

WESTERN INDIA REGIONAL COUNCIL OF ICAI

Introduction to Fraud and Forensic – Professional Opportunities for Chartered Accountants

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Focus Areas

- Forensic Accounting
- Need for Forensic Accounting
- Assignments undertaken
- Fraud Examination
- Type of Frauds

Focus Areas

- Causes of Frauds
- International Guidelines
- Reporting

Forensic Accounting

- **Forensic**, according to the Webster's Dictionary means, "Belonging to, used in or suitable to courts of judicature or to public discussion and debate."
- **Accounting** means, "a system that provides quantitative information about finances" (WordNet 2.0)

Forensic Accounting

- **Forensic Accounting**, according to American Institute of Certified Public Accountants (AICPA) means “the application of accounting principles, theories and disciplines to facts or hypothesis at issues in a legal dispute and encompasses every branch of accounting knowledge.”
- **Forensic Accounting** provides an accounting analysis that is suitable to the court which will form the basis for discussion, debate and ultimately dispute resolution

Need for Forensic Accounting

- Investigative Accounting.
- Litigation Support.

Need for Regulations

- Major Frauds.
- Reduced faith on Auditors.
- Need for stricter controls
- Enhanced Reporting requirements

Need for Forensic Accounting

- Investigative Accounting.
- Review of the factual situation and provision of suggestions regarding possible courses of action.
- Assistance with the protection and recovery of assets.
- Co-ordination of other experts, including:
 - Private investigators;
 - Forensic document examiners;
 - Assistance with the recovery of assets by way of civil action or criminal prosecution.

Need for Forensic Accounting

- Litigation Support.
- Assistance in obtaining documentation necessary to support or refute a claim.
- Review of the relevant documentation to form an initial assessment of the case and identify areas of loss.
- Assistance with Examination for Discovery including the formulation of questions to be asked regarding the financial evidence.

Need for Forensic Accounting

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- Attendance at the Examination for Discovery to review the testimony; assist with understanding the financial issues and to formulate additional questions to be asked.
- Review of the opposing expert's damages report and reporting on both the strengths and weaknesses of the positions taken.
- Assistance with settlement discussions and negotiations.
- Attendance at trial to hear the testimony of the opposing expert and to provide assistance with cross-examination.

Need for Forensic Accounting

- Reduced faith on Auditors.
- Auditors are normally considered as coast guards of the financial ocean of the country.
- Auditors perform an extensive job under the given guidelines, but when it comes to fraud detection, the liability normally is fixed upon the management of the organisation.
- Auditors normally go through the audit process mechanically (Form over substance). They usually see what is shown to them.

Need for Forensic Accounting

- Auditors work on a materiality concept, thus in case an item does not have an impact on the financial statements, they are generally skipped from the audit process
- Review of the Audit is normally based on assumptions.

Assignments Undertaken

- Criminal Investigations
- Stakeholders' and Ownership Disputes
- Insurance and other claims
- Business related Fraud Investigations
- Matrimonial Disputes
- Professional Negligence

The above is an illustrative list

Fraud Examination

- **Fraud** is the crime or offense of deliberately deceiving another in order to damage them – usually, to obtain property or services unjustly. [1] Fraud can be accomplished through the aid of forged objects. In the criminal law of common law jurisdictions it may be called "theft by deception," "larceny by trick," "larceny by fraud and deception" or something similar.
- **Audit**, means, "an evaluation of a person, organization, system, process, enterprise, project or product."
- **Fraud Audit** is the thorough study, inspection or analysis of an issue relating to fraud

Type of Frauds

- Corporate Frauds
- Banking Frauds
- Credit Card Frauds
- Internet & E-mail Frauds
- Matrimonial Frauds
- Securities Frauds
- Employment Frauds

The above is an illustrative list

Causes of Frauds

The Fraud Triangle

Pressure



Perceived Opportunity

Rationalization

Source : Indiaforensic.com

International Regulations

- Sarbanes Oxley Act, 2002 (SOX)

