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## Directions for Improving the Internal Audit of Some Stocks of Circulating Assets

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**Abstract:** The objective of the article is the study of directions for improving the internal audit of some stocks of current assets according to the degree of functionality with a brief statement of the form of their manifestation, for the improvement of the procedural framework and practice in this field. The study in question, carried out mainly through the monographic method and other components inalienable to the dialectical method of knowledge, is based on the authors' own research, as well as theoretical concepts in this field on different dimensions described in the specialized publications of local and foreign scholars, the principles basic and the provisions of professional standards in the field. The results of the empirical study of the current state of the accounting of the distinct patrimonial elements allowed the group of authors to formulate some directions for improving the internal audit of the stocks of current assets according to the degree of functionality with a succinct statement of the form of their manifestation, cur would be: the argumentation of the methods stock assessment and the application of sampling methods in the audit, the improvement of the documentary verification methods of the movement of goods and materials, the organization of the inventory during the audit and the standardization of the audit checks.

**Keywords:** evaluation methods; inflation; audit sampling; documentary verification; inventory

**JEL Classification:** M40; M42

### 1. Introduction

As is known, stocks play an important role in the economic circuit of companies in the production sector. They bring together a wide and varied nomenclature of consumable material goods and circulating assets that are found in a certain substantial form both at the supply and production stage, as well as at the commercialization stage. At the same time, each type of stock has its own particularities conditioned by the way they are obtained and used. The key element in assisting a successful manufacturing enterprise management structure in the fiercely competitive economy is definitely internal audit. All the structural changes that have taken place recently both in the country and abroad (financial, health, security crises, etc.), the establishment of new economic development objectives (with the discount of eminent risks), the foundation of an innovative management system in the framework of entrepreneurship subjects (the rapid development of artificial intelligence) generates new approaches to the organization of internal audit within production entities, including stocks of current assets. In our opinion, the major interest in the implementation of the internal audit as a whole, and of the segment subject to research in particular,

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also belongs to the founders (shareholders, associates) of the entities, who are certainly the most interested in controlling the efficiency and effectiveness of the use of pecuniary, material and human within distinct production enterprises. Therefore, we can conclude that internal audit within modern entrepreneurship subjects has not only general management functions to ensure and consult managers in order to make management decisions based on profit criteria in order to achieve their objectives, but also to strengthen the effectiveness of the result their activity by implementing the recommendations offered for this purpose.

## **2. Related Work**

The internal audit service is intensively promoted for implementation in the activity of modern entrepreneurial subjects, in various fields, such as: the organization and preparation of economic-financial information, budgets and forecasts, its analysis and evaluation on all components (as a whole, and in detail), control of the production process as a process, control of the quality and efficiency of the activity of subdivisions, including on responsibility centers of the enterprise, control over the organization of physical integrity, of the process and accounting treatments regarding fixed assets and current assets, as well as the efficiency of their use according to destination, etc.

The intensification of economic relations on a regional and global level, along with the historical deepening of the relations of the Republic of Moldova with the competitive economy of the European Union (for example, 58.6% of the total exports in 2022, of which with Romania – 28.6%), generates the impulse to reform and modernize the domestic financial record and control system, including the internal audit activity. At the same time, this interest given to the internal audit, including regarding the current assets of the unit, becomes attractive also for the owners (shareholders, associations) of the entities, who literally entrusted the management of the entity to professional managers in order to achieve the proposed objectives, and the internal audit, in turn its is a notorious and indispensable tool of this delegation of governance and at the same time, it completely emanates positivism not only in relation to the current owners, but also to the business partners and potential creditors and investors of the enterprise.

## **3. Concept and Terms**

Any management system organized on the principles of efficiency within an entity implies continuous modernization and the implementation of new policies for the realization of planned strategies, minimization of entrepreneurial risks and permanent improvement of operational results. At the same time, the lack of methodological audit tools in distinct directions generates the emergence of systemic problems that in turn significantly influence the results of the company's activities. The group of authors, as a result of the in-depth study of the specialized literature and the daily practice of some domestic production entities regarding the current state of the accounting of current assets, as well as the peculiarities of their audit, tried to develop the methodological support in this field, by formulating some plausible directions in order to improve the internal audit of some stocks of current assets. These, in the opinion of the authors, will contribute to the improvement of the internal audit techniques applied in domestic production enterprises, which use a wide spectrum of current assets, and at the same time will also lead to the development of the methodological support of the internal audit in general.

## **4. Solution Approach**

The analysis of the current state of the accounting of current assets, as well as the particularities of their audit, allows us to formulate the main directions for improving the internal audit of some stocks of current assets. These include: analysis of current asset stock valuation methods; application of sampling methods in audit; improving the methods of documentary verification of the circulation of stocks of current assets; organizing the inventory during the internal audit.

