MANIFESTATION AND IDENTIFICATION OF FRAUD RISK IN ACCOUNTING

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Abstract:
In a world in which uncertainty and risk generate alternatives or options, economic life does not raise the question of choosing between risky situations and certain situations, but between different degrees of risk and different possible contexts. The existence of a wide range of risks with actual or potential impact on the enterprise's activity is but a certainty, as well as their impact on the enterprise's results. In accounting, identifying and taking on fraud risk contributes to giving increased attention to the financial and accounting activities achieved so that the desire of a true image reflected in the financial statements will not be overshadowed.

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1. Introduction

Any analysis aimed at assessing the entity's activity is primarily based on the information provided by accounting, which has the task to quantify, process and transmit financial information with the help of the financial statements of an entity, thus making the link between the economic substance of the activities and the users of this information, including the policymakers and the entity.

However, at the entity level, several internal and external factors appear, which can generate potential risks or possible risks, which affect the smooth running of the entity, but have the effect of distorting the quality of the accounting information when measures to detect and minimize them are not implemented.

The risk of fraud and error are among the most likely risks to create significant distortions. The difference between fraud and error is determined by the intention of the action which led to distortion of information.

It is well known that it is easier to prevent risks through their actions, based on the best practices of supervision and control meant to reduce or eliminate these risks, than to correct their subsequent effects. The identification, the control and the reduction of threats or errors have a significant impact on the preparation and presentation of the relevant and reliable accounting information, formalized through the financial statements. In this sense, the accounting systems and the internal controls must prevent, detect and correct the errors that occur during the execution of operations within the entity.

2. Fraud and fraud risk, expression and generated effects

Exhaustive knowledge of the main directions of research on the issue of fraud contributes to the proposal of certain efficient mechanisms for the prevention and detection of fraud [I. B. Robu, 2012, p 5].

Fraud means a deliberate criminal offense from the legal order as stated by specific regulations intended to give improper material benefits to the author.

According to international standards of auditing, fraud refers to an intentional action undertaken by one or more persons in the economic entity's management, employees or third parties, which results in misinterpretation of the financial statements

The risk assumed by fraud determines a trend inversely proportional to the cost / profit report. In the case of conducting legal transactions this report has a specified value, in the case of fraud the report will be directed for higher profits generated by such actions. The higher is the assumed risk, the higher are profits, and the cost/profit report is lower.

Regarding the identification of the sources generating fraud risk, we can mention:

- the questionable competence of the entity's management;
- the existence of unusual pressures manifested inside the entity due to: lower profits, applying aggressive policy of expansion which generates a shortage of working capital, making products or services at a fast pace;
- performing some unusual transactions: unusual transactions that occur during the closure of the financial year, complex accounting treatment, transactions with affiliated parties;
- the evolutions registered in the field of information technology have been diversified and the methods/means of implementation of computer-assisted crimes. Cyber attacks and the poor exploitation of the information systems can produce significant financial damages.

Among the forms of manifestation of fraud we can mention the following:

- falsification or alteration of accounting records and/or documents;
- withholding/partial declaration of income for their deliberate non-taxation;
- hiding the real dimension of income by producing fake documents or forged documents;
- setting up shadow companies developing illicit trade operations, identifying managers, associates or shareholders being virtually impossible;
- elimination or omission of unauthorized transactions in order to set the "arrangement" of financial statements;
- diversion or theft of assets;
- contraband;
- misapplication, deliberately and consciously, of the accounting policies to present some misleading final statements to the end-user.

Most forms listed above are considered manifestations of fraud, but some of these events may be the effects of some errors in accounting, which can also distort, sometimes significantly, the credibility and relevance of the accounting information.

The error is the result of unintentional actions that may occur in the background of business information in the financial statements. It is about mathematical or accounting mistakes, unintentional omission or misinterpretation of facts, misapplication of the accounting policies, not deliberately, but without being aware of it.

According to ISA 240, "Characteristics of fraud and error" it is specified: "the differentiating factor between fraud and error is whether the fundamental action that resulted in a misstatement of the financial statements is intentional or unintentional. The term error refers to an unintentional misstatement in the financial statements, including the omission of an amount or a disclosure, the term refers to a fraud action by intentional act by one or more individuals among management, those charged with governance, employees or third parties, involving the use of deception to obtain an unjust or illegal advantage."

Accounting fraud is very difficult to identify and involves creating an apparent legality in accounting using false documents, by keeping a double accounting and falsification of balance sheets, all aimed at minimizing expenses and increasing the collected revenues.

When tax and accounting laws allow legally (legal paradoxes) to manipulate the accounting figures in the financial statements, we are dealing with "creative accounting". Its role is to create an advantage for their companies by distorting most times the information content of financial indicators.

In essence, creative accounting represents "the process by which transactions are structured and processed in such a way that they will produce the desired result" [F.C. Dima, 2009, p 157].

In Romania such operations are quite common, a situation which represents a real challenge to experienced accountants. For example, when contracting a credit by an economic entity, the bank usually aims to exist in the records of a high profit and low expenses. In this context, it will choose a system of depreciation (linear, for example, although the law allows for accelerated depreciation), which allows reducing costs. Increase revenue is achieved by including future revenues (eg, sales in installments), although they could be included phased in deferred income category and therefore untaxed (invoice on the due dates is provided for paid). Also, over-depreciation by the legal establishment of higher depreciation fund real physical and moral wear of fixed assets is one way of reducing the tax base.

