Fraud Risk in Audit Activities According to IAS 8

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Abstract: According to international auditing standards, fraud is an intentionally action realised by one or more persons as management, employees or third parties, action that generate erroneous interpretation of financial statements. The real intention is to cheat. However, there can be involved some erroneous calculus generated by creative accounting. The concept of "error" refers to unintentionally mistakes that could appear in financial statements. We think there could be mathematical or accounting mistakes, unintentionally omission, or wrong interpretation of certain facts, accounting policies wrong application. All these actions are unwittingly. It is very important to identify situations cause and take necessary measures to eliminate them.

Key-words: fraud, illegal behaviour, law enforcement, audit, auditing, auditor, double entry, risk, IAS 8

JEL Classification: K42, M41, M42

1. Introductory remarks

Fraud is a publicized concept in the context of the current economic environment. It is an intentional criminal offense generated by infringement of statutory rules in order to obtain wrongful material advantages. The real intention is to cheat because fraud is generate especially by intentional and bad faith elements that make possible to obtain personal profits at the expense of other persons or entities.

The risk assumed by fraudulent activities causes an inversely evolution of cost/profit report. Under the terms of legal operations, this mathematical report has a fixed value. In case of fraudulent activities, the report terms will divert in the favour of a much higher profits. Exactly this type of illegal actions generates these profits. When the assumed risks are greater, the profits are higher. This relationship generates a lower ratio of cost/profit report.

Legal vision on fraud classifies this offence according to fraudulent or not fraudulent means that generated the illegal act committing: fraud (bad faith) and complex fraud (fraudulent wills). Complex fraud is a criminal offense, being penalised, while simple fraud have only administratively sanction.

2. The fraud in the vision of the international auditing standards

According to international auditing standards, fraud is an intentionally action realised by one or more persons as management, employees or third parties, action that generate erroneous interpretation of financial statements.

The international auditing standards provide the following fraud manifestation ways:

- falsification or alteration of accounting records or reports;

- omission or partial reporting of the entire revenue in order to deliberately avoid taxation;
- hiding the real dimension of revenues using fictitious documents or false documents;
- organising ghost companies which are operating illegal commercial transactions – it is almost impossible to identify its managers, members or shareholders;
- erasing or omission of some illegal transactions in order to "clean" financial statements;
- assets hijacking or its theft;
- smuggling;
- Wrong intentionally and consciously utilisation of accounting policies in order to provide final erroneous situations for external use.

Some of the fraud manifestations presented above are generating by involuntary errors, having no intentionally character. The real intention is not to cheat. There can be involved some erroneous calculus generated by creative accounting. This innovating accounting procedures manipulates accounting numbers and chooses the methods that make possible to find a way to structure all transactions that generate the expected accounting results. Economic entities may plead for good faith and legal loopholes and such elements could remove the alleged criminal character of offence.

The concept of "error" refers to unintentionally mistakes that could appear in financial statements. We think there could be mathematical or accounting mistakes, unintentionally omission, or wrong interpretation of certain facts, accounting policies wrong application. All these actions are unwittingly.

According to IAS 8 "The net result for the period, fundamental errors and changes to the accounting policies", errors refer to calculus mistakes, wrong methods implementation, facts erroneous interpretation, omissions and frauds.

IAS 8 associates notion of error to fraud because the need to solve such existing situations in accounting practice. If the error shows the financial statements reliability drawn up in previous years, we are dealing with a fundamental error, but it remains to auditor and/or manager discretion. The fundamental error is conferred only on the size of the financial effect, but also the nature of the error.

IAS 8 proposes two accounting processing types:

- A reference accounting scheme, according to which the error correction alter non distributed result when the financial exercise which correction is made. In this situation, the entity concerned must provide comparative data on the dashboard of capital and reserves and the profit and loss account.

- An alternative approved method according to which a correction may alter current financial exercise results that requires the client to submit an annex containing a pro-form image for the profit and loss account and for the capital variation, both for the current and previous year.

It is very hard to identify a fraud in accounting statements. It involves a process of legal appearance creation through false documents use, double accounting book, accountancy balance sheet falsification, all this with the aim of increasing expenditure and minimizing revenue received.

When tax and accounting legislation legally allow (legal paradoxes) handling the accounting figures of financial statements, we have to deal with creative accounting. Its role is to create its own companies an advantage through the financial-economic indicators.

Creative accounting is the process based on a flaw in the rules that handle the accounting figures and, taking the advantage of flexibility, choose those information and practices that allow conversion of synthesis statements in order to respect managers will. Transactions are structure in such way to generate the desired accounting result.

Often such operations are finding in our country and they are a real challenge for accounting experts. Usually, they grow deductible tax expense through not actually performed expenses records but which relies on documentary evidence obtained through legal means, duly drawn up and appropriate accounting rules and regulations in force. Most often such costs relate to consulting, marketing and management services payments, which according to the provisions of the tax code, can be deducted if they are carried out for the purpose of earning income without the obligation to establish that they are quantified in obtaining additional income. Another method is false invoices use. The objects of these operations are not really selling. There is only a fictive documents movement concerning property rights. The real goal is to benefit from fiscal facilities generated by export operations.

Using fraudulent transactions, some entities succeed to obtain very consistent profits. Honest entities are disadvantaged because they have to face and felt an unfair distribution of incomes. It is very important to identify this situations cause and take necessary measures to eliminate them.

3. The Auditor Role

All auditors must evaluate fraud risk and voluntary mistakes frequency in their activities. They have to start from the beginning of their mission because fraud is cover by many fictive actions. This situation may generate errors in financial statement, not identified by auditor who would formulate erroneous opinions.

Fraud risk is stimulated by accounting system and internal controls high functional weaknesses. In addition, may doubt about the integrity or competence of the management team, unexplained pressure under or over an entity, unusual transactions, the difficulty in obtaining appropriate audit samples etc. Also the lack of transparency fosters fraud, and the best prevention means are internal control.

Fraud prevention and detection is manager responsibility, auditor having a positive role in preventing ways, but not the responsibility to identify and sample it.

Fraud become hardly to identify because of advances in information technology that diversified computer assisted implementation. Cyber attacks, but also poor operation of computer systems and information technologies can produce significant financial damage.

Significant damage is also generating by confidential information disclosure regarding accounting policies used to promote new products, financial information, customer information etc. We think it is necessary to ensure information systems security including stored data.

4. Conclusions

Using fraudulent transactions, some entities succeed to obtain very consistent profits. Honest entities are disadvantaged because they have to face and felt an unfair distribution of incomes. It is very hard to identify a fraud in accounting statements. It involves a process of legal appearance creation through false documents use, double accounting book, accountancy balance sheet falsification, all this with the aim of increasing expenditure and minimizing revenue received.

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