

# *Financial Crisis and the Role of Auditing Services in its Management* \_\_\_\_\_

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## **Abstract**

*Sustainability and efficiency of financial and operational systems is one of the biggest challenges facing organizations today the public sector as well as non-public sector. Failure to implement the standards and principles of good governance has a major impact in today's crisis economies are going through in many countries. An important role in the management factors that affect various risks that lead to the crisis have systems of internal control and audit services. Audit services help increase managerial accountability by providing reasonable assurance and advice consultancy regarding the accuracy of financial statements, security systems of internal control and effective management of risks facing organizations (public and non-public). The role of audit services is to provide a fair description of the issues, resources, roles and responsibilities combined with useful recommendations, helping stakeholders to reconsider problems and government programs. Auditors help decision makers by assessing whether the organizations are doing what is expected of them and what they are in charge, by spending funds for the intended purposes, and in accordance with the legal and procedural framework. Efficient audits can provide answer for such questions as: are policies implemented by considering the purpose for which it was designed? Have managers implemented effective systems of risk management, control and governance?*

**Keywords:** *Audit service, Managerial accountability, Assurance, Value added tax, Risk*

## **Audit - An important service for every organization**

*“A good, from which should benefit NOT a bad which should be tolerated”*

The main objective of each organization (public or non-public) is achieving the required level of performance. But, in the same time, the organization should apply the principles, standards, rules, laws, regulations, policies constituting the framework within which operations are performed and performance of the organization is estimated. Organizations secure integrity, transparency and responsibility through codes and government policies. Codes are supported by structures which promote these values and audit functions are a key element in the structure of the organization.

Audit service plays an important role in the information and education of high management to find appropriate solutions in achieving the objectives, and helps managers in development of instruments and techniques for the governance of the organization. Auditors that possess a good knowledge of the governance of the organization play a key role in ensuring the required sustainability and success of the organization. Auditors helps decision-makers by evaluating if organizations are doing what is expected to be done from them and what has been entrusted to be conducted from them, for example., a public organization is spending funds for the purposes intended, and in accordance with the legal and procedural framework. Efficient audits give answers to questions like:

- Has the considering policy been implemented according to the purpose for which it has been created?
- Have managers implemented effective systems of risk management, control and governance?

In this way, audit services contribute to the growth of managerial responsibility by obtaining access to these kind of information for all the stakeholders.

Two of the main audit activities are external and internal audit. The main purpose of external audit is to secure if financial statements seen as a whole do not have undeclared evidences, in a notably security. By acting in accordance with auditing standards, external auditors fulfill the relevant procedures:

- a. Without anomalies
- b. Prepared in accordance with relevant legislation and relevant accounting standards and financial reporting, for which they prepare a report comprising a clear expression of their opinion on the financial statements.

So, external audit serves to ensure authenticity and clarity in the view given on financial statements (on a reasonable and argued base) for which the audit opinion is prepared. But, authenticity of financial statements is a responsibility of organization's management.

Contemporary internal audit is developed as a tool of management with the purpose to increase the value of the organization not only by reporting facts, but above all preventing the occurrence of errors, by identifying areas for improvement through the implementation of best professional practices. Contemporary internal audit as an independent activity, perform two important functions:

- Firstly, gives objective assurance on the functioning of: internal control systems, governance and risk management and
- Secondly provides advice and management consultancy.

In this way they add value and improve the organization's activities, helping in the fulfillment of its objectives. Also, internal audit brings a systematic and disciplined model to evaluate and improve effectiveness of risk management, control and governance processes. Internal audit performs an effective monitoring placed by management to review and revalidate internal system account, internal controls and risk management inside the organization.

## **Development of audit services in Albania**

In many countries in transition, it is not understood yet the role and function of contemporary audit, since there still exists the old concept of "inspector" and "controller", a characteristic for centralized economies, concepts that are not relevant to contemporary audit services. Implementation of reforms in these countries towards a market economy requires first and foremost a deep and versatile reformation of the system of internal control and in this framework of auditing services and other safety services.

In Albania, as in many other countries in transition audit services are not efficient yet, not only because of their underdevelopment in the previous period, but also to lack of knowledge (misunderstanding) and misuse of the role of these services by the leaders of the organizations (public or non-public) and specialists in the field.

In the period of the Albanian state after its creation in 1912, it is concluded that audit services according to standards and professional practices have functioned during the Albanian Kingdom (1928-1939), when state finances were audited by Controller Council that had the attributes of an independent body, whose

functions were defined in the Constitution. So, in this period it is concluded that the services of external audit in public sector were implemented according to the principles and international standards.

While in the period of centralized economy (1945-1990) state finances were controlled by institutions like State Control Committee, State Inspection, Control-Revision, where their functions and duties were to adapt the needs of the centralized economy. The main distinguishing feature of these organisms was the complete restriction of institutional position, object of the activity, competence and lack of independence.

