Importance of Internal Audit Missions for Private Companies in Fraud Prevention and Detection

Attila TAMAȘ[1], Daniela PETRAȘCU[2], Monica Ioana TOADER[3]
[1]University "1 Decembrie" Alba Iulia Faculty of Economic Sciences, [2]University "Lucian Blaga" Sibiu Faculty of Economic Sciences, [3]University "1 Decembrie" Alba Iulia Faculty of Economic Sciences
attaconsulting@yahoo.com, daniela.petrascu@yahoo.com, Monica.ioana66@yahoo.com

Abstract. *In this article, the object of the research is the link between the internal audit of the individual entities and the audit risks assumed by the financial auditors and the users of the audited financial statements, especially in the context of economic crises. The research has resulted in some proposals for streamlining internal audit.*

Keywords: internal audit, management, deontological principles, irregularities.

JEL Classification: M42.

1. Introduction

Studies on the recent global economic crisis provide multiple descriptive and financial approaches to this complex phenomenon. There are different meanings of the concept of "financial crisis," as to the state of national organizations or economies that diminish some of their wealth. The conceptual meaning of the notion of financial crisis revolves around the sobriety of this term and the psychological impact on human perception.

Measuring and preventing or anticipating the effects of the crisis have become complex and difficult challenges, tending to become the predominant subjects of contemporary studies.

We aim at investigating the conditions of the crisis at the level of individual entities and at studying the initiating and prevention factors, strictly related to internal audit, as part of the financial audit. The premise of the study is represented by the social responsibility of internal auditors , and also by the incidence of conditions of economic instability on internal audit activities.

❖ **Brief presentation of internal auditor's code of ethics:**

The Code of Ethics is a statement of the values and principles that must guide the daily work and practice of internal auditors.The code of ethics includes the principles and the way of application that the internal auditor should comply with, in order to avoid moving away from the provisions of the standards, in carrying out the audit missions.

The Code of Ethics sets out four fundamental principles, namely: integrity, objectivity, competence and confidentiality.

✓ **Integrity**

Integrity requires honesty and fairness in delivering professional services.[1] Integrity involves not only honesty, but also fairness and sincerity.

In order to achieve a fair and honest internal audit, an environment that provides the basis for overall confidence in all the activities of the internal audit team must be developed, which they have to exercise professionally.

Conduct rules related to the principle of integrity:

[1] Stoian A.,Ţurlea E., Audit financiar contabil, Ed. Economică, Bucureşti, 2001, pag. 37.

- to carry out the activity with honesty, professionalism and responsibility;
- to comply with the law and makes public the necessary communications according to law and profession;
- not to be knowingly involved in illegal activities, and
- not to be involved in acts that compromise the internal audit profession or organization; to respect and contribute to the legitimate and ethical goals of the organization.The above rules are part of the public internal auditor's charter, but it is self-evident that they should also be applied in the framework of internal audit engagements performed voluntarily in private entities.

The Professional Standard 36 of the Accounting Expert on this Standard provides: "Accountants should perform their internal audit tasks with honesty, conscientiousness and accountability, make the disclosures required by law and the rules of the profession, and not consciously take part in illegal activities or engage in dishonorable acts for the internal audit profession and for the internal auditors' association. "[2]

✓ **Objectivity**

Objectivity implies impartiality, avoidance of incompatibility situations, or conflict of interest or situations that may cause a third party to question the objectivity of the auditor. The principle of objectivity requires every professional to be fair, honest in the intellectual sphere and not involved in conflicts of interest.

Rules of conduct relating to the principle of objectivity:

- not to take part in activities and do not establish personal relationships that may affect or are supposed to affect the expression of an independent opinion. These include personal activities or relationships that may conflict with the organization's interests;
- not to accept anything that may affect or is supposed to affect the professional judgment;
- to communicates all significant elements of which they are aware and which, if not disclosed, could prejudice the quality of the reports on the activities under review;
- the professional standard 36, referring to this rule, states: "When carrying out an internal audit mission, the accountants should not take part in activities or establish relationships that might compromise their professional judgment."[3]

✓ **Independence**[4]

When exercising his / her profession freely, the professional accountant must also be free from any interest that might be considered, whatever the reality, as incompatible with his / her integrity and objectivity, such as:

- direct or indirect financial involvement in a client's activities such as accepting forms of remuneration, holding capital, giving or taking out goods, services or money, granting or receiving pledges or bail from or for its clients;
- engaging the professional accountant in the activities of a client as a member of his / her executive or as an employee under the direction of his / her direction;
- acts of commerce or services provided at the same time as the pursuit of a liberal profession which may end in a conflict of interests or are inherently incompatible or contradictory to the exercise of the profession professionally or which are incompatible with the necessity to maintain the position of independence, integrity and

---

[2]Professional Standard 36 ”Misiunile de audit intern realizate de experții contabili”, Ed. CECCAR, București, 2007, pag.16.

