

REFLECTIONS ON RISKS IN FIXED ASSETS AUDIT

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In their audit mission, the auditor can not guarantee that their opinion is absolutely objective, there always exists a certain risk. In this article, the author proposes some solutions and indices about the risks of tangible assets audit. There have been studied several aspects regarding the risk of significant distortion while auditing tangible assets through the research of their components. The risks of non-detection were investigated in terms of tangible audit, also there have been identified and characterized other audit risks identified by the scientists in the field, such as the acceptable audit risk, the business risk or significant risks.

Key words: audit, tangible assets, audit risk, risk of significant distortion, risk of non- detection

JEL Classification: M42

I. INTRODUCTION

The tangible assets are a basic link in the construction of an entity and a qualitative audit of this component requires a thorough analysis of audit risks. The conditions in which the auditor works, limited time for the audit mission and the human factor create a situation where the auditor can not ensure that his/her opinion is absolutely objective, each time existing a certain risk.

This research is focused on issues related to the risk of tangible assets audit by establishing the following objectives:

- characterization of the risk of significant distortion while auditing tangible assets through the research of its components;
- research of non-detection risk through the audit of tangible assets;
- study of other types of audit risks suggested by the scientists in the field, such as acceptable audit risks, business risks or significant risks.

The above objectives arising from International Standards on Auditing (hereinafter - ISA) 315, "Identifying and assessing risks of significant distortion through understanding the entity and its environment" and 200 "General objectives of the independent auditor and carrying out of an audit in accordance with International Standards on Auditing" and from the publications of researchers in the field.

This work has a predominantly descriptive character, the existing phenomena are described in detail, but explanatory elements are also encountered. The research method mainly used is the analysis, because it allows the examination of economic phenomena and processes by their logical decomposition into essential components. At the same time, the method of deduction was also used, that allowed the application of the theories already discovered for the analysis of the facts expressed specifically in time and space, in the form of actual phenomena and processes with reliable and rational argumentation of the position of other authors.

Issues and Discussions

ISA 200 defines the audit risk as the risk, that the auditor would express an inappropriate audit opinion, when the financial statements are significantly distorted. The audit risk is a function of the risks of significant misstatement and of the non- detection risk (ISA 200, 2015, p. 13).

The risk of significant misstatement is the risk that the financial statements are materially misstated prior to auditing. It consists of two components, described as follows at the assertion level:

- inherent risk - the susceptibility of an assertion regarding a class of transactions, account balance or presentation to be materially misstated, either individually or aggregated with other misstatements, before taking into account any related controls.
- control risk - the risk that a misstatement, that could occur in an assertion about a class of transactions, account balances or presentations, which could be significant either individually or aggregated with other misstatements, will not be prevented or detected and corrected in time by the entity's internal control.

Non-detection risk is the risk that the procedures performed by the auditor to reduce audit risk to an acceptably low level will not be able to detect a misstatement that exists and that could be material, either individually or jointly with other distortions (ISA 200, 2015, p. 13).

To assess the risks of tangible assets audit, it is imperative that the auditors have practical experience in accounting for tangible assets in addition to theoretical knowledge. The auditor should obtain a sufficient

understanding of the accounting systems and internal controlling in order to plan the audit and to develop an effective response to it. They are expected to use their professional judgment for assessing the audit risk and designing the audit procedures so as to ensure that the risk is reduced to an acceptably low level (Tanase, Bucea, 2008, p. 54).

ISA 315 states that the auditor must understand the information system, including related business processes, relevant to financial reporting, including the following aspects:

(a) Classes of transactions in the entity's operations that are significant to the financial statements - for tangible assets, it is essential to understand the operations related to revenue accounts at their exit and to cost accounts at their entrance to see, if the mentioned-above operations were reflected correctly. In practice, problems may arise in the operations of reception or disposal of tangible assets free of charge, on their entry / exit from their inventory and their cessation before the end of their lifetime set.

