RISK-MANAGEMENT CHALLENGES AND AUDIT SOLUTIONS IN THE BANKING SECTOR

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Abstract

Financial audit in the banking sector plays a vital role in ensuring financial integrity and in managing the risks encountered by financial institutions. Banks are exposed to a wide range of financial, regulatory, and operational risks, and financial audit supports the identification, assessment, and mitigation of such vulnerabilities. This article explores the main challenges affecting financial audit in the banking sector and proposes solutions aimed at improving audit practices in the context of increasingly complex risk structures and continuously evolving regulations.
Financial audit within the banking industry represents a crucial instrument for guaranteeing the integrity of the financial system, preventing fraud, and strengthening public confidence. Considering the complex, volatile, and inherently risky nature of banking activities, financial audit requires sophisticated methodological approaches, strict standards, and advanced risk-analysis capabilities.
This paper presents the conceptual and legislative framework applicable to financial audit in the banking sector, analyzes the major challenges generated by market evolution and digitalization, evaluates possible solutions for risk management, and includes a comparative case study based on the Romanian banking sector. The conclusions highlight the need for an integrated approach grounded in modern technologies, continuous professional development, and consolidated internal control environments.

Keywords: *audit, performance, baning, challenges, solution, risk*
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The banking sector is a fundamental pillar of modern economies, and its stability is indispensable to the proper operation of the entire economic system. In this context, financial audit plays a central role in ensuring transparency and financial integrity in banks. These institutions face various risks credit, liquidity, market, regulatory requiring auditors to identify and assess risk exposures accurately. Furthermore, recent technological developments and increasingly stringent regulatory requirements generate new challenges for audit professionals.

The banking sector is one of the most highly regulated areas of the economy, exerting a direct influence on the stability of financial markets, consumer confidence, and macroeconomic processes. Through its essential role in financial intermediation, the sector is exposed to major risks: credit, market, operational, liquidity, and reputational risks.

In this context, financial audit plays a fundamental role in monitoring compliance with prudential regulations, assessing the fairness of financial statements, and preventing systemic risks. The complexity of financial instruments, accelerated digitalization, and regulatory evolution amplify the need for professional, modern, and adaptable financial audit practices.

Research Objectives. This study aims to:

1. Analyze the regulatory framework for financial audit in the banking sector;
2. Identify the main challenges encountered by banking auditors;
3. Highlight modern solutions for risk management during audit procedures;
4. Conduct an illustrative case study from the Romanian banking system;
5. Formulate conclusions on the role of financial audit in ensuring stability within the banking system

The research methodology combines qualitative and quantitative techniques typical of economic sciences, emphasizing documentary analysis and case study methods. The primary purpose of the methodology is to correlate theoretical principles with the practical reality of financial audit in the banking sector, in order to identify the major challenges and related solutions for risk management.

The research is descriptive-analytical, focusing on the conceptual analysis of financial audit in the banking sector, assessment of the legal and institutional framework and identification of practical problems and solutions related to risk management.

Given that banking audit comprises both theoretical and operational components, the study adopts a mixed approach:

- **Qualitative:** analysis of regulations, official documents, institutional reports, and academic literature;
- **Quantitative:** analysis of risk indicators and interpretation of data published in banking reports.

1. Challenges of Financial Audit in the Banking Sector

Financial audit in the banking sector is carried out within an operational environment characterized by high complexity, risk exposure, regulatory pressure, and accelerated technological transformation. For these reasons, auditors face a series of challenges that may affect audit quality, professional independence, accurate risk assessment, and the capacity to formulate reliable conclusions.