[3]Professional Standard 36 ”Misiunile de audit intern realizate de experții contabili”, Ed. CECCAR, București, 2007, pag.17.

[4] Păcurariu I., Petrașcu D., Revista economică, 68:2 (2016), ULB Sibiu, Ethics in Accounting Profession Theoretical and Practical Valencesetica,

objectivity of the professional accountant; - the incidence of family and personal relationships on independence;

- the conditions under which fees received from a customer constitute an unacceptably high percentage for the total turnover of the firm of expertise or an individual practitioner; this implies that most of the activity of professional accountants does not deal with the execution of works for a single patrimonial unit, namely a commercial company;
- accepting the execution of works on basis of possible fees, not anticipated in absolute terms, by contract or convention.

✓ **Competence**

Competence implies that the internal auditor will apply the knowledge, standards, skills and experience required to provide audit services. Internal auditors should be familiar with professional standards and norms and should not accept missions for which they do not have the necessary expertise. Rules of conduct relating to the principle of competence:

- engage only in those missions for which they have the necessary knowledge, skills and experience;
- provide internal audit services according to SIA;
- continuously improve their skills, efficiency and quality of service. The professional standard 36, referring to this rule, states: "In the case of an internal audit engagement, accountants must use and apply the knowledge and experience necessary to carry out their duties."[5]

Internal auditors should be experts in audit, risk assessment, management and control, and especially in communication, to properly and efficiently exploit the information they receive. Also, they must have basic knowledge of accounting and information technology (IT) systems and have theoretical-methodological and practical knowledge in the fields of accounting, taxation, audit, law.

Knowledge, abilities, experience and skill, all together, mean professional competence.

✓ **Confidentiality**

Confidentiality implies that internal auditors respect the value and ownership of the information they receive and do not provide information without proper approval unless there are legal or professional obligations to do so. Conduct rules related to the confidentiality principle:

- is cautious about the use of information obtained during the exercise of service duties;
- they do not use information to obtain personal benefits or in any other way that would be contrary to law or to the detriment of the organization's legitimate or ethical goals. The Professional Standard 36, which deals with this norm, states: "When performing an internal audit engagement, accountants should respect the value and ownership of the information they receive: they disclose that information only on the basis of the necessary authorization, unless a legal or professional obligation forces them to do otherwise ";[6]
- internal auditors are required to keep the information in their possession through their duties. They have access to any information, some very personal, according to the procedures, but they receive this information depending on how they work, otherwise they will not receive them. This information should not be disclosed or commented, but should be used, possibly discussed in the team.[7]

---

[5]CECCAR, Op.cit., pag. 19.

[6] CECCAR, Op.cit., pag.18.

[7] Petrașcu D., Auditul intern de la teorie la practică, Lucian Blaga Sibiu Publishing House, Sibiu, 2016

For example, certain information can be used as a manipulation tool. Privacy is important from the slightest detail to the most important. If we are not confidential in minor matters, who will give us major issues for examination?

2. Research Methodology:

In carrying out the study, the research methodology consisted in identifying the main notions of the theme in the national specialized literature and interpreting, from a practical perspective, the effects of non-conformities that were not identified by the internal auditors and later discovered by other entities. The research of the practical aspects as the subject of the empirical approach of the theme, was based onthe situations of nonconformity thought by the authors regarding the access and implementation of projects with non-reimbursable financing.

3. Theoretical perspectives

Starting from the above mentioned aspects, of course regulated by the legislation applicable to the activity of the internal auditors, one can appreciate the existence of an important role of the internal audit in the prevention and detection of frauds not only to the public institutions but also to the private entities.

Fraud hurts the economy as a whole, causes huge financial losses, weakens social stability, threatens democratic structures, causes loss of confidence in the economic system, corrupts and compromises economic and social institutions.[8]

Until recently, companies did not consider fraud prevention a primary objective of the organization's internal control system. Fraud prevention actions were seen as an implicit component of the overall compliance objectives of internal controls and not as a structured program with clear and explicit objectives on fraud prevention and detection.

Also, in the past, shareholders, board of directors and management tended to treat fraud cases as abnormalities resulting from the malfunction of internal controls at a reduced frequency. As a result of the numerous cases of fraud revealed within some more prestigious multinational companies at the beginning of the 21st century, this vision has changed radically. At present, fraud is considered to be one of the most important risks to an organization, intimately linked to market, credit, legal or reputational risks.[9]

It is also a novelty that investors have become more sensitive to the risk of fraud because collateral losses from fraud have significantly exceeded direct financial losses from fraud.

These collateral losses include negative advertising that can seriously affect the reputation of an organization. Thus, investors primarily lose their confidence in the management and the way the company is controlled, which obviously determines the decrease in its value. It also affects business relationships and employee morale.

