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## THE ROLE OF INTERNAL AUDIT IN FRAUD PREVENTION AND DETECTION

**Summary:** *In recent years, good corporate governance has attracted significant attention from the public, regulatory bodies, and the academic community, and the internal audit function has been recognized as a key component of an organization's governance framework. Due to the emergence of increasingly sophisticated forms of fraud, fraud investigation has received growing attention in recent literature. The digital environment has significantly changed the nature of fraud, making it increasingly complex and difficult to detect. This paper analyzes the role of internal audit in fraud prevention and detection. Particular emphasis is placed on the importance of applying advanced technologies that enable faster and more accurate identification of anomalies and traces of fraudulent behavior. This research employs a systematic literature review to examine the role of internal audit in managing fraud risks. The results indicate that the paper contributes to a better understanding of contemporary challenges in fraud risk management from the perspective of internal audit.*

**Keywords:** *fraud, internal audit, prevention, detection*

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## 1. INTRODUCTION

Financial statements represent fundamental documents that comprehensively reflect the financial position of a company and illustrate the effectiveness of management in administering the resources entrusted to them. In addition to serving as a valuable source of information, financial statements constitute the primary channel through which various external stakeholders can evaluate performance and assess a company's growth prospects based on the presented financial information. External users of this information include regulators, investors, creditors, government authorities, and others. The accuracy and transparency of financial information play a crucial role in strengthening trust and maintaining financial stability.

In the contemporary business environment, characterized by increased regulatory expectations, process digitalization, and growing complexity of business transactions, the risk of abuse and fraud represents one of the key threats to the financial stability and reputation of organizations. Addressing these risks requires a systematic and proactive approach, within which internal audit occupies a central position. In this context, it is particularly important to emphasize that auditors must possess expertise in assessing and managing fraud risk for the audit to be effective. Furthermore, independence in fraud reporting is highlighted as one of the factors that enhances the effectiveness of internal audit (Lonto et al., 2023).

Internal audit plays a significant role in prevention and detection through independent and objective assessments of the adequacy of internal controls, risk management, and corporate governance. The tone at the top and the quality of the internal audit function set the pace for the development of an organizational culture oriented toward effective risk management practices. Although primary responsibility for fraud prevention lies with management, a well-established internal audit function contributes to strengthening the control environment, identifying areas of heightened risk, and ensuring the timely recognition of indicators of potential irregularities. In this way, internal audit does not function merely as a mechanism of ex post control, but also as an important preventive instrument in combating fraud and, at the same time, as strong support to strategic management in risk management.

The paper is organized as follows: the first section addresses fraudulent activities as a threat to the financial sustainability of organizations; the second section examines the evolution of the role of internal audit; and the third section discusses the role of internal audit in effective fraud risk management. The paper concludes with final considerations.

## 2. FRAUDULENT ACTIVITIES AS A THREAT TO THE FINANCIAL SUSTAINABILITY OF ORGANIZATIONS

In an increasingly complex and turbulent business environment, fraud has become a significant threat to the sustainability of organizations (Rahman et al., 2024) and represents one of the most topical and widely discussed issues in the contemporary business and social context. According to Milojević (2025:1), “fraud is an act of deviation or omission intentionally committed to deceive other parties who suffer losses or to enable perpetrators to obtain financial gain, directly or indirectly.” Recent studies published in reputable academic and professional journals indicate that a substantial body of research points to the complexity of fraud mechanisms. In general, fraud is an intentional act of deception that benefits certain individuals or groups while causing harm to others. In accounting, two types of irregularities are distinguished: errors and fraud. The main difference between them lies in the element of intent. Namely, fraud detection is often more difficult than the identification of errors, since perpetrators, whether members of management or employees, usually attempt to conceal their fraudulent activities (Anggraini et al., 2019).

