

DEVELOPMENT AND THE IMPORTANCE OF ACCOUNTING AUDIT OF CORPORATION

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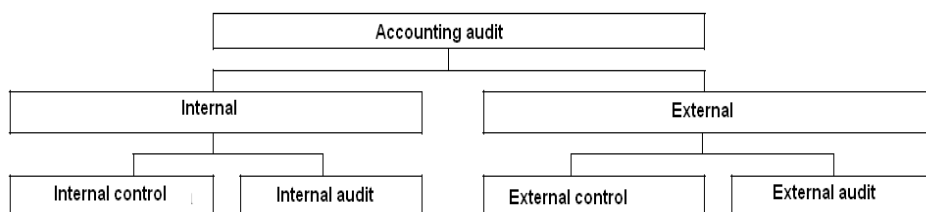
Abstract: Accounting audit of corporations, at all levels of budget users, financial institutions, and other legal entities regardless of whether they are private or public, as an organization with a significant degree of public accountability primarily emphasized the need for transparent and reliable financial reporting. However, the propensity of management to adapt their business to goals of success reputation, deviation of international and national accounting regulations and lack of implementation of standardized management system leads to numerous problems in business, economy subjects, and all levels of budget users. One indicator of this situation is the high level of corruption according to Transparency International data, which covers 181 countries, in the economies of all countries that are in the process of transition, which can lead to a loss of investor confidence and thus slowing economic development. For these reasons, accounting audit becomes more and more important in contributing to ethical management and all employees as individuals, as well as in the expression of the level of social responsibility of juristic persons and institutions.

Keywords: accounting audit, control, auditing, audit in gap, the corporation, budget users, juristic person.

DEVELOPMENT OF ACCOUNTING AUDIT

Accounting audit is an activity that is closely related to the business process as a process of reproduction, which allows continuous operation. In order to ensure the permanence and continuity, the operations must be monitored, so it is conducted in accordance with professional and legal regulations of the market environment in which the corporation operates.

The development of market economy and globalization of the economy, have led in corporations, financial institutions (banks, pension funds, insurance funds) and in other legal entities regardless of whether they are private or public (state), to development of accounting audit activities and its divisions and classifications on *internal* and *external*. As forms of accounting audit an *internal control* and *audit* and *external control* appear, which schematically look as follows:



Since the difference between the control and audit is substantive rather than formal, for clear identifying and practical application it is necessary to present them separately.

INTERNAL CONTROL AND INTERNAL AUDIT

INTERNAL CONTROL as a form of accounting audit, is the system made up of all policies and actions that corporation has established as a legal entity in order to properly and effectively ran the business, to maintain the integrity of the property, preventing and revealed errors, and fraud, ensure accuracy and completeness accounting records and timely compiled reliable financial information. The aim of control is that accountant (the person who handles some of the property) is constantly working properly according to prescribed legal and/or internal regulations, not just at the time of control.

Internal control is surveillance carried out by persons employed in the corporation, and is always subordinated to the management of corporation. Internal control is fully compliant with the general notion of control that had previously existed.

Internal control performs an employee of the corporation - an **internal controller** or only the controller, also known as liquidator. Depending on the scope and work of organization, the corporation may have several internal controllers.

Business encyclopedia⁴¹ says that network of basic controls, which may be individual activities, activities that are directed, in advance prevent, detect and correct irregularities in business and enabling corporations to work on a planned manner, form a system of procedures, called system of the internal control of the corporation.

INTERNAL AUDIT, as a form of accounting audit, is established internal assessment activity of the corporation as a juristic person, which includes monitoring, testing, and assessing whether the accounting system and internal controls are adequate and whether they are effective.

Internal audit as a form of accounting audit and as a discipline is not sufficiently studied nor fully scientifically formulated in our country, because of which sometimes is identified with internal control, which is totally wrong. According to this, internal audit is fundamentally different from internal control. Internal audit should be independent and because of the retention of its independence should not be subordinated to management. Internal audit is a control of a management structure that inform ownership and management structure with its findings, helping both.

