;
- safeguarding the patrimony and information;
- preventing and detecting frauds and errors;
- the corresponding quality of the accounting registers and the elaboration of financial and management information in good time.

If the testing reveals the fact that the systems are well designed and function in an effective manner, then the quantity of transactions subjected to direct testing in order to achieve the audit's objectives can be diminished. After the completion of the audit mission, the audit team composes the internal audit rapport in which it presents the findings in a detailed manner. This detailed presentation of findings it is signed by all the members of the audit team that have a responsibility over the respective audit mission and it is, then, submitted to the audited structure. System audit it is also used when auditing the soundness of the financial management systems because it presents the advantage when assuring detailed observations with regards to the internal control systems allowing, in a systematic manner, the identification of their weaknesses and the formulation of proposals for improving the situation.

3. The role of internal audit in the optimization of resources' consumption (value for money)

Internal audit offers a special attention in giving an added value to the financial management through the audit work submitted, through the simple outline of weaknesses but mostly through the identification of ways in which entity's resources can be better administrated.

Following this logic, the internal auditor within an internal audit mission regarding the financial-accounting activity must evaluate if the resources allocated to the financial-accounting system are administrated in an economic, efficient and effective manner, offering an added value to the economic entity. Such audits are known under the name of performance audits or "value for money" audits (VFM).

What was presented previously can entitle us to accede to those opinions that define audit regarding the optimization of resources (VFM) as it follows: "an independent appreciation for management's performances in its approaches for an economic, efficient and effective usage of available resources". Compared to the above we can conclude that the objective of a performance audit for the financial-accounting activity resides in evaluate to degree in which the principles of good financial management respectively economy, efficiency and efficacy are applied in administrating the allocated resources at the financial-accounting level. Internal auditors, when develop a performance audit mission, have two possibilities for approaching the solidity of the financial administration systems keeping in mind the subject that is subjected to the audit and the involved risks.

The first approach regards the manner in which expenses are administrated and, in particularly, the measures taken for obtaining an optimal usage of resources. This thing involves the evaluation of the approach assumed by the management, the systems used for assuring the achievement of this objective and, also, the testing of the assumed decisions. The audit forms a conclusion over the manner in which the approach assumed by the management has the capacity to assure an optimal usage of resources and, if this doesn't happen, what are the methods for improvement. The second approach includes an evaluation for the achievement of the objectives for a certain program or project and the value obtained by it. This process involves an examination of the achievement of the objectives and of the manner, in which this objective has been accomplished, the expenses involved and, also, an evaluation for the volume of resources used in order to establish if the minimum quantity of resources has been used to obtain a certain result. The audit forms a conclusion with regard to the optimal usage of resources within the program and, if this thing it is not realized the methods necessary for improving the situation.

Synthesizing the above we reveal the fact that, following a performance audit, the internal auditors, on the basis of their professional reasoning, can establish if:

- at the level of the financial-accounting system it is beard in mind the achievement of results and measurable objectives that will allow the achievement of the proposed objective;
- at the level of the financial-accounting system there are systematically planned on the short and long term the realization of objectives;
- the financial-accounting compartment measures continually its performance by monitoring and quantifying inputs from the processes, results and impact;
- the financial-accounting plans are implemented in practice;

- the management of this structure monitors periodically its performance and analyses the motives that have determined the registered abnormalities within the process of realizing the planned tasks and targets;

- the management of this structure identifies the possibilities for improving the performance, establishes its priorities and elaborates a plan for implementing them.

Also, on the basis of these observations, the internal auditors offer recommendations regarding:

- the improvement of the compliance with laws and regulations;
- the reduction of risks based on errors and irregularities;
- the improvement of the manner for organizing the entity's activities and its internal control systems;
- the increase of transparency for the entity's actions through the improvement of methods and accounting procedures;
- the achievement of the established objectives through the entity's policy in a more efficient and effective manner.

Concluding, on the basis of the presented aspects, we emphasize the idea that at the basis of the necessity for auditing the financial-accounting activity stands the management need for information, a necessity that, in time, has evolved as it follows:

- initially, the entity's managers demanded the audit for the financial-accounting activity in order to obtain an assurance over the reliability and accuracy of the financial-accounting information presented in the financial situations and their compliance with national and international accounting standards;

- subsequently, as the economic thinking evolved, managers felt the need to obtain an assurance over the fact that the financial-accounting activity it is regarded as a system works and that at this system's level the internal control instruments have been established and function in order to assure:

- a) the abidance of laws, rules and contracts;
- b) the reliability and integrity of the operational and financial information;
- c) the safeguard of patrimony and information;
- d) the reliability of the financial-accounting informatics system;
- e) the prevention and detection of fraud and errors.

Nowadays, at the management level, along with the need for all the information presented above, there is also the need for information with regards to the economy, efficiency and effectiveness for the usage of the allocated resources for this activity in order to obtain the proposed objectives.

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