The first direction of the audit is associated with the existence of different points of view on the problem of valuation of stocks of distinct current assets. Thus, according to the existing methodological framework on audit engagements, assets are tested for overstatement of the balance, as foreign enterprises strive to present their financial position as best as possible in the financial statements, in order to attract foreign investment, to “satisfy” the expectations of the owners (shareholders, associates) of the entity, etc.

In domestic entrepreneurial activity, as a rule, the following situations occur: 1) profitable enterprises tend to report as little profit as possible in order to reduce the tax burden; 2) unprofitable enterprises strive to show the smallest possible amount of loss or even a small amount of profit in order to have a satisfactory image at the State Tax Service. In this regard, the auditor, as a “lawyer” of the client’s interests, should suggest to the entity’s management models for optimizing the company’s financial and tax policy, and his assessment in this case plays a decisive role. On the other hand, the auditor must understand that the true value of the cost does not exist (for example, when applying the individual valuation method, the method of distributing transportation and purchase costs can be recognized as subjective).

However, most practicing authors recognize as reasonable the method of estimating stocks of current assets (in particular, goods and materials) at cost, because the use of other methods opens up room for manipulation of accounting data and, ultimately, profit the enterprise. The following arguments are presented to substantiate this statement:

- the mentioned method is objective, since the assessment is based on supporting documents and, most importantly, against the corresponding monetary value was (or should be) paid for the object of the assessment;
- this results from the principle of duality, because economic facts must be recognized and evaluated in accounting at initial cost (which have actually occurred);
- economic assets are scrapped at the value at which they were actually acquired;
- the financial results are objectively reflected, as they are not affected by the consequences of the revaluation. It should be noted that in the case of accounting at the actual cost, any revaluation, based on the principle of continuity of the enterprise’s activity, is subjective (if the enterprise exists forever, then there is no need to revalue its assets).

The circumstances mentioned above are of significant importance and must be taken into account when accounting for stocks and developing optimal options for settling their value according to destination. At the same time, it should be noted that regardless of the type, shape, content, dimensions and other identification parameters, current assets (in particular, materials) are scrapped from the moment they are used for production purposes or for other needs and are to be replaced in the supply process or through the entity’s own efforts with new copies, thus ensuring the continuity of the company’s operational activity.

In addition to those mentioned above, there are many other methods (options) for calculating the cost of stocks of current assets, such as: historical value, fair value, contractual value, net realizable value,

revised value (increased or decreased), individual cost; weighted average cost; FIFO (first in – first out); LIFO (last input – first output); BS (basic score); KIFO (at intragroup price); HIFO (at the price of the most expensive lot).

The essence of the BS method is that part of the materials being processed, that is, the minimum required to maintain the production process, is valued separately, and the rest of the materials are valued, as a rule, using the FIFO method. The cost of the minimum required amount of materials is established at the time of establishment of the enterprise based on the cost of the first purchase (it is assumed that this amount of materials is in constant processing and therefore never withdrawn).

The KIFO method is based on the fact that when drawing up the group's financial statements, the disposal of stocks for deliveries within the group is taken into account first. According to the HIFO method, the most expensive lot of inventory is retired first.

The NIFO method, as the economic essence, represents a method of accounting for recovery prices, that is, at the prices of the nearest receipt of goods and materials. In the current conditions of inflation and the change in the purchasing power of the national currency, if the purchases of goods and materials are made frequently, the use of the NIFO method gives results close to those obtained by the LIFO method, the less often goods are purchased, the more will be obtained more different results when using them.

The use of LIFO, NIFO, HIFO methods in periods of inflation usually gives the lowest value of the stock of goods and materials and, accordingly, the lowest profit for the distinct period, which creates hidden reserves for the enterprise. As a result, the company is guaranteed against sudden financial difficulties and saves money on dividends, bonuses and taxes; using FIFO and BS will give the highest values of the above reporting items, and valuation at weighted average cost is a compromise. It should be noted that during periods of falling prices, the expected result will be reversed.

Using the FIFO method in inflation conditions is the least profitable because it results in the need to pay the largest amount of income and property tax in the reporting period, since it provides the lowest cost of sales and the largest amount of the account balance of inventory of goods and materials (with the exception of the NIFO method, which will provide the maximum amount of savings on income tax, which is more significant in magnitude than property tax). Thus, under inflationary conditions, the FIFO method leads to double taxation. In deflationary conditions, the FIFO method will give the most favorable results: the highest amount of cost of goods sold and the lowest amount of the inventory account balance and, as a result, will save on taxes paid in the reporting period.