(b) The procedures, both within the systems of information technology (IT) and manual systems, through which those transactions are initiated, recorded, processed, corrected as appropriate, translated into the general ledger and reported in the financial statements - in practice, it is necessary to follow the entire life cycle of tangible assets, starting with the recognition, initial and subsequent evaluation, calculation of wear-and-tear and depreciation, until their derecognition to see, if errors have been made at recording these operations with the accounting software and whether they correspond to those on paper.

(c) The related accounting records, the supporting information and the specific accounts from the financial statements, that are used to initiate, record, process and report transactions; these include the correction of incorrect information and the way how information is transferred to the general ledger. Records may be manual or electronic form – with regards to the tangible assets, we advise the auditor to monitor whether the presentation of annual financial statements have been followed by a correction of the total financial result through the correction of the accounts for tangible assets. If such operations have taken place, it is necessary to study them carefully, as there may be a risk of fraud.

(d) The way the information system captures events and conditions, other than the transactions that are significant to the financial statements - information systems are vulnerable with regards to the human factor. Therefore, if the calculation formula for the depreciation of tangible assets is indicated incorrectly in accounting software or the accountant does not use the accounting accounts correctly, then they could cause errors. Therefore, the auditor must verify manually whether the information system has correctly set functions and whether there have been used correctly the accounting accounts.

(e) The financial reporting process used to prepare the entity's financial statements, including the accounting estimates and significant disclosures – in the case of tangible assets, it is required to verify the correctness of operations regarding depreciation, post- evaluation, wear- and-tear, because these cases produce the highest risk of having been committed significant errors.

(f) controls related to accounting records, including non-standard accounting records used for recording non-recurrent, unusual transactions or adjustments - such accounting records may appear to tangible assets, when there are certain natural disasters or exceptional occurrences, that is, quite rarely. However, there is a risk in such cases be recorded erroneous operations, the auditor should therefore thoroughly verify these situations (ISA 315, 2015, p 18).

The risks of material misstatement at the financial statements level refer to risks that are related, obviously, to the financial situation in general. According to the researcher Anatolie Iachimovschi these risks may derive from:

- unfavorable economic conditions;
- any financial problems of the audited entity;
- deficient internal control environment.

Unfavorable economic conditions may affect entities, whose main business is closely linked to the exploitation of tangible assets, such as transport entities, agricultural entities and others. Thus, due to competition, consumer demand and supply and the specific accounting of these areas, there is a risk of distortion of information. Therefore, it is proposed that in the audit of such entities to verify the operations regarding the reflection of the subsequent costs of the tangible assets.

Any financial problems of the audited client show probable situations of uncertainty. This may lead to the likelihood of a loss or a financial lock- up, for example, as a result of non-acceptance by the bank of the credit application. In such cases, the entity may be forced to declare bankruptcy and it can cause essential or even dramatic losses or drops in share prices, and investors will show a natural tendency to file lawsuits against the auditor (Iachimovschi 2011, p. 289).

A current example of fraud in Moldova, conducted in late 2014 - early 2015, the capital hole in "Unibank" S.A., "Banca Sociala" J.S.C and "Baca de Economii a Moldovei" S.A., estimated at 9-15 billion lei, equivalent to about 13% of GDP or 58% of budget revenues for 2014. After the first investigations of this case, there was accused their audit company. Obviously, the auditors indicated some drawbacks in their audit opinion, but they seem far more timid than the magnitude of the operations, which should at least have arisen curiosity, if

not doubt. For example, Unibank indicated in their annual report for 2013 a 2.6 times increase in assets and a 5 times increase in the loan portfolio - an anomaly in a market that grew much less (Florea, Bajan, 2015, p. 129).

To avoid such unpleasant situations, auditors should check carefully how further evaluation and the depreciation of tangible assets was carried out. Incorrect reflection of these operations lead to overvaluation and artificially increases in the value of the tangible assets of the entity. As a result shareholders, suppliers, customers, banking institutions will have a false idea about the real situation of the entity's assets.

A deficient control environment is primarily the result of lack of management integrity. Deficiencies in the client's integrity are identified by the existence of conflicts with previous auditors, customers, suppliers, regulatory agencies, stockholders, the state. Such conflicts often associated with audit quality and as a result auditors may be brought in trials on the occurrence of any disagreements (Iachimovschi 2011, pp. 289).