Fraud is a serious problem that affects not only public sector organizations but also those in the private sector, as well as non-profit organizations. Fraudulent activities such as financial statement manipulation, asset misappropriation, or embezzlement pose a serious threat to organizational transparency and accountability. In this context, it is particularly important to consider the role of institutional weaknesses, digital technologies, and ethical factors in the emergence and detection of fraud.

Many criminological theories build upon the Fraud Triangle (Cressey, 1950). The Fraud Triangle identifies three interrelated elements that must be present for an individual to commit fraud: pressure, opportunity, and rationalization. First, the personal and professional circumstances of a potential fraudster must create an incentive or pressure that motivates fraudulent behavior. Second, the potential fraudster must perceive an opportunity to commit fraud in situations where control weaknesses increase the likelihood that fraud will be executed and concealed (Akers & Sellers, 2020). Finally, the individual must possess the ability to rationalize the behavior, convincing themselves that fraudulent actions can be justified in some manner.

“Internal audit provides objective assurance and independent insight into the effectiveness and efficiency of risk management, internal control, and governance processes” (Tari et al., 2025:66). Through this assurance, internal auditors can perform several important activities, including identifying control weaknesses,

assessing the effectiveness of existing procedures, and providing recommendations for improvement, with the ultimate goal of reducing fraud risk to the lowest possible level (Usman, 2024). Particular emphasis is placed on the importance of independence in delivering unbiased assessments and oversight of management.

In addition, internal auditors are responsible for the early detection of financial anomalies through routine and forensic audits. "Internal auditors play a strategic role in fostering an organizational culture of integrity and transparency and in reducing opportunities for fraud" (Irianti et al., 2025:141). However, the effectiveness of this role is influenced by factors such as auditor independence, management support, professional competence, and the adequate allocation of resources.

### 3. THE EVOLUTION OF THE ROLE OF INTERNAL AUDIT

In order to adequately monitor the effectiveness of strategy implementation and the achievement of defined strategic objectives, it is necessary to ensure objective and independent control, one of whose key centers is internal audit (Knežević, 2006:169). Internal audit should adopt a systematic approach to assessing the adequacy and effectiveness of internal controls and risk management within organizations. In essence, internal audit functions as a "control of controls," all to contribute to the achievement of organizational objectives.

Internal audit is an important component of the corporate governance structure within organizations (Coram et al., 2006:4), plays a significant role in organizational performance, and is particularly important in detecting accounting fraud. Therefore, companies need to invest in internal audit processes and training to achieve improved corporate performance (Drogalas et al., 2017). When establishing an internal audit function, management must decide whether to engage internal staff or outsource the function to external providers, to ensure a high quality of internal audit services.

The internal audit function may be oriented toward two main directions: assurance and consulting. Internal audit is required to remain objective; however, its consulting role may threaten this objectivity, most likely due to close cooperation with management (Christopher et al., 2009). The transformation of the internal auditor's role toward that of a strategic advisor is becoming increasingly pronounced (Beke Trivunac & Jeremić, 2025).

Internal auditors are expected to detect or prevent material errors within organizations. When effective, they represent significant support to the work of external auditors. With respect to fraud, internal auditors are as aware as external auditors of the likelihood that fraud will be detected (Apostolou et al., 2001).

Reported fraud often indicates serious problems in internal controls and/or governance structures. Poor corporate governance practices have attracted increased attention for several reasons, as they are associated with a heightened risk of abuse and fraudulent activities, weaknesses in internal controls, and destabilization of organizational performance. In cases of financial reporting fraud, there is a high probability that senior management was complicit in the fraudulent activity.

Practice has shown that, initially, organizations with mature data analytics capabilities prioritize internal control and compliance to ensure the proper implementation of new technologies, later shifting their focus toward risk management and IT security (Wagener et al., 2025:47). In the context of financial security, forensic accounting and corporate investigations play a crucial role in detecting and preventing irregularities, improving internal controls, and strengthening the confidence of investors and other stakeholders (Milojević et al., 2025).