The main challenges include:

- The increasing complexity of financial instruments affects auditors' capacity to correctly evaluate derivatives, securitized portfolios, or other sophisticated products that rely on advanced mathematical models and market-sensitive assumptions.
- Evaluating loan portfolios remains one of the most difficult tasks, as estimating expected credit losses (ECL) is influenced by external factors (macroeconomic conditions) and internal variables (data quality, statistical modelling).
- Accelerated digitalization exposes the banking system to significant cyber risks. Auditors must understand IT architecture, data security, and business continuity mechanisms to correctly assess operational risks.
- Dependence on predictive models introduces uncertainty, as models can be inaccurate, insufficiently validated, or based on optimistic assumptions, thus generating estimation errors.
- Complex and dynamic banking regulations (Basel III, IFRS, CRD IV) challenge internal harmonization processes and require continuous professional updating.
- Fraud risk remains a persistent threat, both internally (data manipulation, unauthorized transactions) and externally (cyberattacks, financial schemes), necessitating advanced detection methodologies.
- Management pressure can affect audit independence, particularly when auditors face resistance against reporting major deficiencies during periods of economic stress.
- Tight deadlines and large data volumes may reduce the quality of audit procedures by limiting time allocated to analysis, testing, and documentation.
- Poor organizational culture can hinder audit activity, especially where internal transparency is low or where tolerance of risky practices is present.

These challenges arise from the specific nature of financial activities, elevated exposure to systemic and operational risks, and structural transformation within the sector.

The complexity of banking products requires auditors to master sophisticated evaluation methodologies, interpret risk models, and understand rapidly evolving economic phenomena. Loan portfolio evaluation a core element of financial analysis is affected by market volatility and changes in consumer behavior.

Accelerated digitalization, while generating operational efficiencies, creates vulnerabilities that may compromise data integrity and confidentiality. Without robust security mechanisms, exposure to cyberattacks may affect banking operations and the reliability of data used in audit procedures.

At the same time, market conditions and increasingly sophisticated regulatory requirements generate pressure on auditors, compelling rapid adaptation and continuous professional development. The complexity of the regulatory framework may hinder the implementation of audit recommendations and complicate compliance processes.

Auditors' responsibilities increase as fraud risks grow becoming more inventive and harder to detect thus imposing the use of advanced analytical tools (AI, data mining) and close collaboration with IT experts. Internal pressures (e.g., managerial influence), combined with time constraints, can affect auditor independence and objectivity, reducing the value of audit as a financial protection instrument.

Finally, organizational culture plays a decisive role: institutions with a strong culture of compliance and transparency grant auditors easier access to information, fostering a healthier environment; whereas weak organizational cultures generate additional risks by obscuring critical information.

Tabel 1 — Synthesis of Major Challenges in Banking Financial Audit

Challenge	Main Causes	Implications
Complexity of financial instruments	Advanced models, derivatives	Incorrect valuations, misreporting
Credit portfolio	Sensitive ECL models, volatility	Under-provisioning, systemic risk
Digitalization	IT vulnerabilities, big data	Financial losses, disruptions
Dependence on predictive models	Questionable assumptions	Inconsistent estimates
Complex regulations	Frequent updates, multiple standards	Non-compliance, administrative burden
Fraud	Complex schemes, external attacks	Losses, reputational damage
Pressure on auditors	Managerial interests	Compromised independence
Tight deadlines	Data volume	Insufficient analysis
Organizational culture	Low transparency	Limited access to data

The challenges encountered in the financial audit of the banking sector are multidimensional and directly influence the quality and relevance of the conclusions formulated by auditors. They originate from both internal factors (organizational culture, internal control, risk management) and external factors (market conditions, regulatory requirements, technological trends).

To ensure an efficient, unbiased, and reality-adapted audit process, it is necessary to:

- strengthen auditors' competencies,
- implement modern technologies,
- maintain continuous alignment with regulatory frameworks,
- promote an ethical organizational culture.

Only through an integrated, prevention-oriented approach can banking financial audit effectively contribute to safeguarding the stability of the financial system and enhancing public trust.

2. Approaches and Solutions for Combating Risk in Banking Financial Audit

The risk management in banking financial audit is a complex process, interconnected with internal control functions, corporate governance, and the supervisory framework. The fundamental role of auditors is to assess the accuracy of financial statements in the context of continuous exposure to systemic, operational, credit, and reputational risks. This section examines the main approaches used to manage risk, as well as modern solutions applicable in banking practice.

