

Significance of Auditing to Control the Financial Crisis

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Abstract: *The financial crisis we faced in the most recent decade did not come on abruptly. Academics must investigate the underlying causes of the financial crisis. In terms of corporate governance, we'll strive to concentrate on internal control and internal audit. According to studies, there are certain warning indicators that the financial crisis may be coming, but the root of the issue lies in insufficient financial detection and a lack of understanding of the significance of the internal audit role in the internal control system. One of the key foundations of company governance is internal audit. Our study intends to examine how financial auditors view their knowledge of internal controls as a factor in the development of high-quality financial reporting and as a means of improving the audit process. Using information from 70 of the 1178 members of the Romanian Financial Auditors Chamber who are auditors from all over the country of Romania, we also assess in this study the significance of internal audit in the internal control structure. We have concentrated on the empirical study in Romania to emphasise the research.*

Keywords: ACFE (Association of Certified Fraud Examiners), financial crisis, fraud, internal audit, and internal control.

I. INTRODUCTION

The relevance of internal controls and internal audit has greatly increased during the past ten years. This study aims to offer survey evidence of the internal control's necessity, ability to stop fraud, and ability to raise the caliber of financial reports. According to the IFRS 2011 handbook, the purpose of financial reporting is as follows: General purpose financial reporting's goal is to offer financial data about the reporting institution that may be used to decide whether to give it resources and to determine whether its management and governing board have used those resources in an effective and efficient manner (Bruce, Danie, Tapiwa, & Raymond, 2011). Many scholars and standard-setters have stressed the significance of accurate financial reporting. The audit intern serves a critical role in preventing errors and frauds. The financial reports must accurately reflect the company, as was previously indicated, in order to make efficient and effective use of the resources offered. Companies that provide accurate financial reporting should consider the role of auditors.

Accounting scandals, such as those involving Enron in 2001, WorldCom in 2002, Qwest Communications, Adelphia, Global Crossing, Nortel, and Parmalat at the start of the twenty-first century, complicated the financial world and drew attention to its murky nature. After this type of financial crisis, external auditors have come under fire, but scholars have realised the value of internal audit and that it cannot be overlooked.

Internal auditing is described as an impartial, objective assurance and consulting activity aimed to provide value and enhance an organization's operations by the Institute of Internal Auditors (IIA, 2011). By applying a systematic, disciplined approach to review and enhance the efficacy of risk management, control, and governance procedures, it aids a company in achieving its goals. According to studies, there has been a 10% rise in staffing and resources for internal audit since the accounting scandals. When compared to earlier crises, the frequency of conversations and information sharing between the audit committee and internal audit department has increased by 25%. 2009 (Atanasiu & A).

By keeping an eye on organisational risks and ensuring that organisational procedures are efficient and effectively controlled, the internal audit function serves a special role in corporate governance (IIA, 2003). Internal audit and internal control are components of corporate governance, and they can be viewed as the cornerstone of the financial system in order for it to function properly. It goes without saying that if the top management verifies and assesses the

internal audit reports, it makes sense. Otherwise, the organisation begins to sag if the senior management doesn't have time to review reports and ignores them. This study seeks to demonstrate, based on this claim, the importance of internal audit in the internal control structure system for the financial markets. If the internal control function is effective, it will help with the preparation of the financial reports and help to prevent any irregularities.

II. REVIEW OF LITERATURE

According to numerous sources (e.g., AICPA 2007; Beck 1986; Bierstaker et al. 2006; Heier et al. 2005; Hooks et al. 1994; Mautz and Mini 1966; PCAOB 2008; Rae and Subramaniam 2008; Wales 1965; Wells 2008), an efficient internal control system (ICS) is the primary method of preventing, detecting, and correcting fraud and errors. However, what exactly an effective ICS is is mostly an assumption made by ex post forensics, a type of induction, carried out by practitioners. (Barra, 2010)

Recent academic research has demonstrated that an effective internal audit system may stop financial statement fraud. By engaging in financial statement fraud, management may try to employ fabricated accounting methods to make the company appear financially successful. When examining financial statements, auditors ought to be somewhat sceptical. To recognise typical fraud techniques, taxonomies of financial statement fraud are also developed (Rezaee, 2009).

