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Hybrid audit as an innovative approach in the audit practice of forestry

Georgieva, Daniela and Bankova, Diyana

INTERNATIONAL BUSINESS SCHOOL – BOTEVGRAD,
BULGARIA, Police Faculty, Academy of the Ministry of Interior,
Sofia, Bulgaria

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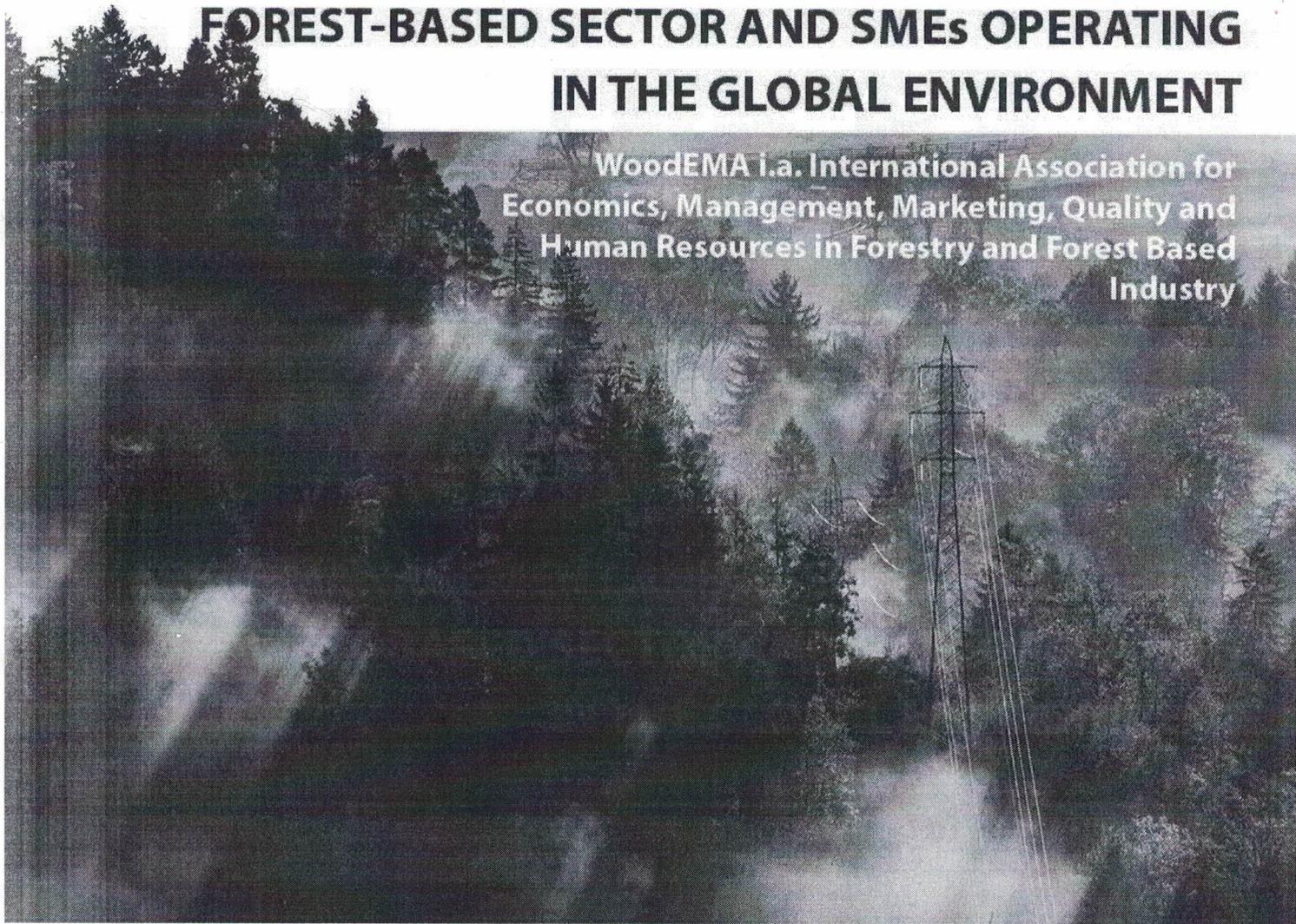
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**CRISIS MANAGEMENT AND SAFETY FORESIGHT IN
FOREST-BASED SECTOR AND SMEs OPERATING
IN THE GLOBAL ENVIRONMENT**