On auditing tangible assets it is considered appropriate for the auditor to determine whether there were conflicts with the previous auditors, if after tax audits there were not found errors related to tangibles or if the entity is in conflict with suppliers or customers. When such violations occurred in the past, they might repeat.

The first step of the auditors is to consider the overall audit risk, that they are willing to assume in verifying the fidelity of financial statements, when the financial statements are, in fact, misstated. Considering the importance of this action, it is surprising, but few definitions are about the level of overall audit risk. In the auditing standards it is stated that the audit must be planned so, that audit risk is limited to a low level. The audit risk can be represented either in qualitative or quantitative terms (Manoli, Zlatina, 2013, p. 167).

In practice, for the determination of the overall audit risk the auditor uses his/her professional judgment. If quantitative strategy is used, it is determined the overall risk of 5 or 10 percent, and using the qualitative strategy they operate with the concepts of low or moderate risk. As a result, on auditing tangible assets it is recommended to the auditor to establish a low risk or up to 5%, because this section is of significant importance, so the auditor should accordingly make a greater audit effort.

From the definition of audit risk, audit risk infer that is the product of inherent risk, control risk and detection risk. Inherent measured on the auditor's assessment of the likelihood of significant distortions due to fraud or error in a segment prior to the evaluation of the internal control (Botez, 2015, pp. 6). Inherent risk is equivalent, in fact, with the possibility that a balance of an account or a category of financial operations contain erroneous information that could be significant individually or when aggregated with misstatements in other balances or financial operations, as a result of the lack of effective internal controls (Paraschivescu, Nita, 2008, pp. 58).

In the case of tangible assets audit, we propose to the auditor to assess the inherent risk by answering the following questions:

- do the entity accountants responsible for the accounting operations related to tangible assets have a high degree of training?
- is the information system (accounting software) error prone?
- are there any suspicions of fraud?
- were there any losses of acts on fixed assets?
- were there any suspicious transactions with fixed assets, such as entrance/exit or others?

Examples of circumstances that may lead to inherent risk specific for tangible assets are:

- the accountant does not keep purchase and sale registers, the minutes of acceptance/release of fixed assets, evidence records of fixed assets, inventory registers and other records;
- the information system (accounting software) is not licensed, the entity lacks IT specialists or contract with an entity specializing in IT;
- there exist the possibility of theft of fixed assets due to lack of evidence thereof;
- not found on demand certain evidence documents relating to tangible assets;
- unusual transactions were found on entry / exit of tangible assets, or after inventory.

Control risk measures the auditor's assessment of the standing, if the error exceeding the tolerable misstatements is prevented or detected by the entity's internal control. If the auditor considers the internal control system completely inefficient in prevention or detection, the control risk will be assessed as very high, even as 100%. In addition to this, we highlight the quite common situation in audits, that the entities have not organized a system of internal control. The relationship between the control risk and the inherent risk is quite close (Botez, 2015, p. 6). the

The assessment of control risk in tangible assets audit represents the assessment of accounting systems and internal control of the entity and prevention and detection of significant erroneous information (Năftănăilă, 2009, p. 75). It is necessary to evaluate each account balance of property and equipment and at a high level for some or all assets, when the accounting systems and internal controls are not effective or the evaluation of their effectiveness is not efficient.

When auditing tangible assets, there can be used control tests performed to obtain audit evidence about the effectiveness of the accounting systems and internal control, that is, whether they are suitably designed to

prevent or detect misstatements of significant erroneous statements on the way of performing internal controls over a certain period.