In response to this situation, investors require the development of anti-fraud mechanisms focused on prevention and timely detection of fraud. There is a growing emphasis on internal controls and on internal audit as key elements of these mechanisms.[10]

---

[8] Nicolescu C., Spălarea banilor mai multe repere într-o lume atipică, Ed. Universităţii Lucian Blaga, Sibiu, 2007, pag.92.

[9]Munteanu.A., ș.a.: „Auditul intern la întreprinderi şi instituţii publice: Concepte, metodologie, reglementări, studii de caz”, Wolters Kluwer, Bucureşti, 2010, pag. 33.

[10]Idem, pag.33.

In view of the above, it is also important to mention the issues related to the fraud risk. In the category of fraud risk, the following possibilities can be considered:

- management fraud;
- complicity between employees;
- inappropriate segregation of tasks;
- unauthorized use of resources;
- conflict of interests;
- inappropriate maintenance of confidential files / information.

✓ **Responsibilities in fraud preventing**

Fraud prevention responsibilities within the organization are shared between: executive management, audit committee, and internal audit.

Executive leadership: has ultimate responsibility for implementing mechanisms to prevent and detect fraud on time. Members of the executive management are those who will have to give explanations in case of fraud.

Audit Committee: Has the role of overseeing fraud risk management and actively monitoring anti-fraud efforts undertaken by executive management.

Internal Audit: represents an effective line of defense against fraud, both in risk monitoring and in the prevention and detection of fraud. Internal audit is a tool available to the audit committee, the only one able to independently assess fraud risks and anti-fraud measures implemented by executive management.[11]

While performing the current activities, internal auditors must:

- have sufficient knowledge to identify indications of possible fraud;
- be vigilant in cases where a situation involves a risk of fraud;
- assess the need for further research, inform the competent person within the organization and take steps to eliminate or reduce the possibilities of such cases.

There is a clear distinction between internal auditors and fraud investigation specialists, both in terms of their roles and responsibilities, as well as through specialization and professional training.

Of course, the role of the internal auditor in detecting fraud depends on his / her professional training and practical skills.

In practice, the role of internal audit may include:

- supporting management to define auditable anti-fraud mechanisms;
- the facility to assess fraud and reputational risks at the organization and business processes level;
- assessing the links between the risks of fraud and internal controls;
- auditing frauds;
- supporting specialists in investigating fraud;
- supporting efforts to remedy the deficiencies;
- reporting to the audit committee on issues related to anti-fraud mechanisms, assessing fraud and reputational risks, cases or suspected frauds.

Internal auditing can not fully prevent fraud, but it can adapt its way and working procedures to increase its chances of correctly identifying and interpreting fraud indications.[12]

Internal auditors should have a high level of theoretical knowledge and practical experience in order to be able to fulfill this role successfully. They must know possible schemes and fraud scenarios specific to the organization's field of activity (eg, insurance, retail, telecommunications, etc.) and be able to recognize the indications of those fraud schemes.In order to implement the above mentioned, it is necessary to invest in the specialization of the internal auditors by financing their specialization

[11] Idem, pag.34.
[12]Munteanu , ş.a.,Op.Cit., pag.35.

courses. Other organizations call on external specialists (contracted under service contracts) to carry out audit missions, convinced that they have high-class specialists at not very high costs.

- ✓ **Assessing the risk of fraud**

In assessing the risk of fraud, the auditor should consider, inter alia, the following questions:[13]

- ➢ can the fraud be favored by the remuneration of management or employees?
- ➢ how strong are internal controls? Can they be avoided?
- ➢ who in the organization would be motivated to commit a fraud?- Have there been major changes in the organization?
- ➢ does the organization operate in a domain or geographic area at high risk of fraud?
- ➢ have there been cases where members of the management or employees were investigated in cases of fraud?

The entity's ability to prevent and detect fraud depends on a correct and complete assessment of the risks of fraud.

In practice, risk assessment of fraud is a seven-step process:[14]

- ➢ organizing the fraud risk assessment.
- ➢ determine the processes, organizational units and locations to be evaluated, both in terms of the value of the transactions and balances, as well as the known specific risks.
- ➢ identification of possible scenarios and fraud schemes.
- ➢ assessing the likelihood of fraud.
- ➢ assessment of the degree of importance of identified fraud risks (assessment of possible losses).
- ➢ determine existing internal anti-fraud controls and assess the extent to which these internal controls cover the risks of fraud. This stage also identifies the vulnerabilities of the internal control system.
- ➢ develop or modify the audit plan based on the fraud risk assessment results.

