

FRAUD RISK ANALYSIS IN AUDITING FINANCIAL SITUATION OF ENTITIES IN THE FIELD OF AGRICULTURE

Gabriela Ignat, Assist. Prof., PhD and Constantin Iatco, Prof., PhD, "Ion Ionescu de la Brad" University of Agricultural Sciences and Veterinary Medicine, Iași

Abstract: The most important sources of financial information in a nation, accounting and, implicitly, auditing, have disciplined the field of economics, promoting confidence in business as well as imposing rules on complying with the financial discipline, through adequate means of issuing documents of synthesis and accounting. Nowadays, counseling in the field of fraud risk management is acquiring high significance in all European Union countries. For this reason, The International Standard in Accounting 240 was created, considering a series of aspects, among which delineating the limit between fraud and error, imposing professional skepticism, and assessing the risks of erroneous presentations. According to ISA 240, assessing fraud risk is done precisely, for each financial exercise, at the level of annual financial statements and the main accounting assertions regarding the categories of transactions and events connected to the time period that was audited, assertions concerning the account balances at the end of the period, assertions concerning information presentations and descriptions. In specialist literature, in the case of assessing fraud risk, it is mentioned that the auditor take into account the contradictory events and aspects signaled in the past, but this is difficult for new clients, or in the situations when one cannot have access to the conclusions drawn by the previous auditor (Soltani 2003). In assessing fraud risk one should not overlook the time factor, because some financial infringements can be done and remain undiscovered throughout multiple financial exercises. In this paper, the authors, relating their views to the specificity of agricultural business in the county Iași, have the aim of designing a fraud risk analysis, taking into account a series of economic and financial indicators. Simultaneously, they have taken into account the underlying factors in accounting frauds at the level of the agricultural entity. Based on the estimated level of fraud risk resulting from annual financial statements, the authors have delineated recommendations for planning and applying audit procedures in order to acquire the audit evidence, as well as recommendations for preventing and detecting fraud. In this paper, the authors, answering specific entities in agriculture in Iasi country, have proposed an analysis of fraud risk depending on a number of economic and financial indicators determined. Also have been the underlying factors accounting fraud risks at entity level in agriculture. Depending on the assessed risk of fraud resulting from the annual financial statements, the authors have outlined recommendations for both planning and performing audit procedures to obtain audit evidence and to prevent and detect fraud.

Keywords: risk, fraud, financial statements, financial indicators.

Introduction

In the current period, an increasing risk of fraud is propagating within the processes of auditing financial statements. Within the triad of economic, legal and psychological factors, the financial fraud appeared, this being the reason why, in specialist literature, we find various arguments for the necessity of auditing financial situations. Starting from the main causes of fraud risk appearance, *Association of Certified Fraud Examiners* (2011) proposes a classification of fraud in the form of a tree (fraud tree), containing three main categories: fraudulent statement, asset misappropriation and corruption.

Given the fact that fraud occurs in various areas of auditable fields, and taking into account the idea that it represents an objective for internal audit, a problem arises: that of the degree of involvement of internal auditors in preventing, detecting and investigating fraud, and, more objectively, the degree up to which their involvement is recommended, so that they can still preserve their professional independence and objectivity, both representing necessary characteristics for each profession.

Material and method

Approaching audit has been focused on analytical procedures regarding financial statements and operation categories, as well as detailed testing of elements in the selected samples from each category of operations, in order to get the necessary evidence to achieve the general and specific objectives of financial audit. General and specific objectives of tests have been established, as well as the method of testing, the content of detailed tests applied at the stage of execution to check the assertions of each category of operations/ selected accounting areas.

Results and discussions

The case study ran its course at an entity in the agricultural field. The entity is included in the category of public institutions running double-entry bookkeeping. Preparing and presenting financial statements is the responsibility of the management of the entity. The budgetary execution account reflects the finality of operations connected to revenues and expenditures, leading to the determination of the way in which the entity has observed the framework for expenditures specified in the MADR approved budget, as well as their authorization and legality. Following the analysis of the execution account, what was observed was the fact that no integrated system existed at the level of the entity, all the accounting operations being performed manually, representing a risk factor in its activity.