#### **4. INTERNAL AUDIT AND FRAUD RISK**

Fundamentally, no activity within a company can be viewed independently of risk. Every organizational activity involves a certain degree of uncertainty inherent to risk, including fraud risk (Karyono, 2013:1). As organizations strive to reduce the incidence of fraud, their fraud prevention and response programs continue to rely heavily on internal audit activities. Over time, through continuous examination of organizational systems, internal auditors develop a comprehensive understanding of business processes, key risks, internal control systems, and employees (IIA, 2009). This accumulated knowledge significantly enhances their effectiveness in identifying and detecting fraud.

As noted by Mitrović et al. (2025:69), “internal control represents a set of defined rules, procedures, and mechanisms aimed at improving business operations,” and it plays a proactive role in reducing and preventing fraud risk. The more effective the implementation of internal controls, the higher the level of prevention of abuse and fraud within an organization. When organizing internal controls, it is essential to address key issues such as policy and procedure development, strengthening governance structures, risk assessment, transaction monitoring, and employee training (Milojičić et al., 2024).

Cook and Clements (2009) expressed concern regarding the insufficient use of best available tools, while simultaneously expressing hope that internal auditors would develop the skills necessary to continue combating fraud through the use of such tools. Data analytics software represents a highly important tool for collecting and visualizing data in innovative ways, ultimately leading to increased

internal audit effectiveness. By enhancing the internal audit function's ability to detect trends, relationships, patterns, anomalies, potential fraud, and data irregularities, data analytics software enables internal auditors to provide a higher level of assurance (Wagener et al., 2025:42).

Certain groups of managers who intend to commit fraud tend to maintain weak internal control systems (Caplan, 1999). This further implies that auditors may expend less effort investigating fraud in weak control environments. In other words, poor internal controls make it more difficult for auditors to detect fraudulent activities (Albrecht et al., 2006). Neglect of internal controls by management may itself be considered a form of fraud.

## 5. CONCLUSION

There is no doubt that the internal audit function represents a vital organizational function, as it adds value. Moreover, its usefulness is reflected in the reduction of errors subsequently identified by external auditors. One of the key ways to reduce fraud within organizations is to enhance the effectiveness of internal audit, which applies equally to both private and public sector organizations. It can be emphasized that fraud detection capabilities are improved in organizations that have integrated the internal audit function into corporate governance compared to those that have not.

Internal audit is evolving from a retrospective control function into a proactive system of organizational intelligence. Increasingly, auditors are engaged in continuous risk forecasting, real-time anomaly monitoring, and providing essential support to strategic managers in the decision-making process. This transformation leads to value creation and innovation, while positioning internal audit as a dynamic force within the corporate governance system and calling for a redefinition of its institutional role and future contributions.

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## FORENZIČKA ANALIZA ZAMAGLJENIH BILANSNIH POZICIJA U KREATIVNOM FINANSIJSKOM IZVEŠTAVANJU

**Sažetak:** U savremenom poslovnom svetu potrebno je posvetiti pažnju forenzičkom računovodstvu zbog problema i manipulacija u finansijskom izveštavanju. Činjenica da vlasnici i menadžment nastoje da daju lažne informacije radi ostvarenja njihovih ličnih interesa predstavlja manipulaciju u finansijskim izveštajima koju treba zakonski urediti koristeći principe i metode forenzičkog računovodstva. Da bi investitori sa sigurnošću i poverenjem mogli da analiziraju finansijske izveštaje, ovi izveštaji treba da sadrže jasne, pouzdane i relevantne informacije o poslovanju preduzeća. U radu će biti izvršena forenzička analiza bilansnih pozicija koje su najčešće izložene manipulacijama i prikazivanju lažnih informacija u finansijskim izveštajima sa ciljem oblikovanja finansijskog rezultata i stvaranja lažne slike o stanju preduzeća.

**Ključne reči:** kreativno računovodstvo, finansijske informacije, manipulacije, forenzička analiza