In addition to those listed, the internal auditor should include an element of unpredictability in his work programs. For a concrete example of fraud detection with the help of audit, I bring to your attention the International Standard on Auditing (ISA) 240 which recognizes two ways of deliberate distortions: one relates to fraudulent financial reporting and the other to distortion of assets.[15]

a) fraudulent financial reporting - which involves intentional mistakes or omissions of amounts or information in the financial statements for misleading users. This fraud may involve:

- acts of deception, such as the manipulation, falsification or modification of the accounting records or supporting documents on the basis of which the financial statements are prepared;
- misinterpretation or intentional omission of events, transactions, or other significant information in the financial statements:
- the deliberate misapplication of accounting policies related to the assessment, recognition, classification, presentation or disclosure of information.

b) embezzlement (misappropriation) of assets is the fraud that involves the theft of assets of an entity.Fraud, whether fraudulent financial reporting or misappropriation of assets, involves incentives or pressures to be commited. All these aspects are hard to report and sometimes almost impossible to prove.

---

[13] Idem pag. 36.
[14] Munteanu V., ş.a.,Op.Cit., pag.37-38.
[15]Journal„Contabilitatea expertiza şi auditul afacerilor": nr.12 Decembrie 2011: authors Bugnet O.C., Dumitrescu A,C., Deliu D.,: article „Auditul financiar şi raportarea fraudelor – part I-„ pag. 57.

In planning the audit work, the auditor should use the questioning of management to determine whether material misstatement is due to fraud or error.The auditor is interested in both the management's assessments of the fraud risk and the existing prevention and detection systems, as well as the internal accounting and internal control systems established for the prevention and detection of errors.[16]

The above mentioned questionnaires may include the following:

- location of affiliates, business segments, types of transactions, significant account balances, how issues are addressed by management;
- the work of an entity's internal audit function and whether the internal audit has identified fraud or any significant deficiencies in the internal control system;
- how management tells employees their views on responsible business practices and ethical behavior, for example through ethics or codes of conduct.

As I have already explained, these issues are sensitive, difficult to detect, but that is precisely why the internal audit is concerned with the majority of missions.

For a clear understanding of fraud it is important to know the three important factors associated with its accomplishment:

- opportunity;
- motivation;
- self-justification.

Opportunity: generally occurs due to deficiencies in internal controls and creates an atmosphere in which embezzlers are convinced that they will be successful and will not be discovered.

Motivation: often occurs as a result of the financial pressures resulting from an excessive lifestyle, from the difference between wages and responsibilities, as a result of the pressure to achieve certain financial goals, the superiority complexes of the perpetrator, or simply greed.

Self-justification: is the internal dialogue of the offenders justifying their own actions. The author of the fraud convinces himself that the employer owes this remuneration.

✓ **International Standards on Auditing (ISA)**

ISA 240 Fraud and error. Fraud and error in financial audit

Audit of financial statements is perceived by most information users to be the activity of identifying frauds and errors, but also to present the fair image of the financial statements. Thus, the International Standard on Auditing 240 - The auditor's responsibility to consider fraud and error in a financial statement audit engagement defines:Fraud as "intentional action by one or more persons in the management, those charged with governance, employees or third parties, action involving the use of deception in order to obtain an unfair or unlawful advantage."The error refers to unintentional misstatement in the financial statements, including the orientation of an amount or a presentation.[17]

Annual financial statements may be distorted due to human fraud or error. The difference between the two terms is the extent to which action is intentional or unintentional.[18] While fraud is a concept widely depicted in ISA, the auditor does not intend to determine legally whether fraud has occurred but to suspect or identify this case in order to observe significant misstatements in financial statements. Fraud may be characterized as fraudulent financial reporting or asset misstatement. Thus, fraudulent reporting is done by management of the business entity by avoiding controls using techniques such as: fictitious entries in the journal register; inappropriate

---

[16]Journal „Contabilitatea expertiza şi auditul afacerilor": nr.12 Decembrie 2011: authors Bugnet O.C., Dumitrescu A,C., Deliu D.,: article „Auditul financiar şi raportarea fraudelor – part I-„ pag. 61.

[17] Ibidem, art. 3

[18] Petrașcu D., Op.Cit. pag.122

adjustment of the assumptions and changes in the judgments used to estimate the account balances; hiding or not presenting facts that could affect the values recorded in the financial statements, etc.

Distortion of assets often involves false records or documents made in order to hide missing or pledged assets without proper authorization. Distortion of assets is manifested in several ways, namely: embezzlement of cashing, use of assets for the personal use of another entity, theft of intellectual or corporal assets, making fictitious payments, etc.

The misstatement of financial statements is an unintended feature of mathematical or accounting mistakes that occurred in the data collection or processing stage of the financial statements through incorrect accounting estimates or the misapplication of accounting policies that refer to valuations, and so on.

The auditor identifies the accounting errors in order to correct them on the basis of the retained earnings. He also decides, regarding the relative importance of distortion, assessing the repercussions on the financial statements.

Auditing rules specify that the auditor is required to advise management on the discovery of fraud or error. If fraud suspicions are not eliminated and errors are not corrected, the auditor should consider their impact on the audit report. Thus, the auditor may express an *reluctant or contrary opinion,* if he considers that deliberate or unintended misstatements have a material effect on the financial statements and they do not reflect a true and fair view; or *a reluctant opinion, or the inability to provide an opinion* if the audited entity prevents the auditor from obtaining sufficient and evidential information to enable the occurrence of fraud or error.