The assessment of the inherent risk was done for each category of operations, having in view the documentation of the factors involved in the process, namely: the nature of the activities performed by the entity in the period which was audited, the unusual economic operations, assets susceptible to be diverted, the number of locations where the entity operates, the complexity of applicable laws, the training and professional competence of the employees and other specific factors, using the professional reasoning of the auditors in assessing the risks.

The assessment of control risk was performed for each category of operations, having in mind the level of confidence in the entity's system of internal audit and according to the professional judgement of the auditor. Taking into account the assessment of the categories of risks, for each category of economic operations, a summarizing table was prepared.(fig. 1)

Audited category of operations	Inherent risk	Control risk
O1 – Personnel expenses	Medium	Medium
O2 – Goods and services	Medium	Medium
O3– Capital expenses	Medium	Medium
O4 – Non-current assets	Medium	Medium
O5 - Grants	Medium	Medium

O6 – Non-current receivables	Medium	Medium
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Figure 1 - The categories of risks

In determining materiality we have taken into account the legal framework as well as the requirements imposed by other relevant regulations which could affect the established level of materiality. To establish the materiality, numerical values were calculated through applying percentages of 0, 5%, 1% and 2% for the category of economic operations “payments made”, this being the most important element within financial statements, as follows:

Materiality	Value of category	0,5%	1%	2 %
Payments made 31.12.2013	7.908.286	39.541	79.083	158.165

Therefore, the level of materiality that was established for auditing the financial statements prepared and reported by the entity on the 31st of December 2013 is 79.083 lei, a level under which the errors discovered offer to the auditors a reasonable amount of confidence in the reality and fidelity of the figures in the financial statements. In accordance with the International Standards for Audit, the authors have taken into account the importance of acquiring information on the entity’s activity, the identification of events, transactions and practices which could have a material effect on financial statements.

The legal framework is one of the most important external factors. In 2013, the entity was forced to apply new regulations regarding: grants, accounting, public acquisitions, and payments of salaries. The interest manifested by the community, by mass-media and the users are being regarded as medium in comparison with the financial information of the audited entity. At the level of the entity, the inventory of agricultural credits was made through recording them in the special record for the beneficiaries of financial support, following the application forms submitted by the undertakers. The applications which received a favourable answer were sent by entity to the Ministry of Agriculture and Rural Development, through expense accounts.

For each economic agent, annually, the unit opened account sheets for various operations, recorded manually, in which the expense accounts sent to the Ministry and the orders were written down. In the bookkeeping, only the agricultural credits that were paid in the respective financial exercise were registered and, implicitly, reported; the unit did not record the expense accounts left unpaid by the end of each year.

Regarding the payments left undone at the end of the financial exercise, on the occasion of the annual inventory, no confirmation was requested with the economic agents in what concerns the agricultural credits that were requested, approved and settled. Deviations were caused by the lack of written work-related procedures, namely the instructions regarding the tasks for each employee, the exercising of competences and responsibilities for each job, as well as the fact that accounting was conducted manually.

The estimated value of the deviations found is 565.253 lei, representing 495.665 lei, illegal payments, without any evidence, without having submitted applications to receive allocations of public funds for agricultural credit in accordance with Law no. 150/2003 on the four undertakings (SC Mold TIG, SC AGROMOV, SC VITA PROD, SC COMY), plus penalties calculated until 03/31/2014 in the amount of 69.588 lei. The economic and financial consequences of the deviations from legality and regularity identified consist of damaging the

state budget with the value of public funds provided in addition – illegally – to the sum of 495.665 lei, as well as the erroneous reporting through financial statements on the amount of subsidy. The deviation was possible due to the inappropriate exercise of forms of internal control by not applying the procedure set about hiring, validation, authorization and payment of budgetary expenditures required by law and in accordance with the budget law and the destination set and non-compliance with applicable laws.