Thus, in a period of inflationary price growth, it is more profitable for enterprises to use LIFO and NIFO, since the method of estimating reserves in itself does not change the real financial position of the enterprise (it is changed by the amount of taxes payable). If the amount of taxes payable in the current period is higher, then the enterprise will have less working capital for the purchase of current assets, financing of capital investments, etc. and the less revenues, in the end, will receive the budget, since the development of the enterprise due to unbearable tax time may slow down or even stop.

In the case of using these methods, it does not say about reducing the amount of taxes payable in general, but only about the fact that part of them, which, when using other methods, is paid in the reporting period, will be paid to the budget in the next period. However, it must be recognized that there are situations when it is better for an enterprise to choose FIFO, for example, to attract investments, receive bank loans, since financial institutions will evaluate the financial position of the borrower in terms of their ability to return their investment and receive interest and dividends. It should be borne in mind that the chosen method must be applied consistently.

In accordance with the Law on Accounting and Financial Reporting, the use of any valuation methods is allowed if the accounting policy of the enterprise establishes that they allow to accurately reflect the property status and financial results of the enterprise. When using the NIFO method, the value of current assets and cost of sales are closest to current market prices, and, having stipulated the use of this method in the accounting policy, the enterprise has the legal right to apply it in accounting. However, its application raises additional questions: on the credit of which account should the difference between the actual costs of acquiring assets and the estimated prices of the next purchase be attributed to the debit of the accounts that reflect these working capital stocks?

Enterprises have the right to write down those current assets, the price of which has decreased during the year (morally obsolete, or partially lost their original quality) and to reflect them in the balance sheet at the end of the reporting year at the price of a possible sale, if it is lower than the initial acquisition cost, with the difference attributable to prices for financial results. Such a markdown should be made based on the results of the inventory of these values on the basis of the order of the head of the enterprise.

Since an important part of the audit tests is to check the assessment of inventory accounts for distortions, errors, the sequence of application of the chosen method, generalizing the most common violations is one of the areas for improving the audit of current assets.

Another way to improve the audit of working capital is the use of sampling methods, which is based on the use of the audit standard “Audit sampling”. When planning the use of a sampling method, the auditor must decide on the magnitude of: the degree of acceptable risk so that the results of the sample do not lead to an incorrect conclusion (risk of sampling); allowable (acceptable) distortions; and expected misstatements.

The auditor then determines the appropriate sample size using statistical sampling methods or, using non-statistical methods, uses professional judgment in considering the effect of each factor on the sample size. It should be borne in mind that sampling with a high bias tolerance may result in data that are too rough to support a conclusion that the account as a whole is not materially biased. A large sample will also help to detect both frequent and rare distortions contained in a given sum. A small sample can only be reliable for detecting frequent deviations and distortions. As a general population, for example, account 217 “Goods” can be considered. The division of the general population into subsets according to some specific feature (for example, by nomenclature) is called stratification. It is recommended to use it with a high probability within the general population to increase the economic effectiveness of the test (smaller total sample size).

The sample size should be determined in advance, because it is necessary to: take action before underchecking (not getting enough information) or overchecking (getting more data than required), and also control the level of audit costs. Based on this, it is proposed to determine the sample size using the method of monetary sampling and determining the reliability coefficient (R) according to the following formula:

$$R = \frac{P_{ab}}{\sum_{-1}^n x_1}$$

where:  $P_{ab}$  - admissible size of an error in cost expression;  $x_1$  - the value of the  $i$ -th element of the general population in value terms;  $N$  - the number of elements of the general population.

When applying this method, conclusions are drawn on the basis of the absolute size of the errors. The error margin is the maximum level of error that the auditor is willing to accept in relation to the population and still consider that the audit objective has been achieved. For example, an auditor who

considers errors acceptable, the amount of which does not exceed 15 thousand lei, with an amount for the general population of 300 million lei, will deal with reliability (or otherwise the degree of acceptable risk) in the amount of 5%, then the sample size in a monetary sample study will be equal to:

$$N = \frac{R * \sum_{-1}^n x_1}{P_{ab}}$$

where: N - sample size; R - reliability factor.

Sampling can be done using the following methods:

- a) a random number (using a computer program to generate them);
- b) systematic sampling, in which the auditor calculates an interval (n) by dividing the sum over the population by the size of the sample, determining a starting point between intervals 1 and n, and then methodically selects every nth element of the population being tested.

Based on the results of selective testing, the significance of errors in the general population as a whole is assessed. To do this, the error found in the sample must be projected onto the population. The error in the general population can be calculated by the method of average deviations, by the method of outages. However, it is not enough to apply only methods for quantifying the error in the general population. It is necessary to analyze each cost deviation and determine for what reason it arose: due to a misunderstanding of the principles of the accounting report; due to simple mistakes and inattention; due to deliberate fraud or poor management of internal control procedures. It is necessary to evaluate the impact of the identified deviations on all items of the financial statements of the enterprise.