4. Practical perspectives

For a pragmatic understanding of the importance of internal audit missions to private entities, the authors of this paper outline in this paper fraud situations that could be avoided if internal audit missions were organized.

✓ Examples of conditions or events that increase the risk of fraud or error:

- aspects regarding the honesty or competence of management;
- leadership is conducted by one person (or a small group of people) and there is no effective council or supervisory committee;
- existence of an unjustified complicated corporate structure;
- permanently ignoring recommendations to correct the main shortcomings of internal control, if such corrections are appropriate;
- existence of high fluctuation of basic accounting and financial personnel;
- the significant and long lack of staff from the accounting service;
- frequent changes of consultants - lawyers or auditors.

✓ Unusual internal or external circumstances affecting the business of the company:

✓ the branch of activity is declining and the number of bankruptcies is increasing;

✓ insufficient working capital due to the decrease of the profit or the too rapid expansion of the activity volume;

✓ income quality drops, for example, due to rising credit risk, changes in business relations strategy, or the choice of an accounting policy that makes the improvement of financial result conditional;

✓ the trader needs a profit-increasing trend to secure the market price of his shares;

✓ the firm has considerable investment in a branch of production or production technology undergoing rapid change;

✓ the economic agent is heavily dependent on one or several kinds of products or customers;

✓ the financial dependence of top management on the results of the economic activity. There is pressure on accountants to prepare financial reports in an unusually short period of time;

✓ unusual transactions;

✓ unusual transactions, especially towards the end of the year, which have a significant impact on profit;

✓ complicated transactions or tracking methods;

✓ transactions with related parties;

✓ excessive payment for services (for example, lawyers, consultants or intermediaries).

✓ **Factors of fraud risk exposure through fraudulent financial reporting**

➢ *Incentives and pressures.* Financial stability or profitability is threatened by the entity's economic, branch of activity or operating conditions as (or indicated by) the following: a high level of competitiveness or market saturation, accompanied by declining margins, increased vulnerability to rapid change, such as changes in technology, product obsolescence and interest rates, a sharp decline in customer demand, and more and more bankruptcies within its sector or the economy in general, operational losses that threaten bankruptcy, prescription or hostile takeover, moodary flows from recurrent negative operations or the inability to generate cash flows from operations while reporting revenue and revenue growth, rapid growth or unusual profitability compared with other companies in the same sector, new accounting requirements, saturated or regulation.

➢ *Excessive pressures on leadership to meet the requirements and expectations of third parties* due to the following:

• profitability or expectations of trends from the investment analysts, institutional investors, major lenders or other external parties (especially expectations that are unjustifiably aggressive or unrealistic), including management's expectations for, for example, press releases or optimistic messages on the annual report;

• the need to obtain the additional capital needed for the entity to remaining competitive, taking into account the financial position of the entity, including the need for funds to finance major expenses with research and development or capital expenditures.

➢ *The personal financial situation of management or those charged with governance is threatened by the financial performance of the entity*, which results from the following: important financial interests in the entity, a significant percentage of management remuneration is represented by premiums, shares or other incentives the value of which depends on the entity achieving unusually high targets in terms of exploitation results, financial position or cash flows, personal guarantee of the entity's debts.

➢ *Excessive pressure on management or operational staff to achieve the financial targets set by those charged with governance*, including sales or profitability incentives.

✓ **Opportunities for fraud and favorable conditions**

▪ The nature of the sector or operations entities provides the opportunity to make fraudulent financial reports that may arise for the following reasons: significant transactions with related parties that are not part of the normal business activity, strong financial presence or ability to dominate a particular branch of a sector that allows entities to dictate the terms and conditions for vendors and customers, which may result in inappropriate transactions or are not concluded under objective, assets, debts, income, or expense based on significant estimates that involve unusual subjective reasoning or uncertainties that are difficult to corroborate, significant, unusual or particularly complex transactions, especially those close to the end of the period, which pose difficult "background and form" problems, significant operations located or carried out across international borders in jurisdictions with different business environments or cultures, the use of intermediaries for which there is no clear economic justification, significant bank accounts or operations with subsidiaries or branches of tax havens for which there is no clear economic justification.

- Management monitoring is inefficient as a result of the following: dominance of one person or a small group (in an entity not managed by an owner-manager) without adequate controls, inefficient supervision of those charged with governance over the financial reporting and internal control process.
- The existence of a complex and unstable organizational structure, proven by: the difficulty of determining the organization or individuals having interests in the control of the entity, an excessively complex organizational structure involving entities with numerous or unusual legal statuses, the increased rate of staff turnover in senior management, legal advisers or those charged with governance.
- Internal controls are inadequate as a result of inadequate monitoring of controls, including automated controls and interim financial reporting (where external reporting is required), as evidenced by: increased fluctuation of staff or inefficient employment in accounting departments, internal audit or information technology, inefficient accounting and information systems, including situations involving significant gaps in the internal control system.