In the period 2008 – 2013, the financial bookkeeping only recorded – and implicitly reported – only the agricultural credits settled in the respective budgetary exercise, without the entity recording the unsettled payments at the end of each year.

The budgetary provisions received from the Ministry for supplying the accounts of the entity with the necessary funds are not accompanied by the recording of the payments, thus creating the possibility for mismatches between in distributing the various amounts of money and the ones established at the level of the Ministry. Regarding the remaining payment returns at the end of the budgetary exercises, on the occasion of the annual inventory, no confirmation was made with the economic agents in view of the required, approved and settled agricultural credits. Likewise, the inventory of payments at the level of the entity and the Ministry was not thoroughly analyzed, and, as a result, one could not notice whether some of the payments were not made, and that their value was bigger at the level of the entity than at the level of the Ministry. The inventory of budgetary credits, legal and budgetary commitments was not organized and conducted. The credit officer did not designate, through a decision, someone responsible – and his/ her replacement – for organizing and conducting the inventory of budgetary credits.

During the 2013 budget year, at the level of the entity, one did not finalize the procedures regarding the coverage of the four phases of budgetary execution of expenses, namely employment, liquidation, authorization and payment; likewise, one did not organize and conduct an inventory of budgetary and commitments according to the legal framework. We found that the unit does not comply with the principles of legality, regularity, economy, efficiency and effectiveness, conclusion drawn for the case in which the cumulative amount of errors / deviations from legality and regularity observed and extrapolated to the audited population is above the threshold of significance; audited financial statements are prepared in accordance with the applicable financial reporting framework in Romania and they do not provide a true and fair view of the financial position, performance and modifications of its financial positions. The errors and irregularities of the legality and regularity found in the analysis were:

One did not take the necessary steps to recover the sums representing disability compensation paid to the employees and which exceed the value of monthly contributions, and the salary fund was not completed with the necessary sums. In the period 01.01.2013-31.12.2013 the entity paid compensations to the employees (benefitting from insurance), their value exceeding the sum of their debts for that time frame.

The entity, as employer, did not require from the Health Insurance House, in writing, a recovery of these sums, worth 4.331 lei. Not all the legal necessary steps were taken in order to recover (from individuals and companies) the sums of money representing grants received illegally, for an estimated amount of 79203, 75 lei. Also, some budgetary receivables for which the sums were collected were maintained in accounting and reported in the financial

statements prepared by the audited entity at the end of 2013 (the value was estimated at 21.989,5 lei); The compliance with the clauses stipulated in the contract regarding terms of payment was not monitored and the payments were not recorded, while the penalties for delay were not tracked down in the case of companies, due to the fact that the entity had hired goods from the state's public property, the estimated value of the deviation being 1.247,6 lei.

The lack in organizing the record of budgetary and legal commitments caused an inability to know, at any given moment and for any subdivision of the budget approved for the current budgetary exercise, the credits consumed and the amount of credits available for the future. The failure to properly record budgetary commitments lead to the impossibility to provide, for each subdivision of the approved budget, information regarding: available credits; legal commitments ;) payments made, based on the legal commitments for a given moment; the balance accounts that need to be paid by the end of the year.

From the sample analysis of the documents made available, the following facts were observed:

By the 31st of December 2013, 603 debtors (agricultural producers – individuals and companies) are recorded in the bookkeeping of the entity, with a total sum of 501.773,62 lei (415.562 lei debt and 86.212 lei penalties, sums representing the value of forms of support from the state for establishing agricultural businesses, received illegally by the business entities, under the circumstance of not having established the agricultural business corresponding to all areas of land for which they had requested grants; the figures are shown analytically below:

- the amount of 377.821,4 lei (299.001,5 lei debt to which 78.819,9 lei penalties is added) represents grants offered unjustifiably to a number of 424 agricultural producers (individuals and companies) in 2005, in the form of direct support from the state of 175 lei/ ha for agricultural areas of up to 5 ha to establish crops (of which 135 lei for purchasing seeds, pesticides and 40 lei/ ha for acquiring the necessary carburants needed to perform automatized stages in cultivating the crops), in a situation where the agricultural business entities did not utilize all the areas of land for which they requested grants to establish crops – the financial support is stipulated in GEO no. 117 of 14 July 2005 regarding the direct state support for establishing crops in the autumn of 2005;
- the amount of 24.362,22 lei (16.971 lei debt to which 7.391,22 lei penalties is added) represents grants offered unjustifiably to a number of 149 agricultural producers (individuals and companies) in 2005 in the form of direct state support, in value of 250 lei/ ha for areas of up to 5 ha, to establish crops;
- the sum of 99.590 lei represents financial support in the form of “de minimis aid” of 200 lei/ ha for areas used for autumn crops, areas of minimum 1 ha up to maximum 120 ha, offered unjustifiably to a number of 30 agricultural producers (individuals and companies) in 2008, within a context where no such crops were established for all the areas included in the grant request.

By checking the way in which the legal provisions and the common legal procedures regarding tracking and collection of debts, the following conclusions became obvious:

- The analyzed entity lacks a centralized record which would show, generally and structurally (according to the type of financial support/ grant) the number

and type of actions (notifications/ court actions) carried out in order to recover the sums of money unjustifiably paid to the debtors.

The most significant deviations connected to the way of tracking and recovering debts originating in unjustified payments to agricultural producers, in the form of various financial supports offered by the state, consist of:

- An annual inventory of property items consisting of this type of receivables was not conducted, and the results of the inventory of budgetary receivables were not put to proper use.
- The debtors' balance accounts were not analyzed in order to coordinate the data gathered from the technical and operational record of the Legal Department and the accounting record;
- There was no operational procedure related to the activity of monitoring and recovering this type of budgetary receivables.
- One kept in accounting and reported in financial statements prepared by the audited entity some budgetary receivables for which the corresponding sums were paid, for a value estimated to be 21.989,5 lei
- Not all legal steps were taken to recover the sums representing grants offered without justification; the value was estimated to be 79.203,75 lei.

With the inventory of these claims not done, meaning that the debtors' balances were not analyzed in order to coordinate the data from the technical – operational records of the Legal Department and the accounting record, simultaneously with the absence of formal, written procedure and the lack of legal measures to recover from agricultural producers (individuals and companies) the sums representing unjustified grants (including the way of enforcement), all these elements have generated, on the one hand, the distortion of the information in the balance sheet prepared by the entity on the 31st of December 2013, and on the other hand the impossibility of completing the sums reimbursed by the audited entity from the state budget in the form of financial support for agricultural producers. From the assessment applied to the organization and functioning of the the internal/ managerial control system at the level of the entity, and taking into account the deviations from legality and regularity recorded after performing the financial audit, the following aspects were noted:

- The entity did not go through all the stages of organizing and implementing the internal/ managerial control system, in order to ensure an efficient management of the funds, thus:
- The unit does not possess an elaborate, approved and applicable methodological reglementation, namely the work methods and the procedures necessary to meet the demands of internal control regarding its activity, as covered in O.M.P.F. no. 946/2005 for the approval of the Code for internal/ managerial control, comprising the internal control/ managerial standards in the case of public entities for developing the control systems. Their absence represents a risk in reaching specific objectives.
- No adequate, complete and accurate documentation exists, one which would correspond the structures and policies of the public entity, comprise work methods, formal management policies, manuals, operational instructions, timetable of document circulation, check-lists or other forms of presenting the

procedures specific to the activities performed in relationship with credits for agricultural production.