Internal audit perform an employee of the corporation as a juristic entity - an **internal auditor**, a skilled independent auditor. The internal auditor evaluates whether the system of internal control is adequate and whether it is effective or not. Depending on the scope and work of organization, the corporation as a juristic entity may have more internal auditors.

Internal audit, in slightly different way, interpret International professional association of Internal Auditors - *The Institute of Internal Auditors*⁴², which creates the International

⁴¹ *Encyclopedia of Business*, 2nd edition, Thomson Gale, SAD, 2006.

⁴² The institute of Internal Auditors, SAD, koji ima brojne filijale šrom sveta, a najpoznatiji su u Velikoj britaniji i Irskoj.

Standards of Professional Practice of Internal Auditing⁴³. The internal audit standard is defined as an independent and objective assurance and consulting activity designed to improve value and improve the organization's activities. It helps an organization to accomplish its objectives by introducing a systematic and disciplined approach to evaluation and improvement of effectiveness of managing risk, control, and management processes. The purpose of standards is to explain the basic principles that suggest what should be the practice of internal auditing, establishing a framework for performing and promoting a wide range of internal audit activities that increases the value, establish the basis for assessing the implementation of internal audit and encourage process improvement and business organizations.

International standards of professional practice of internal auditing include standard features dealing with the characteristics of organizations and persons performing internal audit activities. Performance standards that describe the internal audit activity and define quality criteria based on which to assess the quality of providing these services. Implementation of standards relating to all internal audit services and are defined for: (U) assurance activities, and (K) consulting activities.

Dictionary that contains and explains the specific terms used in Standards. Formulation of standards explains formulating and publication of standards as a continuous process. Standards Committee Internal Audit carried out extensive consultations and discussions before the publication of the Standards. This includes collecting comments on the draft of the standards.⁴⁴

EXTERNAL CONTROL AND EXTERNAL AUDIT

EXTERNAL CONTROL is a form of accounting audit performed by persons who are not employed in the corporation as a legal entity, and that is always strictly directed to specific areas of business.

External control is the control of the authority of the country or state control, which may be of different levels. Prosecution can perform the external control, tax administration, or the Indirect Taxation Administration, Ministry of Government and other government authorities. Subject of external control, except corporations, banks and other financial institutions as legal entities, are state authorities, budget users - municipalities, ministries of government, the prosecution, and the judiciary and others. With its work, control contributes to strengthening the authority of the business disciplines of legal persons and the society as a whole, ensuring control of inflow and outflow of the budget as the main source of funding each state.

External and control of state authorities as a form of state control has inspection authorities, which consists in taking the measures of repression for the irregularities committed in the business.

⁴³ *International Standards for the Professional Practice of Internal Auditing*, The Institute of Internal Auditors, SAD, 2003.

⁴⁴ Đurasović V. „*Interna kontrola i interna revizija*“, Finrar, d.o.o. Banja Luka, 2007, str. 297-327.

EXTERNAL AUDIT, also called independent auditing, is a form of accounting control made by audit firms that have an adequate number of persons certified as a certified auditor and working license. External or independent audit includes financial statements of the corporation as a legal entity.

The aim of the financial statements audit is to provide an independent auditor to express its opinion whether financial statements, in all material respects, are prepared in accordance with prescribed financial reporting framework. For expressing an opinion, the auditor obtains relevant audit evidence allowing a reasonable basis for expressing opinion. Expressing its opinion on these financial statements, an auditor provides a high, but not the absolute level of assurance that the information does not include materially significant error. Absolute assurance is not possible to achieve by audit, among other things, because most of the evidence that the auditor has at its disposal by nature has a compelling, but not definitive character.