✓ **Favoring attitudes**

- Communicating, implementing, supporting or applying ethical values or standards of the entity by management or communicating inappropriate ethical values or standards.
- Excessive participation of non-financial management or preoccupation with selecting accounting policies or determining significant estimates.
- There is a history of security breaches, complaints against the entity or management related to fraud or breaches of the law.
- There is an overriding interest in management to maintain or increase the price of the entity's shares or profits through the use of unjustifiably aggressive accounting practices.
- Management is committed to analysts, creditors and other third parties to realize what appear to be unjustifiably aggressive or certainly unrealistic forecasts. Leaders do not adequately monitor significant controls.
- The management fails to correct the significant deficiencies in internal control.
- Management's interest in using inappropriate means to minimize revenue reported for tax purposes. A low moral between senior management.
- The owner-manager does not distinguish between personal and business transactions. Factors of risk of fraud by asset embezzlement.
- Factors of fraud risk associated with misstatements resulting from embezzlement of assets are also classified on the basis of conditions present in the organization: incentives, pressures, opportunities and favoring attitudes.
- Some of the fraud risk factors associated with the misstatements resulting from fraudulent financial reporting may arise from the misstatement resulting from the embezzlement of assets. So, the risk of fraud through fraudulent financial reporting comes from the risk of fraud by embezzling assets. In other words, the risk of fraud through asset embezzlement is contagious (pervasive risk). Inadequate management monitoring and deficiencies in the internal control system may be the cause of distortions resulting both

from fraudulent financial reporting and asset embezzlement. The following are examples of fraud risk factors associated with the misstatements of assets.

✓ **Incentives and pressures**

▪ Personal financial obligations can put pressure on management or employees with access to cash or assets that can be stolen (embezzled).

▪ Existence of tensed relationships between an entity and employees with access to cash or assets that may be stolen may be a reason for those employees to embezzle those assets. For example, tensed relationships can be created by the following:

❖ known or anticipated redundancies;

❖ recent or anticipated changes in employee pension schemes and compensation;

❖ promotion, compensation or other rewards that do not reach the expected level.

✓ **Opportunities for fraud and favoring conditions**

Certain features or situations may increase the likelihood that assets will be embezzled. Thus, the opportunity to embezzle assets increases when there are: significant cash in the company, small inventory items with high value or demand, easily convertible assets such as bearer bonds, diamonds or computer components, small fixed assets, etc.

Inappropriate internal control over assets may increase the likelihood ofthose assets to be embezzled. For example, the embezzlement of assets may occurdue to the following: lack of proper separation of service duties or independent controls, lack of adequate supervision of senior management, such as travel or reimbursement, lack of adequate supervision by management of asset managers, for example , inadequate supervision or monitoring of remote locations, lack of procedures for selecting employees for positions giving access to assets, inappropriate records of assets, lack of an appropriate system of authorizations and approvals for transactions, poor security of cash, investments, stocks or means fixed, lack of full and timely reconciliation of assets, lack of periodic and appropriate documentation related to transactions, etc.

Favorable attitudes: ignoring the need to monitor or mitigate the risks of asset embezzlement, ignoring internal control over asset embezzlement by circumventing existing controls or by failing to correct defectsknown from internal control, behavior that indicates a lack of clarity or dissatisfaction with the way the entity treats the employee, changes in behavior or lifestyle, tolerance of small-scale theft.

In order to eliminate or reduce to a controlled level these significant factors of material misstatement of the financial statements under the conditions described, the internal control system, including internal audit, is the major part of the internal control system. It aims at achieving the entity's objectives under conditions of compliance, efficiency, reliability of information and protection of patrimonial assets. In his / her mission, the financial auditor has the task of identifying, evaluating and reporting the risks of material misstatement, as indicated by ISA 240 and developed in ISA 315.

Below are some examples of nonconformities found by authors in the implementation of projects financed by European funding, examples that support the above.

Case no. 1: Eligibility of service costs such as "Diagnostic Analysis, Analysis of the Internal and External Environment of the Business, Conclusions and Suggestions for Action" in the Expenditure category "Expenditure on Purchasing Services for Economic Analysis, Market Studies, Business Plans" within Order 3345 / 14.11.2008[19].