✓ **Strengthening Internal Control**

A key solution for mitigating risks is strengthening internal control. By establishing clear procedures for approving transactions, verifying documentation, and restricting access to internal systems, banks can significantly reduce errors, fraud, and intentional manipulation. Auditors evaluate not only the formal existence of procedures but also their effective implementation in daily activities. A strong internal control environment facilitates the prompt detection of irregularities, ensuring transparency and accountability.

Example: The application of the "four-eyes principle" for approving significant transactions is a requirement outlined in the EBA (European Banking Authority) Guidelines on internal governance. This obliges credit institutions to ensure that every major financial approval is verified by at least two individuals, thereby reducing the risk of fraud or error.

✓ **Rigorous Evaluation of Credit Portfolios**

Another major solution involves rigorous assessment of credit portfolios. Since lending is the primary source of risk, auditors examine whether banks grant credit based on objective criteria and whether they systematically monitor clients facing financial difficulties. Reviewing provisions for loans with high default risk helps preserve financial stability by preventing substantial losses. Proper portfolio evaluation supports early problem identification and timely preventive measures.

Example: The National Bank of Romania (NBR) publishes annually, in the Financial Stability Report, analyses concerning the evolution of non-performing loans (NPLs). In Romania, the NPL rate was a major concern after 2009–2015, and prudential rules imposed strict evaluation of portfolio quality and disposal of non-performing assets, significantly reducing systemic risk.

✓ **Use of Stress Testing**

Stress testing is a fundamental method for analyzing vulnerabilities. By simulating adverse economic scenarios — such as interest rate hikes, currency depreciation, or a significant increase in non-performing loans — banks can anticipate how key financial indicators would perform under stress. Auditors evaluate the outcomes of these simulations to determine whether banks maintain sufficient capital buffers and effective response strategies.

Example: In the 2021 and 2023 EBA stress tests coordinated with the European Central Bank (ECB), significant institutions across the EU were subjected to severe recession scenarios. The aggregated results, which were made public, showed that the European banking sector generally maintained adequate capital levels, although certain banks were required to strengthen reserves.

✓ **Integration of Technology in Audit Processes**

Technology plays a crucial role in risk mitigation. Modern IT systems enable fast analysis of large datasets, automatic detection of suspicious activities, and validation of reporting accuracy. Using digital tools allows auditors to identify anomalies more quickly, shortening inspection time and increasing analytical precision. This solution is indispensable considering the growing volume and complexity of financial transactions.

Example: The implementation of electronic transaction-monitoring systems (AML transaction-monitoring systems) is a legal requirement for all credit institutions in Romania under anti–money-laundering regulations. These systems automatically generate alerts when suspicious transactions are detected, which are subsequently reported to the National Office for the Prevention and Control of Money Laundering (ONPCSB).

- ✓ **Validation of Risk Models**

Banks frequently rely on mathematical models to estimate default probability and expected credit losses (ECL). Validating these models is essential to prevent systemic errors. Auditors verify whether models rely on real data, if assumptions are plausible, and whether the results are consistent with observable market outcomes. Periodic validation ensures that assumptions are updated and estimations adjusted in line with changing economic conditions.

Example: Annual reports of major banks in Romania include public disclosures on revisions to ECL models based on macroeconomic developments. During 2020–2022, in the context of the COVID-19 pandemic, many European financial institutions updated their macroeconomic scenarios used in ECL modeling, increasing provisions for expected losses.

- ✓ **Continuous Professional Training**

Another important solution concerns ongoing training for bank employees and auditors. The banking environment evolves rapidly, and the emergence of new financial products and digital technologies requires constant skills upgrading. Training programs enhance analytical capacity, deepen understanding of emerging risks, and encourage best-practice adoption.

Example: The European Banking Authority (EBA) regularly organizes specialized training courses for professionals from credit institutions, covering ESG-related risks, digitalization, and AML/KYC topics. Furthermore, most major banks operating in Romania report employee training initiatives in their annual reports.