The audit is conducted by the International Standards on Auditing - ISA. An audit is an element of state control and regulated by law. It differs from inspection and it serves for the needs of improving corporation business, not for punishing for wrong and improper actions. The audit does not have inspection authorities.

External audit perform independent and external auditors who in its report express an opinion whether the financial statements are prepared in accordance with international standards. The fact that an annual audit of financial statements will be performed can act as a means for preventing errors and frauds.

If the existence of fraud or misstatements is discovered, even if the auditor suspects that there are criminal activities whose impact on the financial statements is immaterial, the auditor shall immediately notify the management of the corporations, and if there is suspicion on top management, the auditor should seek legal advice which will help to determine further actions to be implemented. Upon completion of the audit consists of the audit findings-report of independent auditors. The audit findings and independent auditor's report includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. It also includes appraisal of accounting principles and accounting estimates in accordance with accounting standards made by management, as well as the overall financial statement presentation, which enables reasonable assurance whether the financial statements contain or not wrong important information.

Independent Auditor's Report at the end contains the *conclusion (summary)* whether the financial statements in accordance with accounting standards and legislation represent fairly the status of assets, equity, and liabilities, and results of operations, changes in equity, and changes in cash flows on a particular day.

Independent auditor's report can be with positive, negative opinion and with reservation. Positive opinion without reservations may contain certain effects on the balance sheet, which are described in paragraphs (marked parts of the report), observations, and recommendations as well as to pay attention to certain questions.

"GAP IN AUDIT" is called the difference between the expectations of users of financial statements and the actual capabilities of audit. Specifically, the owners of capital have always sought to preserve and increase their equity and as users of financial statements audit is expected that the audit detect whether their capital is protected from fraud, and

to provide security for its efficient use and fair representing. *It is this difference between what users of financial statements (the owners of capital-shareholders, investors, customers, suppliers, government, chambers, stock exchanges, financial analysts, lawyers, and others) expect and what objectively system of thrust driven audit can provide is called the "gap in audit."* External or independent auditors their assurances made based on audit evidence verifying financial transactions based on documents, and based on assurances give their opinion on whether the financial statements in accordance with international accounting standards and statutory accounting regulative, fairly present the state of assets, capital and liabilities as of the exact date, as the results of operations, changes in equity, and changes in cash flows for the period ended on the same day. Constant dialogue between the independent audit and users of financial statements provide, on the one side, reducing suspicions of the auditor's opinion and on the other side independent audit is becoming more aware of the responsibilities for its independent and professional work in providing opinion based on assurance system.

THE IMPORTANCE OF ACCOUNTING AUDIT

The importance of accounting audit in business is reflected in the reliability of financial reporting of the achieved performance, according to applicable legal and professional regulations of market environment where corporation operates. Endeavour owners and management structure that the image of their property, financial and profitable position appears different than it really is, depending on the goal that they want to achieve is known for a long time. The reason for increased attention by the professional and regulatory bodies to accounting audit at the beginning of this century lies in the discovery of major financial scandals committed by individuals in top management structures of large corporations.

The importance of the accounting audit is reflected primarily in the expression of the level of social responsibility of corporations as legal persons and institution of a state. *The classic concept, according to which corporations should constantly increase wealth of the owner, became the concept that corporations, as part of a society, need to realize as the primary objective of increasing social wealth.* Therefore, in accordance with this affirmation of the role change and instead the primary responsibility of the owners change, so there is a social responsibility of businesses subjects and even more the role of state institutions and regulatory bodies in the development of the concept. The importance of such developed concept of accounting audit would create the results of the general responsibility for the development of economy and society as a whole.