The ACFE has conducted extensive study on the effects of internal control weaknesses (Association of Certified Fraud Examiners). This study identifies the key element that made fraud possible. In 38% of the cases, the major shortcoming was highlighted as a lack of internal controls, such as a lack of task segregation. Internal controls were present in more than 19% of the cases, but they were circumvented by the fraudster or fraudsters in order to commit and cover up the fraud. The lack of a reporting mechanism was the control deficiency that was least frequently cited by the CFEs who took part in our study, which is interesting given that hotlines are consistently the most effective detective control mechanism and that less than half of the victim organisations had one in place at the time of the fraud. (ACFE, 2010)

According to Prawitt et al. (2009), the Internal Audit Function (IAF) can enhance reporting quality by reducing potential flaws in incentive system layout. Another study conducted in Romania at the national level by Dumitru Matis and Cristina Bota (2010). The authors of this study made an effort to assess how important it is to prepare an internal audit report in order to guarantee strong corporate governance. One of the questions posed to respondents asked if they saw an opportunity or necessity for the internal audit report in the context of ensuring transparency for sound corporate governance. Yes, as stated by 58,70% of respondents, creating the internal audit report can help to improve transparency. However, 39.13% of respondents said no.

One of Holt and DeZoort's important studies on internal audit was published in 2006. (Holt & DeZoort, the Effects of Internal Audit Report Disclosure on Perceived Financial Reporting Reliability, 2006). This empirical study aimed to demonstrate how the internal audit report affects investors' faith in the accuracy and reliability of financial reports. Investors affirm that they place more faith in the veracity of the financial reporting of companies that produce internal audit reports than in those that do not.

Later, the same authors expanded on this work. Their research focuses on how to make internal audit reports more transparent to external stakeholders in terms of governance. They analyse the literature and the findings of 18 semi-structured interviews with analysts, audit committee members, internal auditors, and policymakers to assess the potential costs and benefits of IAR disclosure, including increased transparency and accountability as well as increased information load, legal exposure, and reporting costs. They come to the conclusion that an IAR has the potential to enhance current governance disclosures, boost stakeholder trust in the effectiveness of governance, and encourage internal audit vigilance. The Need for an Internal Auditor Report to External Stakeholders To Improve Governance Transparency (Holt, DeZoort, & Deborah, 2008)

Descriptive examination of financial auditors' opinions of internal control devices

The section "Knowledge and Assessing of Internal Control" includes a section on the second research challenge, which is represented by the proper understanding and appreciation of the internal control mechanism.

The first question in this section asks respondents to rate the significance of various hazards that can be mitigated through the use of internal control mechanisms.

Monitoring the financial reporting process, which must result in accurate, trustworthy financial information, is the objective of the independent audit committee. The audit committee should not, of course, spend the entire day in the organisation supervising the accounting records as a result of this monitoring process. Internal control system deficiencies are seen as a major contributor to the falsification of financial data. The capacity to ensure timely and accurate financial reporting could be negatively impacted by insufficient internal controls over financial reporting and accounting procedures. On the other hand, every publicly traded firm needs to have an internal control department that is appropriate for its size and should work with knowledgeable individuals who can verify if the financial reports were generated accurately and reliably.

III. CONCLUSION

Three primary occupational frauds have been identified by AFCE:

1. Asset misappropriation
2. Corruption
3. False financial statement.

According to ACFE (Association of Certified Fraud Examiners), these professional frauds include: Asset misappropriations are frauds in which the culprit takes or misapplies the resources of an organisation. Corruption schemes entail an employee using their influence in business dealings in a way that goes against their duty to the employer in order to profit either themselves or someone else. Schemes involving the purposeful falsification or omission of crucial information from an organization's financial reports are referred to as financial statement fraud. Falsely recording revenues, hiding obligations or expenses, and fraudulently inflating reported assets are all examples of common fraudulent financial statement manipulation techniques (ACFE, 2010).

The aforementioned fraud definitions highlight how crucial the internal control function is in the financial markets. Internal control plays a crucial role in the financial markets, we conclude. Executive management and the company's administration must place priority on the internal control reports in order for them to function properly. Otherwise, the applicants for internal control risk having their efforts ignored, which could lead to insolvency, particularly for businesses.

Huge financial losses have been incurred, particularly in the last ten years following the 1929 USA financial crisis. Every financial activity in the world could have an impact on other financial markets around the world because we live in a global village. Reliable and accurate financial reports are the first step in preventing any financial uncertainties. Otherwise, there will inevitably be financial crises in the financial markets, and this could set off a destructive wind that affects the global financial system. Since the financial markets serve their purposes globally, numerous practitioners and auditors have analysed the implications of internal control while creating mathematical models. It is important to bring all the components together for an internal control to be effective. Otherwise, senior managers would find it challenging to make good choices, and this sort of poor choice could lead the company's financial structure to tremble. Internal audit may enhance the transparency and caliber of the financial position as a consequence of the research and in accordance with the researches. To avoid negatively influencing the decision-making process, users of financial information should appropriately interpret the financial reports. Additionally, studies demonstrate that the internal audit report is important and a chance for the companies' senior management. Results from the studies that were found above could differ from country to country. Its attempted here to establish an opinion about the new European nation that switched from communism to democracy in 1989. Romania was more successful than any other Balkan nation at luring foreign investment. Romania might be the ex-communist nation in the area that has adapted to east countries the best.

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