- ✓ **Cooperation Between Internal and External Audit**

Colla boration between internal and external auditors represents an effective means of strengthening risk-control processes. Internal audit teams possess in-depth knowledge of ongoing operations, while external auditors provide independent and objective assessments. Combining these perspectives allows for a comprehensive evaluation of risks, reduces overlap, and ensures consistent recommendations.

Example: EBA's internal governance guidelines mandate cooperation between internal and external audit functions to facilitate the exchange of information required for comprehensive risk assessment. This practice is also reported in the annual reports of major Romanian banks.

TABEL 2 — Solutions for Combating Real Risks

Solution	Explanation	Main Benefits
Strengthening internal control	Clear rules, continuous verification	Prevents fraud and errors
Credit portfolio evaluation	Client analysis and provisioning	Reduces losses
Stress testing	Simulation of crises	Preparedness for adverse conditions
Technology in audit	Digital systems for analysis and control	Rapid identification of issues
Model validation	Verification of model accuracy	Avoids misestimation
Continuous training	Ongoing staff development	Adapts to emerging risks
Internal + external audit	Integrated collaboration	Stronger control

In conclusion, the solutions for mitigating real risks in banking financial audit serve to prevent significant losses, protect customers, and maintain the stability of financial institutions. The combination of internal control, rigorous credit evaluation, adverse-scenario simulation, the use of modern technology, periodic model validation, continuous training, and cooperation between internal and external audit ensures a comprehensive and effective approach to managing banking risks.

Conclusions

The conclusions indicate that the effectiveness of the audit process and risk management depends directly on the quality of internal controls. Banking institutions that apply the "four- eyes principle," as stipulated in EBA guidelines on internal governance, demonstrate a higher level of procedural discipline and a lower appetite for operational risk. Moreover, mechanisms for monitoring credit portfolios imposed by IFRS 9 requirements and supervised through periodic NBR reports have proven essential in limiting losses generated by non-performing loans.

Stress tests coordinated by the ECB and EBA constitute a central instrument for evaluating the resilience of banks under adverse scenarios. Publicly available results from the 2021–2023 exercises confirm that the European banking sector generally holds sufficient capital levels, but that certain institutions remain vulnerable under severe shock conditions, justifying proactive recapitalization measures.

Beyond traditional financial considerations, the integration of digital technologies within banking activities has created new vulnerabilities. The implementation of AML/KYC systems following Directive (EU) 2015/849 and Law 129/2019 in Romania demonstrates the need for continuous technological oversight. Audit plays a critical role in evaluating both the design and the operational efficiency of such systems to prevent fraudulent transactions and money-laundering risks.

The conclusions also highlight the importance of periodic validation of risk models. The recalibration of IFRS 9 ECL models during the COVID-19 pandemic revealed how sensitive such estimates are to macroeconomic changes, reinforcing the proactive role auditors must play in testing assumptions, verifying data quality, and validating results.

Another key aspect is the need for continuous professional development among bank personnel and auditors, particularly given the rise of digital transformation and emerging ESG and cyber risks. Educational programs promoted by EBA and the National Bank of Romania contribute to professional harmonization, enabling a multidisciplinary approach to risk.

Finally, cooperation between internal and external audit has been identified as a determinant factor in increasing risk-assessment efficiency. Information exchange and methodological alignment provide a more complete view of institutional vulnerabilities, reducing overlaps and fragmentation in analysis.

In conclusion, banking financial audit is undergoing a structural redefinition driven by convergence among regulatory, technological, and global economic forces. System stability depends on a coordinated application of integrated solutions: strong internal governance, rigorous credit-portfolio assessment, robust resilience testing, advanced technology adoption, continuous model validation, ongoing professional development, and sustained professional collaboration. Their unified implementation strengthens public trust, enhances transparency, and supports the long-term resilience of the banking sector in an environment characterized by uncertainty and volatility.

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