Control tests include:

- checks on evidence documents underlying the economic and financial operations or other events to obtain audit evidence about the compliance with internal control procedures (Paraschivescu, Nița, 2008, pp. 59). For example, it is checked in case of the sale and purchase of a property, if the transaction has been authorized and confirmed first by primary documents with special a regime (the tax bill, the invoice), if the minutes of acceptance/release of the fixed assets has been drawn correctly etc. ;

- investigation and observation of internal controls, which, on their performance have not found any deficiencies. Thus, they determine the persons responsible of accounting for tangible assets and through some tests they determine if it are work at a high level, and if its internal control techniques are effective. If, in addition to the specialist in accounting for tangible assets, the entity has an internal auditor, then the latter is also tested;

- revising the internal controls to ensure they have been correctly performed by the entity. In the case of ttangible assets, the simplest method of their internal control is inventory. If after inventory non-conformities were not detected, the next step is to check the way the internal control calculated the depreciation, further evaluation and wear-and-tear of tangible assets.

Non-detection risk is generally the risk, that a significant material deviation or inaccuracy which was not corrected by the internal control, can be not detected by the auditor (Paraschivescu, Nita, 2008, pp. 59).

Such a risk is a function of the effectiveness of an audit procedure and its application by the auditor. In practice, the detection risk can not be reduced to zero due to the influence of such factors as:

- the auditor examines all transactions of a class of account balances and disclosures;
- the possibility that an auditor might select an inappropriate audit procedure;
- to misapply an appropriate audit procedure;
- to misinterpret the audit results (Manoli, Zlatina, 2013, pp. 171).

Researchers, such as Cristina Alina Năftănăilă mention in their works there is an inverse relationship between detection risk and the combined level of inherent and control risks. Therefore, the higher the assessment of inherent and control risks, the more audit evidence the auditor obtains from the performance of substantive procedures to reduce the non-detection risk, and thus the audit risk to an acceptably low level. When the auditor determines that detection risk regarding the assertion on the financial statements of an account balance or of a class of significant transactions (in our case of tangible assets) can not be reduced to an acceptable level, the auditor expresses a doubtful qualified opinion or is unable to express any opinion (Năftănăilă, 2009, pp. 76).

On auditing tangible assets, the auditor may express a low opinion or may be unable to express an opinion, when there are suspicions as to the integrity, experience and knowledge of the audited entity's accountants, to the fact that the transactions with fixed assets are not carried aut normally and / or the existence of suspicions about the loss or distortion of tangible assets.

Mr. Daniel Botez, Doctor in "Accounting", Associate Professor, operates some other forms of risk, such as the acceptable audit risk. This type of risk is a measure of how the auditor is willing to accept the existence of a significant misstatement in the financial statements after the audit has been completed and a definite opinion has been expressed.

We find in the speciality literature a risk category, in direct connection with the audit risk acceptable. To decide on the acceptable audit risk properly, the auditor determines the audit risk mission. This is the risk that the auditor will suffer injuries, after the audit has been completed, even though their audit report was correct. Audit risk has a close connection with business risk. For example, if a customer declares bankruptcy after the audit has been conducted, the probability of raising the legal liability of the auditor is high, even if the audit has a high quality.

Some auditors agree on the need to take account of this risk while planning the audit, and some do not. But those opposing the rik mission influence on the volume of evidence collected can not provide opinions for different levels of assurance. In contrast, those who accept this idea believe,that it is right for auditors to collect more audit evidence, which provide more experience and lead to a rigorous audit revision, especially in the case of high juridical exposure or other adverse actions, that may affect the auditor's existence (Botez, 2015, pp. 7).

In our opinion, the auditor should consider the acceptable audit risk and should establish an appropriate audit risk mission. In the literature we find opinions that this risk may be between 12% and 10%. Factors influencing the risk of the mission and therefore the acceptable audit risk are: the extent to which external users trust the financial statements, the likelihood that the entity will have financial difficulties after the audit report is published and management integrity. In the national economy, although these factors are meet, they can hardly be avoided.

In particular regarding the tangible assets, this risk may be high, when the accounting value of tangible assets is overestimated and their depreciation has not been calculated properly or at all, and the entity is over-

indebted. Accordingly, the entity may reach a situation where they can not meet creditors or to declare bankruptcy.

Another audit risk described in the literature, which can be subjected to the auditor is the business risk. It is associated with the profitability and survival of the entity. It is raised in discussions the evaluation need before the risk assessment of inherent, control and business risks. The auditor should use the knowledge gained to understand the client's business and industry so as to assess the client's business risk, i.e. the risk that customer's business fails in achieving its objectives (Baptism, 2015, p. 7).