---

[19]Order of M.E.F. for the approval of the lists of eligible expenditures for the projects financed under the operations 2.1.1 "Research projects in partnership between universities / research and development

Correct approach:

The indicative offer submitted by the Provider (no number and without the date of issue) is limited to:

- financial offer: 90,000 lei - without any justification, namely financial substantiation (e.g. - performance fee x number of hours);
- technical offer: only a description of the purpose of the services, without any methodological detailing of the services to be provided (persons, methodology, documents to be elaborated, deadlines, etc.);

If the actual purchase was made on the basis of the same documents presented here (or others with similar content), then we believe that this expense does not meet, from the point of vue of the purchase, the provisions of ORDINANCE no. 1120 of 15 October 2013 on the approval of the simplified procedure applied by private beneficiaries in the framework of projects financed by the structural instruments, the "Convergence" objective, as well as in the projects financed by the EEA and Norwegian financial mechanisms for the award of supply, service or works contracts. We mean:

- the provisions of CHAPTER II - Direct Procurement, stating that*: In this case, the procurement dossier will include a note on the estimated value*; I stress that such a note must be based on applicable and acceptable hourly rates for such services; if the rule had been limited solely to the existence of an invoice, and not to a justifying note for determining the value of the acquisition, it could have been methodologically presented (in the absence of references to the applicable principles below) such an indifferent invoice of the amount enumerated, or it is precisely that supporting note that validates the limit of such an amount;
- CHAPTER V - Principles applicable to the present proceedings, which state that:

During the entire procurement process, the following principles must be considered when adopting any decision:

- *the principle of transparency;*
- *the principle of economy;*
- *the principle of efficiency;*
- *the principle of effectiveness.*

Transparency means informing the public about the application of the simplified procedure.

The principle of economy is to minimize the cost of resources allocated to achieve the expected results of an activity while maintaining the appropriate quality of these results.

Respecting the principle of efficiency requires an optimal ratio between the result (quality) and the financial resources allocated.

The principle of effectiveness aims at achieving the specific objectives set for each planned activity in order to obtain the expected results.

We consider that the above three principles, namely **the principle of economy, the principle of efficiency and the principle of effectiveness**, are not proven to be fulfilled due to the lack of important elements regarding the financial and technical justification of the acquisition value, respectively the expenditure, as mentioned above to the content of the service offer.

---

institutions and enterprises", 2.1.2 "High-level scientific RD projects with the participation of specialists from abroad "and 2.3.3" Promoting Business Innovation "of the Priority Axis 2" Competitiveness through Research, Technological Development and Innovation "under the Sectoral Operational Program" Increasing Economic Competitiveness "2007 - 2013, OG no. 812 of December 4, 2008

Finally, even if this type of expense falls naturally to item 18. *Expenses with the purchase of services for carrying out economic analyzes, market studies, business plans* of ORDINANCE no. 3345 of November 14, 2008, and even if its necessity is demonstrated (accepted by IB), it is still not demonstrated that the requirements of economy, efficiency and effectiveness are met when purchasing them.

Case no. 2:

Premise: According to Appendix 1 to the financing agreement, "The Beneficiary / Partner is required to submit to the MA / IB requests for reimbursement for the expenses incurred within 3 months of their execution ..."

Non-compliance found: the meaning of the above statement - issuing / obtaining the invoice means making the expense;

Correct approach:

According to GD no. 399 of 27 May 2015 on eligibility rules for expenditure under operations financed by the European Regional Development Fund, the European Social Fund and the Cohesion Fund 2014-2020 - Article 2, we have the following provisions:

(1) Without breaching the provisions of art. 3 and 4, in order to be eligible, an expense must cumulatively fulfill the following general conditions:

a) be **contracted** by the beneficiary and **paid** to him under the law from 1 January 2014 to 31 December 2023 and between 1 September 2013 and 31 December 2023 for expenditure under operations financed by the Youth Employment Initiative , observing the implementation period established by the managing authority through the contract / decision / financing order;

b) be accompanied by invoices issued in accordance with the provisions of national law or the State in which they were issued, or other accounting records on the basis of which the payment obligation and supporting documents relating to payment are to be recorded, and the reality of the expenditure incurred, to which expenditure can be verified / controlled / audited, subject to the provisions of Art. 131 par. (2) and (4) of Regulation (EU) No. 1.303 / 2013;

c) be in accordance with the program's provisions;

d) be in conformity with the contract / decision / financing order concluded between the managing authority or the intermediary body and the beneficiary, in compliance with art. 65 par. (11), art. 70, art. 71, art. 125 par. (1) and art. 140 of Regulation (EU) No. 1,303 / 2013;

e) be reasonable and necessary for carrying out the operation;

f) to comply with the applicable European Union and national legislation;g) to be registered in the beneficiary's account, in compliance with the provisions of art. 67 of Regulation (EU) No. 1303/2013.

Therefore, no expenses which are not actual payments may be introduced in the Reimbursement Application, this being the case only for the Payment Request.

The case no. 3: Civil convention eligibility for Project Team and General Administration Expenses.

Correct approach:

According to the job description, the said M.D. is a project director.

It follows from the extension decision and the content of the service contract (civil convention) that the existing relationships are labor and not civil.

