CONSIDERATIONS ON RISK ASSESSMENT IN AUDITING THE PERFORMANCE OF CREDIT INSTITUTIONS

DR. AVRAM ROXANA-LOREDANA, ASSOCIATE PROFESSOR AVRAM COSTIN DANIEL
West University of Timisoara, , Faculty of Economy and Business Administration, University of Craiova,
roxana.avram@e-uvt.ro, avramcostindaniel@yahoo.com

Abstract:
The analysis of credit institutions' performance is based on a set of financial and non-financial indicators through which a multitude of aspects are investigated in order to outline the accurate and complete image of bank performance.
The audit risk of banking performance is a very high when considering the multitude of investigated aspects, the huge volume of operations carried out and their complexity, while the banking activity is not interrupted, only accidentally. The main concepts that give content to the performance of credit institutions are: assets quality, liquidity, results, capital adequacy, market risk and last, but not least, financial risk. In order to assess the audit risk, as a preliminary step in the planning of audit activity, it is necessary for the auditor to obtain information on the involvement of those responsible for governance, on how to organize internal control and audit activities, monitoring and reporting activities, and the existence and reliability of information systems appropriate to banking.

Key words: *audit risk, banking performance, corporate governance, internal audit, internal control*

JEL classification: M42, L25, G34

1. Introduction

Banking performance is achieved with the increasing complexity of banking products and services, accompanied by more competitors and the growing interest of economic agents and population for both deposits and loans, which compels the credit institutions to adopt a risk management, characterized mainly by caution. Under present conditions, a special importance is given to the correlation of bank resources and investments' maturity, without losing sight of the quality of the accepted assets and guarantees.

Risk management requires compliance with the following coordinates:

- Supervision and involvement of those in charge of governance;
- Identification, assessment and monitoring of risks;
- Control activities;
- Monitoring activities;
- Reliable information systems.

The auditor should plan audit procedures based on the audit risk assessment, based on the quality and quantity of information available regarding the involvement of those responsible for governance, how they are aware of and assess risks, how internal control and audit are organized, and especially on the specialized conclusions of IT audit.

However, banking is subject to a well-defined regulatory and supervisory framework, whether we are talking about national legislation or the Basel Agreements. Thus, the risk in the banking activity is a limited one, which must respect the constraints given by the capital adequacy, being, at the same time, a limitation of the credit extension in order to avoid the systemic risk (Bonin, Hasan, Wachtel, 2005).

We must not overlook the fact that the bank's top management sees capital adequacy as a constraint, by limiting credit expansion and, implicitly, an impediment to achieving profitability targets (Ling, Zang, 2006).

At the same time, it should be noted that small banks tend to take more risks than large banks, given that they need to increase their market share (Hirtle, Kovner, Plosser, 2020). Thus, large banks will have less risky portfolios and, at the same time, higher profitability rates (Drobetz, Schillhofer, Zimmermann, 2004), which will tend in the long run towards a consolidation of banking systems and, *per a contrario*, larger risks for the small banks. In this regard, small banks will have a constant need to improve their performance control and audit mechanisms, and, implicitly, to adapt them to the inherent risks, whether they are endogenous or exogenous.

2. Supervision and involvement from those in charge of governance

Those in charge of governance must approve the risk management policies. These policies must be correlated with the bank's business strategy, its capital strength, management experience, regulatory requirements and the types and values of risks that the bank considers acceptable and substantiate its risk profile.

Those in charge of governance will not lose sight of the following issues:

- risk management is a complex process, which requires that its implications on the bank's liquidity must be analyzed before introducing a new banking product or service on the market to and, by internal rules and appropriate procedures, these risks can be identified, assessed and monitored;
- good risk management cannot be achieved without a precise knowledge of the maturity structure of attracted funds and investments and, even more, without a correlation between them;
- a good knowledge of the clientele, of its habits and behavioral peculiarities, can ensure a proper management of the risks, allowing the bank to counteract both the phenomenon of volatility of the attracted funds and that of over-indebtedness;
- it is preferable to diversify the sources of funds and their maturity as well as to diversify the loan portfolio in order to avoid dependence on certain clients.

The mission of those in charge of governance is first and foremost to create an organizational culture that rewards values such as: respect for laws and regulations, a professional and responsible work environment in the face of internal control, internal audit and possibly the audit committee.