### *The audit service reform in Albania*

Reforms that started in 1991 required review and deep treatment of conception, organization, content and functions of audit services. So, in 1992, was established by law State Control Service, independent body from the government, while in December 1997, to improve the activity of this institution was established the organic law of this institution. But, it should be noted that, these two laws in their entirety didn't fulfill the principles and contemporary international standards of external audit.

External audit especially in public sector, is still far from being a contemporary audit, as it works in developed countries, with the primary mission to provide if financial statements of public organizations have no evidence of undeclared, in a notably security, and to evaluate money's performance (the collection and use) to taxpayers.

In this period (after 1992) it was determined the legal obligation to audit financial statements of non-public companies from accounting expert and auditing companies. The process of preparation of audit professionals and their organization in Albania began with the adoption of the law "For Commercial Companies" which established a series of provisions for the statutory audit of commercial companies from audit professionals called "Authorized Accounting Expert". The law on "Commercial Companies" authorizes the government to issue detailed rules for the professional organization. The creation of procedures and audit standards is based on international standards published from professional organisms. The retention level of professional skills of the members and their further improvement can be provided through a continuous training process.

Internal audit in public sector began to function in year 2003 (with the approval of the law for performing this service), by disconnecting the dependence of control structures from operational structures (in financial management), and passing these structures under the dependence of the highest level of public management units. Financial control structures were converted into internal audit structure, but this

conversion process created a series of problems and difficulties in the conducting and operating of audit activity according to standards and professional practices of internal audit.

The management of organizations in Albania still has an incomplete conception and a low awareness of the role that contemporary audit services have. This is related to the quality of audit activities, where in many cases is not evaluated in the required level from contemporary standards, and lack of knowledge and abuse of these services from a lot leaders of organizations.

## **Problems in the implementation of audit activities**

Ensuring a high level of quality of audit activity remains a very acute problem that constantly arises for solutions, as for the audit of public entities activity, as for the entire system under audit. Establishment and operation of a quality assurance program of audit activities, which consists in the development of the existing regulatory framework, theoretical and practical, as well as capacity building professional auditing will promote increased levels of labor audits.

Also, it is concluded limited role of auditors – simply taking records – by not giving appropriate recommendations for the improvement of the systems in order to avoid that negative events to return in ordinary phenomenon. In many cases it is concluded a non-accurate recording of findings, incomplete treatment of observations, making recommendations to often inappropriate and impracticable, which bring negative impact on the results of work and on the quality of audit activity.

Communication of audit results, the exchange of informations between the organizations remains one of the weakest points of the system especially when it comes to public governance units. Findings and recommendations are necessary for the line management in the audited field, through their findings and recommendations, value is added to the organization's activity.

The risk assessment process is still less developed in the methodologies applied in practice by auditors. Concrete cases of risk assessment are sporadic and not the usual practice of the audit work. On the other hand, for the leaders of organizations, the concept of "risk management" and placing controls as their response to a matter still remains unresolved. Developing strategies based on audit risk assessment of the activity of organizations and training of auditors with practical methods for risk assessment and treatment, would increase enough the efficiency of this activity. Based on the determination of areas with the highest risk, audit structures establish their highest priorities. Thus, in subjects or areas with higher risk are involved the main sources of audit, which means that, in these audits include staff on high

professional level, and sufficient time for the evaluation of subjects is ensured, and technical expertise upon request and other sources.

A very important principle in audit activity is independence, because an independent audit service is essential to its effectiveness. Safety can be achieved when: (1) the head of the audit has the right of access directly to senior management of the organization, as well as audit staff have full access to all activities that are audited, (2) the adoption and implementation plans is done from the audit activities of the organization on the basis of professional standards and practices. Independence can be ensured if the auditor does not have responsibility for operational functions. Also, they do not have direct responsibility for, or have no authority over any activity that is subject to audit. Audit staff should not be involved in the design, construction, management and running of systems that can be audited by them. But this does not prevent auditors to advice and comment on performance improvement and change.

In many cases it is concluded violation of functional independence of auditors by managers of organizations (especially public ones) starting from programming audit activities and to the realization of them.

Another important element is the body audit authority, who should have full and unlimited access for all activities within an organization. Auditors should have the authority to obtain information and explanations that they consider necessary to fulfill their objectives and responsibilities. Also, auditors should have the authority to require the management responses for any finding or recommendation involved in their work in a timeline.