On auditing tangible assets, the auditor's initial concern is targeting the risk of significant misstatement of the financial statements due to the client's business risk. For example, companies often use reorganization in the form of acquisitions or mergers of operations the success of which depends on the operations of two or more entities. If planning is not synergistic the value of the tangible assets may be impaired, affecting the true image of the financial statements.

Client's business risk assessment is done by carrying out analytical procedures. It is proposed that the auditor will compare the indices of customer's tangible assets with the indices of the economic branch to which the entity or its competitors belong to see if any abnormal differences in comparison with the previous years or the industry averages. Thus, the auditor considers whether the carrying amount of property has not suffered erroneous over- or under-estimations, which may mislead creditors. For example, a plot of the audited entity may be overvalued compared to other analog land of another entity and the audited entity may contract a bank loan for an amount greater than the de facto land pledged. Therefore, in case of default, the pledge would not cover the amount of debt to the bank and might go bankrupt. The auditor should consider such a risk in order to avoid unpleasant situations.

Another audit risk similar to the risks described above are significant risks is the audit risk requiring special audit consideration. Significant risks generally refer to professional judgments and unusual transactions. Professional judgments, for example, relate to the estimates of the fair value of tangible assets in the financial statements.

As part of risk assessment, the auditor determines which of the identified risks are significant and require special attention. To identify these risks for tangible assets audit, the auditors take into account several aspects such as:

- if the identified risk is a fraud risk;
- the likelihood of emergence of that risk;
- the impact of the risk size on significant misstatements and its ability to cause multiple distortions;
- whether the risk is related to recent changes in the economy, in the accounting system or others;
- the complexity of transactions;
- whether the risk involves transactions with related parties;
- the level of subjectivity in the measurement of financial information;
- whether the risk involves transactions that are outside the normal course of business or attract the auditor's attention at the stage of understanding of the entity and its environment (Botez, 2015, p. 8).

Conclusion

Audit risks in the audit of tangible assets can derive from unfavorable economic conditions, any financial problems of the audited entity or deficient internal control environment. We are drawing attention to the fact, that in the audit missoin of such entities, the subsequent operations on reflecting the post- costs of the tangible assets should be considered and to check carefully how further assessment and depreciation of tangible assets were carried out.

Conflicts are often associated with audit quality and as a result, auditors may be brought in trials on the occurrence of any disagreements. On auditing tangible assets we propose that the auditor determines whether there were conflicts with previous auditors, if the following tax audits have not found errors related to tangible assets or wether the entity is in conflict with suppliers or customers. If such deviations occurred in the past, they might repeat.

In the determination of the overall audit risk, the auditor uses professional judgment. In particular, for the tangible assets, we suggest auditors to establish a low-risk or up to 5%, because this section is of significant importance, so the auditor should make a greater effort to audit.

The inclusion of the inherent risk in the audit risk model is one of the most important concepts in auditing. We propose, that for assessing inherent risk in the audit of tangible assets, the auditor to answer several questions concerning the training of accountants responsible for the accounting operations relating to tangible assets, the information system propensity to error, the existence of suspicion of fraud and others.

The assessment of control audit risk of tangible assets audits is the process of assessment of the accounting and internal control systems of the entity and prevention and detection of significant erroneous information. We urge the auditors to evaluate each account balance of any property and equipment at a high level for some or all assets, when the accounting and internal control systems are not effective or the evaluation of their effectiveness is not efficient by the use of control tests.

Non-detection risk is generally the risk that a material irregularity or a significant inaccuracy, which has not been corrected by the internal control, may not be detected by the auditor. In the case of auditing tangible assets we recommend the auditor to express a qualified opinion, when there are suspicions about the accountants' integrity, experience and knowledge of the audited entity or when the transactions with the fixed assets are not carried out normally.

In literature there also can be met other audit risks, such as acceptable audit or business risks. We consider reasonable that these forms of risk will be taken into account, when auditing tangible assets, because they are of most importance as accounting elements of any entity.

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