FACTORS OF INADEQUATE ACCOUNTING AUDIT IN OUR COUNTRY

Accounting audit depends in any economic environment and thus in our country of the quality and development of the normative basis, the introduction of standardized management systems and competency management and accounting personnel structure in the application of professional and ethical standards. If in the business ambience of the state predominates necessity of introducing the concept of standardized management systems such as basic standardized system of management: quality management system,

environmental protection management system, management system of occupational health and safety, management system of social responsibility of corporations and other management systems depending on the activity, in such an environment actions in business processes are not standardized and logically difficult to monitor. In accordance with that, the most visible factors of inadequate accounting audit in our country, as a country in transition, occur at two levels: I) the macro level and ii) the micro level:

D) At the macro level indicating the occurrence of systemic corruption, stand out:

a) *Lack of legal regulations on money flows in the payment system.* If the banking sector took over the payment system, it is logical that it supervises that services and, although that is regulated by law. Otherwise, all financial transactions can be performed without any obligation to pay taxes and contributions, very of often situation in our country. The consequences of this situation are the problems in the financing of public pension funds and social health insurance and all budget users.

b) *Non-performing of financial statements of public (state) corporation revisions,* which is closely associated with the lack of the legislation on financing political parties, set by top management of these corporations. In this way, the management is more convenient to party and less to state, because party based elite protect the people it set.

II) At the micro level, stand out:

a) *The emergence of creative accounting* i.e. fraudulent financial statements calculated to fraud to presented to users hidden desire and not a true picture of actual performance depending on the business goals of the managerial structure, and thus are undesirable.⁴⁵ Although the term “creative accounting” in the subject matter is not always used interchangeably, more authors under this term includes all accounting practices that intentionally deviate from international accounting standards to presented desire and not a true picture of actual performance in order to maintain investor’s confidence, realize rights on management bonuses that depend on income i.e. in creating conditions for the use of options on shares, preparing for taking over, or defense against enemies takeover, suspension of taxes on income to future accounting periods, payment of bonus for the selection of a strategic partner to the detriment of small shareholders by paying lower stock prices, are just some of the goals of management that cause the appearance of creative accounting so these goals could be realized.

How to recognize that the management has used creative accounting instruments:⁴⁶ Unexpected and unexplained changes in accounting policies, especially if they a bad performance is recorded; profit growth as a result of an unplanned sale of assets; unexpectedly high attribution or writing off the value of property; significant transactions with related parties ; increase of participation in total sales, providing

⁴⁵ O „kreativnom računovodstvu“ videti: Stolowy H. i Lebas M., (Korporativno finansijsko izveštavanje, str.657), i Mulford. C i Comiskey E., (2002)The Financial Numbers Game: Detecting Creative Accounting Practices, Wiley, str.3)

⁴⁶ Mohnram: (2003) *How to manage earnings management?*, Accounting World, Institute of Chartered Financial Analysts of Indija Nr.10

customers with more favorable terms of payment, extension of deadlines, increase of the difference between net income and net cash from operating activities compared to previous years, growth gap between the differences of net income before tax and taxable income; big profit adjustment in the last quarter of the year; change of the auditor or audit firm that audits the financial statements.

b) *The phenomena of non-compliance with ethical rules in business*, that arise when the accountants under the pressure of the management acts contrary to professional rules, which is often in the conditions of general unemployment.

Continuously improving and strengthening the normative basis of staffing levels, through a permanent dialogue at all levels of accounting audit with on the one side and users of financial statements from the other side, provide reliable removal of a unreliable factor to inadequate accounting audit.

RESUME

The risk of unforeseen damages that might arise from the loss of confidence of investors and other users in the business environment or state ambience in which seeks to do business, because of the underdevelopment of authority and personnel basis, incomprehensive audit of all sectors of the economy and the low level of public accountability of business entities as well as budget users of all levels, executive and legislative authorities of the state, regulatory bodies, professional organizations and audit firms, the normative basis, the development of accounting audit, respect for legal and professional accounting regulations, must be given the highest degree of attention. At the state level, the primary task is continuous improvement of law regulations and strengthening the personnel structure of the accounting audit, at the level of economic entities and other legal entities: the introduction of internal audit, strengthening internal controls and compliance with professional and ethical standards by accountants and top management.

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