WoodEMA i.a. International Association for
Economics, Management, Marketing, Quality and
Human Resources in Forestry and Forest Based
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HYBRID AUDIT AS AN INNOVATIVE APPROACH IN THE AUDIT PRACTICE OF FORESTRY

Diyana Bankova, Daniela Ventsislavova Georgieva

Abstract: Auditing has undergone many changes in the context of globalization and digitalization. Under the influence of the COVID-19 health crisis, additional restrictions are introduced, which are related to the impossibility of physical inspections (desk checks or on-site ones). This has a significant effect on the activities of sectors and enterprises where on-site inspections are a priority, like in forestry. In order to answer the current challenges, the Forest Stewardship Council introduces a new audit approach, called "hybrid audit". The main goal of the study is to analyze the benefits and risks of hybrid audits in forestry. This will be done by (1) performing a comparative analysis with other types of audit (particularly financial and IT audit) and (2) deriving the characteristics and requirements of the hybrid audit. The study is conducted based on the scientific methods of analogy, analysis and synthesis, induction, deduction, and logical approach. The results of the study outlined the need for specific, local forestry-related rules and methodology of the procedures for the hybrid audit to be developed. Additionally, there is a risk of gaps in the check and verification of the forestry documentation and resources when using the hybrid audit.

Keywords: hybrid audit, forestry, management, risks, benefits

1. INTRODUCTION

Development of the COVID-19 epidemiological situation on a global basis has negative impacts and consequences on a number of sectors, including forestry (Belova and Hristova, 2021, p 46). As a result, many enterprises are facing challenges of different kinds: financial, economic, and social. Health authorities limit restricted physical contact with accountants, lawyers, and managers of the enterprises. This is the reason why the audit community is experiencing increasing difficulties in conducting audit procedures. That negatively affects the internal control environment in the forestry auditor's procedures in terms of identifying gaps, and/or frauds in the forest enterprises and in documenting the tests and performed procedures. Procedures related to the licensing of forestries are characterized by specific audit procedures (preparation for certification, preliminary audit, basic audit for certification, annual audits/inspections, special audits) (WWF booklet, 2016). Due to the difficulties arising from the inability to make physical inspections and audits the Forest Stewardship Council (FSC) is introducing an innovative approach to conducting a "hybrid audit". Hybrid audit is defined as a combination of a remote desk audit and an on-site inspection. This type of audit is still new in audit practice and therefore it is not sufficiently analyzed in the scientific literature. The main objective of this paper is to make a theoretical analysis of the hybrid audit in forestry in terms of some positive and negative aspects of its application. An additional goal is a general comparative analysis of the hybrid audit and the currently applied financial and IT audits to be made. The object of research is the audit procedures in forestry, and the subject of analysis is the hybrid audit proposed by the FSC. To achieve this goal, the authors set the following research tasks:

- To outline the nature of hybrid audits by distinguishing it from the other types of applied audits, more precisely financial and IT audits.

- To identify the benefits and negative aspects of introducing the hybrid audit into forestry practice.

The used scientific methods and approaches in the current study are: logical, deductive, and comparative methods, as well as the methods of analysis and synthesis. The results of the study contribute to the literature by presenting the possibilities of using hybrid audits in forestry. As a limitation of the study, it can be pointed out the fact that it presents a theoretical basic based on collected secondary data, due to the lack of practical research as the hybrid audit is still a new method.

2. SIGNIFICANT RISKS AND GAPS IDENTIFIED IN THE FORESTRY

The audit function needs to be updated at all times concerning external and internal factors (external and an internal audit) that affect the subject matter of the audit. The audit is widely used and can have various manifestations: medical audit; human resources audit; marketing audit; audit of corporate social responsibility, social audit, and others. The use of relevant audit procedures and types of audits depends on the specific risks and activities being checked. In the specialized literature it is outlined specific risks and issues of audit in forestry (A framework for audit quality key elements that create an environment for audit quality, 2014; Auditing Forests: Guidance for Supreme Audit Institutions, 2010; Audit guideline on fraud, 2014; Nicorescu et al, 2021, p. 2). Generally among the significant risks are: the way information is received (including in-field observation); the selection of appropriate procedures, requiring the use of appropriate tools and technologies, by the specifics of the activity; the results of the performed procedures; key actions for the preparation of the financial statements and contextual factors, public opinion, factors influencing external audit fees. Studies of audit reports to the financial statements of forestries in Bulgaria (Georgieva and Bankova, 2020) are indicative of reported issues related to the disclosure of contingent assets and liabilities, the real value and impairment of assets, problems in the activities of companies, income and expense reporting, as well as the receivables and liabilities of the forestry. Georgieva and Bankova (2020) point out that it is important to pay attention to human and institutional capital as well, including management, government, consumers, and regulators. This requires further analysis of risks such as: the risk of attempted fraud (documentary, on the field checks, or interviews); intervention by forestry management staff; risks associated with incorrect accounting and valuation of biological assets (as required by International Accounting Standards (IAS 41), changes in the size of the land, etc., risk of lack of information, risk of lack of long-term financial strategy. In this respect, it is necessary to pay more attention to the methodological problems that arise. It is necessary for each country that certifies its forestry to have updated standards according to which the licensing is related to the emerging risks that take place.