Strict irregular situations of general expenses of trade companies lead to their overpricing by increasing the economic burden of their growth. The usually resort to tax deductible expenses to increase by recording certain expenses that were not actually performed, but based on evidence, they were acquired through legal means, properly prepared and adequate current accounting regulations. Most times such expenditures aim at the payment of consulting, marketing or management services, which according to the Tax Code may be deducted only if they are performed in order to obtain revenue without establishing the obligation to quantify in obtaining additional income.

Another method is to issue invoices without transmitting effectively the goods, taking place only a written circuit of documents and a fictitious transfer of ownership. This category also presents "the export without specification", where goods destined for export do not leave the country, but there is only one fictional circuit of tax documents to take advantage of tax incentives specific to export transactions.

Due to the fact that through fraud some persons or interest groups accumulate huge profits at the expense of honest partners who feel unequal distribution of income, it is important to identify the causes of generators, so that efforts to reduce/combat can be oriented in the right and real direction.

3. Modalities to identify and control the risk of fraud

In order to implement effective control measures, it is important to know the possibilities and the forms of risk.

An approach to risk, in terms of the possibility that they occur, highlights the existence of two categories: potential risks and possible risks.

Potential risks are recorded in all economic entities having a higher probability to occur, if it is not established an effective control to prevent, detect and correct any errors.

Possible risks is the part of potential risks to which the entity has not taken timely effective measures designed to limit and, therefore, there is a high probability that errors occur without being detected and corrected.

The responsibility for the prevention and detection of fraud goes to the entity's risk management by:

- conducting internal control systems;
- implementing and conducting internal audits;
- ensuring the performance of external audits (financial audits).

International Standard on Auditing 400 "Risk evaluation and internal control" presents the internal control as "all policies and procedures (internal controls) adopted by the management of an entity to assist in achieving management's objective of ensuring as much as possible consistent leadership and efficient business, including adherence to management policies, the safeguarding of assets, prevention and detection of fraud and error, the accuracy and completeness of accounting records and the timely preparation of reliable financial information".

The risk of fraud is increased by the functional deficiencies of the accounting and internal control. Also, the lack of transparency fosters fraud, which is why the best means of prevention is the internal control.

After exercising the internal control, the internal audit function occurs, which evaluates the effectiveness of the internal control system in detecting fraud and fraud risk management by:

- "setting out the action plans that establish the responsibilities and the measures to reduce the risk of fraud;
- developing a response plan that defines exactly the steps to be followed if a fraud was reported or detected;
- review of the policy and strategy of reducing the risk of fraud and of the action plan;
- management of the risks related to the activities/schemes/programs within the entity which include the risk of fraud;
- promoting ethics and ethical principles appropriate to the entity." [M. Ghiță, 2009, p 147]

Financial auditors, when identifying fraud and fraud risk, perform the following procedures:

- "actions of interviewing the entity's management;
- for those entities that have an internal audit function, the auditor performs interviewing with the internal auditor to determine whether he is aware of the existing or suspected fraud which affect the entity and, to get his view on the risks of fraud;
- the auditor obtains an understanding of the way in which those in charge with the governance exercise supervision for the management processes to identify and respond to the risks of fraud in the entity and internal controls established by management to mitigate these risks;
- the auditor interviews the persons in charge with governance to determine whether they have knowledge of any real, suspected or alleged fraud, affecting the entity. These interviews develop to corroborate the management's responses to the interview;
- the auditor evaluates whether certain unusual or unexpected relationships that have been identified during the analytical procedures, including those related to the revenue accounts, may indicate risks of material misstatement due to fraud". [I. Mihăilescu, N. Marcu, 2010, p.66].

"Fraud audit combines aspects of judicial expertise, investigations and auditing classical techniques. Therefore, auditors who perform fraud audit must have adequate training on how the types of fraud manifestation, as well as fraud cues specific to the activity carried out by the entity" [C. L. Dobroțeanu, L. Dobroțeanu, 2007, p. 104].

4. Conclusions

The manifestation of fraud risk generates a series of distortions of information reflected in the financial statements, making the financial position and performance of the entity to be valued incorrectly, producing unwanted effects in the decision making of the information users.

Practice has shown that fraud, resulting in handling records or documents, their falsification or distortion, is favored primarily by the functional deficiencies of the accounting system and internal control, and the lack of transparency that allows to prevent the risk of fraud.

Consequently, for each entity, it is necessary to intensify the effort to identify and control the potential threats on the financial and accounting process, leading to increased quality of information provided by the financial statements.

The identification and removal of the risk of fraud must be an essential element in the strategy of each entity's management that should aim at implementing an integrated monitoring and control of all activities and to represent a core objective of internal control, organized at the level of the financial and accounting department, and for the internal audit function at the level of the entity, which through the applied procedures and the undertaken processes, take measures or implement strategies aimed at this objective.

Although the existence of accounting and internal control systems may reduce the probability of distortion of the accounting information, whether caused by fraud or error, there is always the risk not to discover or prevent this distortion, especially when fraud was committed as a result of a secret understanding between their employees or when fraud was committed by management directly or through influence, sometimes rewarded, on the employees.

Therefore, an important role in examining and identifying fraud risk belongs to external audit exercised during the financial audit, which in accomplishing its mission must consider the risk related to the material misstatements in the financial statements arising as a result of fraud or error.

The responsibility for prevention and detection of fraud and error rests with the entity's management which is the main responsible for the organization, implementation and maintenance of accounting systems and internal control mechanisms, with the help of which it may reduce the possibility of fraud and error, but do not completely exclude them.

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