Efficiency in audit activity has a significant impact on the determination of accurate and comprehensive scope of the audit engagement. Target engagement should fulfill its terms of reference from systematic reviews and risk assessments, control and governance that includes policies, procedures and existing operations, by: monitoring the achievement of organizational objectives; identify, assess and manage risk for the organization to fulfill its objectives; advise and evaluate policies, within the organization's executives; enabling efficient and effective use of economic resources, supervising losses of any kind, including those arising from fraud, irregularities or corruption; ensuring that systems are established and implemented by management in an efficient and effective economic way; and enabling the integrity and reliability of information, accounts, data, including external and internal reports, as well as the accountability process.

As discussed above, modern audit service is an important tool in the hands of the managers of the organizations (public and non-public) in meeting their objectives. But, there are questions as to why should you support audit services? and where should you rely on?, the answer to these questions is:

*Firstly*, through the services of audit, the managers of the organizations are enabled to have independent opinions on the effectiveness and adequacy of the internal control system that is placed in the organization.

*Secondly*, auditing services, enable to the management of the organizations an internal tool to address specific controls on the weaknesses of the organization.

*Third*, the external auditors are appointed on the basis of statute, to report independently on the financial statements. In this way, their main responsibility is to those who appointed them, eg. Shareholders, while internal auditors only respond managers.

A key question that arises in auditing activities: Can the external auditors rely on the work of the internal auditors? The answer to this question depends: if internal auditors are independent from management, if the unit has enough and capable auditing staff, if their work is done complying to work standards and therefore can believe in such work, whether their work is based on independent systems (safety may change). For this, a questionnaire can be used to assess whether they can rely on the work performed by internal auditors.

While the accountability and objectives of the external auditors and internal may differ, they have a common interest, which means that their work often overlaps. If the external auditor decides to use the work performed by internal audit, he has a responsibility to express an opinion on the audit and that responsibility is not limited by the use of internal audit work. All judgments relating to the audit of the financial statements are those presented by the external auditors.

To strengthen the role of the external audit and to increase its degree of reliability required the external auditors are prohibited to perform non-audit services, and promoting growth in the number of firms that deal with audits only and not other services. The Audit Committee shall appoint and monitor the external audit using carefully prepared specifications and that emphasize on independence and professionalism.

## **Conclusions and recommendations**

Audit services that enable objective and independent advising, help managers to improve the organization's risk management, internal control and governance. Contemporary audit activity is oriented more and more on performance audits. In our country this kind (type) of audit applied very few firms. Public and non-public organizations today face significant challenges, such as: (1) how to ensure resources (human, material and financial) that cost is as low as possible and with the proper quality and standards, (2) are all the used resources available with the right efficiency (running)? and (3) are the defined objectives achieved (results intended)?.

So, the main task of the organization is to achieve the required level of performance, but, at the same time, an organization must conform to all major standards, rules, laws, regulations, policies that form the framework within which the performance of the organization is evaluated. The audit plays an important role in higher education management to find the appropriate solutions to reach objectives and helps managers to develop tools and techniques for the governance of the organization. The auditor that possesses good knowledge on the organization's governance plays an important role for ensuring the sustainability and success both in the public and the non-public sector.

Auditors also play an advisory role that helps the organization to develop the necessary infrastructure especially the internal control system. While the role of providing reasonable assurance helps to provide assurance that the internal control structures are understood by managers, making the work go well. It is difficult to talk about risk management if we do not talk about internal control, and that these two essential aspects of the organization ensure success.

An important role in the auditing activity has Audit Committees (AC). The Audit Committee has delegated authority to act in accordance with its terms of reference, and investigate various areas that has defined in its agenda. Internal and external audit submit periodic reports to the Committee meetings and prepare the annual report for each financial year. The role of ACs is already recognized in business activity and they are becoming mandatory for companies listed on stock exchanges, but also for smaller companies it is recommended their operation.

Special importance during the process of auditing is recommendations given to the management that aim to improve the internal control systems and activities of the organization to achieve the objectives. In general, the recommendations should:

- Improve decision making processes of policies and procedures, developing strategies and setting targets in the audited organizations.
- Improve the internal and external legal and procedural framework of the activity of organizations (establishment of procedures, clear rules to prevent negative phenomena, verifications, authorizations, allocation of duties according to the functions, roles and responsibilities).
- Improve financial management systems in order to ensure efficient use, economy and efficiency of funding (increasing the quality of budget planning and implementation, establishing prudential rules to prevent fraud and theft, the safeguarding of assets, etc.).

Recommendations are also given for professional development of employees in the organization and especially the staff working in the financial management structures, as well as establishing and developing professional audit capacity.



The strategic objective of the audit is to provide recommendations to improve the system and adding value to the organization. Achieving this objective is determined largely by the quality, and applicability of recommendations, indicating the audit responsibility to find the most effective ways of raising awareness of the value management of organizations and benefits from the implementation of the recommendations. Therefore, the assessment of the internal audit activity is not limited only to recommendations, but considers important indicators and the degree of implementation of recommendations.

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