3. OPPORTUNITIES FOR APPLYING FINANCIAL, IT, AND HYBRID AUDITS IN FORESTRY IN THE CONTEXT OF COVID-19

To prevent the previously outlined risks, a fundamental type of audit is the financial audit, which is introduced in many countries after the Great Depression of 1929 (Veysel, 2017). It has wide application and implementation due to changes in the structure and contents of the

financial statements and the possibilities of financial crimes. For managerial use, a financial audit is an insufficient form of control and prevention of abuse and fraud. The reason is related to the weaknesses in the control environment (a common weakness is documentary fraud) and the development of digitalization, leading to new risks and types of fraud, including cybercrime. Cybercrime is causing significant losses, especially during the pandemic situation with COVID-19. This requires additional investment in the prevention of cybercrime in each sector (Bankova, 2020). To meet the challenges of globalization and digitalization, the so-called "IT audit" and "hybrid audit" are emerging, which have an important role in the management of digital processes in forestry. IT audit helps enterprises to better protect their assets by identifying gaps and vulnerabilities in these systems, which lead to inconsistencies with generally accepted information, security guidelines, and good practices. The IT audit provides an objective assessment of the effectiveness of the currently applied controls (the strategic and operational decisions and mechanisms for data protection adopted by the organization) against existing and emerging threats. Information security analysis examines the protection of assets and data, administration and levels of access, information security policies, as well as ensuring business continuity assurance and contingency planning, disasters, and emergency planning. Except for the quality assurance standards (ISO 9001:2015-Quality Management System and ISO 19011:2018 Guidelines for auditing management systems), additional audit oversight of forestries is necessary. The FSC, which is the official international licensing authority for forestry, is taking into account the emerging risk related to coronavirus in the forest sector. New approaches are being sought for the exercise of the licensing and auditing function in the forestry sector, based on the following weaknesses identified by INTOSAI (2020) for unsustainable forest management - Biodiversity and Ecosystem Loss, Forest fires, Illegal Logging, Illegal use of land, Disasters, Conflict, Revenue loss, Livelihood loss, Social problems, Decreased carbon storage, Reduced water quality, Shortage of raw materials for industry. Because of that on November 20, 2020, a new united audit method was approved called "hybrid audit". It is an innovation for forestries and their managers, related to receiving license certification by certification auditors. This type of audit is described in COVID-19 Policy Responses as a united approach to conducting remote work (online meetings, interviews, and on-site inspections). The reason is to minimize the risk to public health, as well as to limit travel and physical contact with other people.

Procedures of the hybrid audit are performed by a qualified person. It is necessary primarily for an auditing plan (audit program) to be developed. This process, as required, must describe which part will be performed on the field and which one online - from distance. It is also necessary to make a risk assessment of the hybrid process, by determining the degree of risk ("high", "medium", "low") for the procedures performed by the auditor (FSC, COVID-19 Policy Responses, p. 11-12). Depending on the identified risk, an audit approach is chosen (one-stage and two-stage). According to item 6 of the COVID-19 Policy Responses (p. 14.), the hybrid audit must include a „qualified audit team leader managing the audit remotely; technical expert(s) and/or qualified auditor(s) on-site to obtain audit evidence; virtual video meetings between the remote audit team leader and the organization/on-site team member(s); interviews with relevant managers, employees, contractors and other stakeholders (remotely and/or on-site; review of relevant documents and records (remotely and/or on-site); conducting the opening and closing meeting of the hybrid audit with physical/virtual presence of the full audit team (auditors and local experts) together with relevant staff of the organization, and other