Since reimbursement is claimed in the Project Management Expenses category - staff costs based on Service Contracts (civilian conventions), we consider that these costs are not eligible. In addition to the tax considerations below, I consider that according to the Eligible Expenditure Order it is foreseen that the Salary Costs per project are cumulated per person with all direct salary incomes obtained from the financing contracts concluded from the Priority Axis "Competitiveness through

Research, Technological Development and Innovation "and from the budgetary funds allocated to the National Plan for Research and Development Innovation II for the period 2007-2013 and can not exceed the limits stipulated in Annex 3 to the Government Decision no. 475/2007 regarding the approval of the National R & D Plan II for the period 2007 - 2013. (2) The salary expenses are settled according to the labor contract and / or proportionally to the percentage of the job description / attendance sheet related to the specific tasks implementing the project ".

Case no. 4: expenses for producing on own direction of some products

Description:

The following documents are sent by the Beneficiary as attachments to the Refund Application:

- Reception notes no. 90, 95, 96, 97 from 31.07.2013 - 4 pages.
- Calculation of the production price for products used as raw material.
- 12 pag- Accounting notes - 3 pages.
- Consumerreceipts -3 pages.
- Energy invoices - 3 pages.
- Summary "Laboratory equipment and instruments" - 1 pag.
- Verification Balances May 2013, June 2013, July 2013 -9 p.

Correct approach:

- all supporting documents, such as consumer receipts, summaries for equipment amortization, etc. from the Beneficiary are stamped by X Ltd which does not represent the Beneficiary in relation to third parties, being only associated (owning shares);
- according to the summary for equipment amortization, the average number of days calculated per month is 20 days (with an exception - laboratory spectrometry - 29.75 days), compared to the average of 21 working days / month - by here comes a difference in the calculation of the amortization / day;
- there is no proof of the energy calculation per unit of measure nor 2% of administrative expenses; costs are not significant, but for the accuracy of the calculation these amounts must be justified (by substantiating the calculation method);
- otherwise the calculation methodology is correct.

Conclusion: the calculation contains some minor errors, but the documents do not meet the requirement of supporting documents within the meaning of the law as they are issued by another entity on behalf of the Beneficiary.

5. Conclusions

This article addressed a very sensitive but also topical issue and almost impossible to remove from the economic and social life of any country, namely fraud.

The detection of fraud through audit missions is particularly difficult and delicate at the same time because, although sometimes fraud is visible, it is hard to be proven and the auditor is often in a position "not to see" what "one sees".

Regarding the risk of fraud in the financial statements, we believe that managing this risk can be one of the best measures that organizations can take to reduce exposure to fraudulent financial reporting. Complete elimination of fraudulent financial reporting is most likely not possible, but organizations can take action to reduce their exposure to this risk. We believe that the combination of effective fraud risk governance, with detailed fraud risk assessment, fraud prevention and detection, as well as timely investigations and corrective actions can significantly reduce the risk of fraudulent financial reporting.

Although fraudulent financial reporting is a taboo subject that organizations / entities do not want to recognize because of the damage that can be brought to them, the reality is that most of the time organizations have had some experience on this issue. Organizations should therefore take proactive measures to anticipate these risks of fraudulent financial reporting before they occur and to take action to prevent unwanted effects. The implementation of proactive measures would help to establish a climate in which decisions are made to protect employees and ensure a positive culture within organizations.

Finally, we conclude that in this weakened economy, the risk of fraud and fraudulent financial reporting is growing and organizations / entities need to be vigilant and find solutions to discourage potential offenders and unlawful reporting practices using internal audit on a much broader scale.

References

Munteanu A., Zuca M., Zuca Ş.: „Auditul intern la întreprinderi şi instituţii publice: Concepte, metodologie, reglementări, studii de caz”, Wolters Kluwer, Bucureşti, 2010.

Nicolescu C., Spălarea banilor mai multe repere într-o lume atipică, Ed. Universităţii Lucian Blaga, Sibiu, 2007.

Păcurariu I., Petrașcu D., Revista economică, 68:2 (2016), ULB Sibiu, Ethics in Accounting Profession Theoretical and Practical Valencesetica.

Petrașcu D., Auditul intern de la teorie la practică” , Ed. Universității ”Lucian Blaga” din Sibiu, 2016.

Stoian A.,Ţurlea E., Audit financiar contabil, Ed. Economică, Bucureşti, 2001.

Standardul profesional 36 ”Misiunile de audit intern realizate de experții contabili”, Ed. CECCAR, București, 2007.

Revista „Contabilitatea expertiza şi auditul afacerilor”: nr.12 Decembrie 2011: autori Bunget O.C., Dumitrescu A,C., Deliu D.,: articol „Auditul financiar şi raportarea fraudelor – partea I”.

Revista „Contabilitatea expertiza şi auditul afacerilor”: nr.12 Decembrie 2011: autori Bunget O.C., Dumitrescu A,C., Deliu D.,: articol „Auditul financiar şi raportarea fraudelor – partea I”.