Another way to improve the audit of working capital is to improve the methods of their documentary verification, which includes: checking the compliance of balances of working capital in reporting with accounting registers and the General Ledger; reviewing an account in the General Ledger in order to detect unusual or rare correspondence of accounts, comparing representative financial statements with similar indicators for previous periods (for example, comparing the share of costs in the cost of finished products); analysis of the correctness (completeness, modernity) of posting and disposal of working capital stocks on accounting accounts, including checking for compliance with primary documents, requirements of regulatory documents, accounting policies of the enterprise, consideration of the feasibility of transactions; analysis of supply contracts confirming the company's ownership of working capital stocks or their belonging to third parties, as well as delivery conditions, since the assessment of current assets directly depends on them; verification of the correctness of the distinction in accounting for sources of reimbursement of various costs at the expense of cost, profit and other target sources; distribution of costs between work in progress and finished products in production, the value of distribution costs for the balance of goods in trade was determined; checking the valuation of working capital stocks based on the principle of the lowest valuation (actual cost / market); verification of the correctness of the calculation of the total cost of certain types of working capital, carried out by multiplying the number of values by prices. As a result of summarizing the results of all audit procedures performed, the auditor's opinion is formed, which is documented in the audit report.

The next important direction in improving the audit of working capital is to expand the use of inventory. Documentation and inventory are two elements of an accounting method that, when applied together, provide reliable data on property, liabilities and actual quantity. Inventory is a source of accurate and reliable information about the availability of economic assets, allows you to identify facts that are not documented at the time of their commission (loss of values as a result of natural loss, abuse, theft, errors

in the execution and implementation of warehouse operations), will provide an opportunity to control the activities of materially responsible persons.

The role of inventory in the audit of enterprises is very large. The presence of the auditor at the inventory plays a key role, since the inventory provides reliable evidence of the reality of working capital stocks. The fact is that, contrary to the still occurring practice, when auditors consider it possible not to engage in an inventory at all, believing that an audit is possible without it, in my opinion, without performing the procedures related to the inventory, reporting cannot be confirmed. Sometimes the audited enterprises turn out to carry out an inventory or invite an auditor to it. However, many audit firms insist on their implementation. If the working capital stock is significant and the client refuses to conduct an inventory with the presence of representatives of the audit firm, the auditor should consider issuing a negative opinion or a qualified opinion regarding the stock of current assets.

In the function of the auditor during the inventory goes: presence during the inventory, if the stocks are significant and if the auditor is confident in the expected results; monitoring the implementation of inventory procedures and identification in order to determine the degree of their compliance with regulatory legislative acts and their ability to solve the triple task; ensure the accuracy of inventory results; eliminate double counting and ensure complete coverage of stocks; identify obsolete and slow-moving, as well as damaged stocks; verification of the correctness of the count based on a random sample; verification of the correctness of the description of operations for the reporting period in areas where stocks are moving; obtaining satisfactory explanations for significant inconsistencies with credentials, correcting the latter.

The most common shortcomings in inventory procedures include: non-compliance with the rules for checking weighing instruments; inclusion of an inventory of unverified in kind balances of working capital; release and acceptance of working capital in the process of conducting an inventory without appropriate registration, for example, the absence of marks in receipts and expenditure documents; non-compliance with the rules for checking prices in inventories; carrying out an inventory by incompetent persons.

Inventories are associated with significant losses in turnover and an increase in production (circulation) costs. Reducing the direct and indirect costs of inventory can be achieved by: reducing the number of inventories carried out, carrying out only economically necessary (the positive effect on which exceeds the costs of their conduct) and legally justified inventories; reducing the timing and improving their quality as a result of improving methods; application of sampling techniques. Reducing the loss of turnover in retail trade will allow the rational placement of goods in trading floors and warehouses, in which the minimum number of goods is stored on the trading floor, which allows you to save the time for their re-accounting. An effective policy regarding the level of working capital invested in stocks will reduce the cost of inventorying excess stocks, minimizing transportation costs and the costs of storing excess unnecessary and obsolete stocks.

## **5. Conclusions**

An analysis of ways to improve the audit of working capital allows us to conclude that the most promising direction is the development and implementation in the practice of audit firms of top methods that regulate the sequence of audit procedures. To do this, such tasks as determining the main components of the methodology for auditing working capital stocks should be solved; standardization

of procedures that make it possible to form an audit program for current assets taking into account risk; development of top methods for individual sections of the audit of working capital stocks.

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