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available information". Supervision after the procedures of certification of forestries should also not be underestimated. For this reason, the FSC unifies and digitizes audit reports in different languages (German, English, Spanish, French, Japanese Portuguese, Russian, Ukrainian, and Chinese), and the certification body facilitates access to information. With the use of the new option (the hybrid audit), the licensing authorities apply procedures that are a compilation of external audits. It is carried out based on a remote form, as well as for specific components on-site inspections that are performed at the discretion of the audit team. Nicorescu et al (2021, p.10) state that "the higher the number of auditing days, the higher the use of online and hybrid approaches". Without claiming to be an in-depth comprehensive analysis, Table 1 presents the author's view on the possible benefits and negative aspects of the implementation of financial, IT, and hybrid audits in forestry. The analyzes are done based on some specifics of the forestry sector activities outlined in the scientific literature (Chobanova et al, 2018; Jelačić, et al, 2010; Gejdoš and Potkány, 2015; Popova, 2018).

Table 1. Types of audits in forestry

Type of audit	Audit objectives	Benefits of using the approach	Negative aspects of using the approach
Financial audit	Review of financial statements and accounting policy, accounts, disclosures, and business processes.	- Inspection from an independent certified public accountant ; -Review of accounting documents and policy.	Lack of mandatory audit companies rotation.
IT audit	Inspection of IT controls.	- Ability to detect mistakes in electronic platforms.	There is a lack of standards for IT audits in forestry.
Hybrid audit	Hybrid inspections with desk checks or on-site.	- Developed COVID-19 Policy Responses (2020). Collection of derogations, interpretations, and frequently asked questions, FSC International Canter; - Possibility to work from distance (Teleworking); - Prevention of infection with COVID-19, etc.	- Requirement to develop local rules and methodology for hybrid audit; - Probability of failure to review documentation on-site; - Review of assets, inventories, etc.

From Table 1, it can be stated that each of the analyzed types of audits has weaknesses for further improvement. In the financial audit, it is necessary to implement rotation about the auditor performing a financial audit of the specific industries like forestry. This method will minimize the risk of neglecting audit procedures. About the reflected finding for the IT audit of forestry - it is difficult to unify the needed framework. The reason is that each forestry has an individual management structure. However, it is necessary to have minimum criteria and requirements for IT controls in forestry. The hybrid audit is a way to unite financial audit and IT

audit. The aim is for audit procedures under the licensing regime to be easier to implement. It is important a check on the IT systems and the possible weaknesses that will arise due to the lack of standardization of digital processes to be done. However, the use of the hybrid audit requires additional IT knowledge related to the used software not only by the auditors but by the relevant stakeholders involved in the different audit procedures. This leads to the need for additional skills and resources. The lack of relevant local rules and methodology will lead to a significant time to be developed and implement the reliable and unitized procedures. We should not neglect the fact that there are many people in the field (from the management, staff, control institutions, etc.) who can refuse the new approach, as it is part of the overall psychology of people when implementing something innovative. Another issue could come in terms of gaining companies' trust when implementing the hybrid audit. In this respect, this type of audit is still not mature enough, so it could reflect a lack of understanding by the managerial staff of the companies.

4. CONCLUSIONS

In a conclusion, it can be stated that the digitalization of inspections and checks through hybrid audits facilitates the process of certification of forestry. This approach can preserve the health of employees, which is fundamental in the conditions of COVID-19 or other health crises, but also in other conditions that prevent the possibility of physical documentary and field inspections. Despite the outlined positive aspects, there are indications that a hybrid audit leads to a risk of introducing asymmetric information. This requires additional technical knowledge from auditors who will apply the hybrid approach to forestry inspections. Additionally, financial resources need to be provided to ensure cyber protection of key information from forestry activities. Subsequent research on the issue should be aimed at a more detailed analysis of the benefits and weaknesses of conducting a hybrid audit, based on primary and secondary data collected and analyzed by the implementation of the necessary hybrid audit procedures.

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Authors address:

Bankova, D.¹; Georgieva, V. D.²

¹Counteraction to Crime and Public Order Protection, Police Faculty, Academy of the Ministry of Interior, Sofia, Bulgaria, International Business School, Botevgrad, Bulgaria

²International Business School, Botevgrad, Bulgaria

^{*}Corresponding author: diyanabankova@gmail.com, danielagr999@gmail.com