- Duties regarding the conduct of activities specified in Law no. 150/2003 on giving grants to economic entities are encribed in the job descriptions of the individuals responsible for receiving, approval and payment of expense accounts for agricultural credits, but the statements are not precise and there is no clearly delineation between the duties of the department head and the office chief, both being “responsible for the implementation of Law no. 150/2003 regarding production credits offered to business entities”.
- One did not identify and assess the risks regarding the activities/ operations undertaken by all subdivisions of the entity, and did monitor them in order to establish adequate internal controls, and the risk register was not prepared;
- The operational procedures related to work flow, processes and activities within the business entity were not elaborated or/ and brought to date;
- The instruments of internal control, which would ensure the compliance with the general and specific requirements of internal control for the entity checked, provided by the applicable laws, were not identified.

The economic and financial consequences of the inadequate organization and functionality of the internal control system consist of malfunctions as well as deviations from legality and regularity throughout the entire activity of the business entity, and they were recorded accordingly in the official report. As a result of applying the specific audit procedures, consisting of analytical procedures and detailed tests on financial statements, on expense accounts (the statements used as justification for obtaining public funds associated with agricultural credits granted under Law no. 150/ 2003, fully reimbursed) and account records of economic agents benefitting from public funding, as well as on justification documents reflecting the entity’s transactions, deviations from legality and regularity were noted, deviations which generated damage. The causes of the deviation consist of the lack of proper procedures and adequately implemented work methods, including instructions for distributing the tasks to the employees according to their respective jobs, and also the faulty management of accounting.

The economic and financial consequences of the deviation from legality and regularity consist of damaging the state budget with the value of public funds granted without proper justification documents, amounting to 495.665 lei, as well as the erroneus reporting of the sum stipulated by the grant in the financial statements.

- The adequate functions within the entity were not established;
- The operational procedures were not elaborated or brought to date, according to work flows, processes and activities;
- The instruments of internal control were not properly identified in order to ensure the compliance with the general and specific requirements of internal control within the framework of the audited entity, according to legal provisions.

The economic and financial consequences of the lack of proper organization and the malfunctioning system of internal control consist of disfunctionalities as well as deviations from legality and regularity throughout the entire activity of the audited entity, some of them

identified and recorded along with the financial audit; another consequence was the impossibility to check the manner in which each employee fulfills his/ her individual tasks.

Conclusions

Only the agricultural credits paid in that particular budgetary exercise were recorded and, implicitly, reported in the financial statements prepared; the entity did not record the expense accounts left unpaid at the end of each year. The budgetary provisions received from M.A.D.R. for supplying the necessary amounts of accounts belonging to the entity are not accompanied by an adequate record, thus creating the possibility of misadjustments arising from uneven distribution of payments, in comparison with the distribution pattern established by the Ministry. In what concerns the expense accounts left unpaid, on the occasion of the annual inventory, the entity did not confirm payments with the economic agents regarding the agricultural grants requested, approved and settled. The recording of budgetary credits and legal commitments was not properly organized and carried out. The person responsible for organizing and recording the budget was not adequately designated. The entity did not take the necessary measures to recover the sums representing disability compensation, exceeding the value of monthly contributions, and the salary fund was not refilled accordingly.

The recommendations made by the authors are the following:

Organization and keeping up-to-date of property records, in order to ensure:

- conducting accounting and technical – operational recording according to categories, for each item, taking into account its characteristics
- the elimination of all mismatches between real values of operations undertaken and the ones recorded in bookkeeping, between the data in the balance and the financial statements;
- accounting records of payments without justification documents and full recovery of these payments, together with their unrealized benefits;
- organize, track and report budgetary and legal commitments according to the legal framework, namely:
 - the establishment, through local norms, the documents, their circuits and the persons authorized to carry out operations dealing with validation, authorization and payment of expenses;
 - recording, in specific accounts off the balance sheet, of budgetary credits and budgetary and legal commitments.

The identification of all budgetary credits connected to personnel expenses and settled for the payment of medical leave, for all employees, as well as taking the legal measures to recover and replenish the corresponding budgetary credits.

The inventory of state budget claims managed by entity and the undertaking of all specific actions for exploiting the results of the inventory and recording them.

The corrections necessary for recording, in an accurate manner, in the technical – operational and accounting records of the amount of receivables.

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