We must not lose sight of the fact that for banks, public trust capital is as important as equity and permanent capital, that trust is hard to gain and can be easily lost, and "when trust has disappeared, the crisis has appeared " - utters an old banking axiom, still valid nowadays.

3. Control Activities and Internal Audit

The audit risk is evaluated after a careful analysis of the way in which the internal control and audit activity is organized, starting from the cognitive valences of internal control and from the transparency practices that give credibility (Dănescu, 2014) to the credit institution's operations.

For risk management, credit institutions must have both internal control and internal audit, which follow specific tasks through an accurate assessment and reporting of positions and results, a setting of limits, a reporting and approval of exceptions from limits, a safety and a backup plan. The purpose of internal audit organized within and for the benefit of the bank, is to express, evaluate and monitor the adequacy and effectiveness of internal control. Internal control, designed and performed by those in charge of governance, management and personnel, in order to provide reasonable assurance as to the achievement of the bank's objectives regarding the credibility of financial reporting, the effectiveness and efficiency of operations, as well as the compliance with applicable laws and regulations, has a very important mission in risk management.

Each bank must have an adequate system of internal control over the risk management process expressed in accordance with the national regulations, which are agreed with the Regulations developed by the Basel Committee on Banking Supervision.

4. Monitoring Activities

Banks are required to develop risk management models through methodologies and assumptions for measuring and managing assessed risks that are constantly updated in order to be able to respond promptly to market's challenges. The internal audit is called upon to periodically test the risk management process so to verify its compliance with policies, rules and working methodologies and the extent to which operational controls prove effective. There is a risk of certain deviations occurring due to the way in which controls are applied by the company. When such deviations are detected during the testing of controls, the auditor should undertake specific investigations to understand the problems that have arisen and their potential consequences.

Most of the information used in monitoring activity is produced by the entity's information system, which, in the case of banks, is almost entirely computerized. For the auditor, the question is whether and to what extent he can use the entity's information for monitoring activities, such as the internal auditor's reports, to ensure that the information represents a credible basis and is sufficiently detailed for what the auditor is undertaking.

5. Reliable and credible computer systems

For risk management, the bank's IT systems must provide, in a timely and consistent manner, adequate financial operational and compliance information. The large volume of operations performed compel the credit institutions to develop reliable and credible information systems that must meet a number of conditions, including: the existence of an internal control system, audit trail, control of the computer system and files' preservation.

The existence of an internal control system is meant:

- to verify that the operations performed by the bank, as well as the internal organization and its procedures, comply with the legal provisions and banking norms in force;
- to verify the quality of the accounting and financial information, in particular the conditions for the recording, preservation and availability of such information.

In order to achieve these objectives, credit institutions must implement internal rules and procedures, the most significant of which relate to:

- elaboration of a document specifying "the objectives of internal control and the means intended to ensure this function", a document called "audit card";
- appointment of a person as evaluator of the coherence and effectiveness of the internal control system;

- elaboration of an annual report on the conditions under which internal control is ensured;
- review of the annual report by those in charge of governance and establishing measures to strengthen internal control and audit.

An important role in the reliability of information systems is the audit trail. The audit trail is defined as a set of procedures that allow the reconstitution of operations in chronological order, justification of all information on the initial situation so that it is possible to retrieve the path to synthesis documents and vice versa, explaining the evolution of balances from one situation to another due to changes in the accounts.

Audit risk can be influenced by the total of operations supervised that often pose storage problems. Technological advances allow the storage of these mass operations through micro-files, micro-films and hard drives, which ensures the adequacy of the reference system to the needs and possibilities of processing the financial and accounting information.

6. Conclusions

Banking performance is an image of the financial and economic consequences of decisions made by those charged with governance and is measured by a multitude of financial and non-financial indicators. The external auditor is called upon to express an opinion on how the information presented in the annual financial statements is accurate, credible and prepared in accordance with financial reporting standards. To this end, the financial auditor must plan the audit procedures according to the audit risk assessment in order to obtain adequate and sufficient evidence to formulate the audit opinion. Banking risk management proves to be an extremely complex activity for bank management because it involves both the activity of attracting temporarily available amounts from customers and placing them in conditions of profitability and classification in the risk profile. Getting in contact with those charged with governance, bank management and those charged with internal control and audit, the external auditor will need to understand the specifics of banking and the problems related to management of the risks taken by credit institutions, which will allow him to properly assess the audit risk.

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