International Guidelines

➤ ICAI

➤ IAASB

➤ AICPA

➤ European Court of Auditors

➤ IIA

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Objectives

- Prevention
- Detection
- Response

Fraud Detection

- Field Standards
- Identifying Red Flags
- Reporting Standards

Field Standards

- Planning
- Supervision and Review
- Study and Evaluation of Internal Controls
- Compliances with Applicable laws and Regulations
- Audit Evidence

Skill Sets

- Qualifications and Experience.
- Knowledge and command of all relevant legal provisions including Criminal and Civil and also well versed with the legal system and the court procedures.
- Ability to go beyond the numbers and be analyse substance over form.
- Ability to reconstruct past records.
- Ability to critically analyze financial statements.

Skill Sets

- Proficiency in Information technology and computer applications.
- Knowledge of psychology in order to understand the thinking and motive behind criminal behavior and to set up prevention programmes that motivate and encourage employees.
- Curiosity, persistence and creativity.
- Confidence to maintain his composure when acting as a witness.
- A good professionally trained team to assist him in his work

Planning

❖ Potential Fraud Risk Areas

- Obtaining understanding of the organization; general environment, individuals etc.
- Past reports of auditors or other sources.

❖ Identifying Fraud Areas

- Discussions with Management and those charged with Governance
- Document preventive and detective controls
- Tolerance to malfeasance in the organization
- Presence of factors contributing to fraud; incentives/pressures, opportunities or attitudes/rationalisation

Planning

❖ Action Points

- Identifying Red Flags
- Check whether adequate controls exists.
- Defining audit procedures
- Finalise scope of audit
- Identify qualified audit team
- Discuss with Audit team

Identifying Red Flags

- Difference between error and Fraud
- Professional Skepticism

Potential Red Flags

❖ Human Resources

- Unusually high turnover among
- Improper segregation of duties
- Concentration of Power
- Gifts from Vendors and customers
- Personnel not taking leave or staying at home when sick
- Unusual Display of wealth
- Dissatisfaction amongst staff

Potential Red Flags

❖ Finance

- Excessive interference of Superiors
- Incomplete or late recording of transactions
- Cash payment receipts or acquittance with similar signatures.
- Documents missing and / or altered.
- Significant unexplained items in reconciliation statements

Potential Red Flags

❖ Sales & Revenues

- High variations in periodical bookings of Revenues
- Excessive overdue receivables
- High Revenue Fluctuations compared to corresponding periods

Potential Red Flags

❖ Procurements

- Insufficient competition
- Complaints from potential suppliers about unfair practices in award of tenders
- Excessive use of exceptional procurement process
- Size of contracts
- Complaints about sub-standard goods
- Ex employees functioning as executives of vendors
- Use of intermediaries or agents

Potential Red Flags

❖ Tendering

- Manipulation of procurement thresholds to avoid prior review
- Contract amounts just below the threshold for competitive bidding
- Inadequate bid evaluation criteria or procedures.
- Bidding documents not made available to all prospective bidders
- Short or inadequate notice to bidders

Potential Red Flags

❖ Tendering (Cont'd)

- Similarities and Common pattern in bids.
- Unsealed bids or bid-opening procedures not transparent
- Lack of Transparency in process.
- Delivery of poor quality goods, services or works
- Frequent contract amendments or acceptance of unreasonable demands of the vendor
- Payments made without matching invoices.
- Unusual amendments in invoices

Potential Red Flags

❖ Inventory and Assets

- Excessive Inventory
- Missing or incomplete inventory or assets Weak control over physical assets
- Disposal of assets not documented
- Undervaluation on sale of Assets
- Frequent repairs to assets

Supervision and Review

- Rely more on substantive testing after proper sampling
- Perform analytical procedures
- Surprise visits to warehouses to check inventory or stocks
- Check bank accounts or cash accounts without prior notice
- Use market data, if possible, for validating prices and costs
- Search payroll records for duplicate entries
- Survey disaggregated set of beneficiaries

Evaluation of Internal Controls

- Discuss with those charged with Governance
- Study and document existing controls
- Identify any redressal mechanism
- Whistle blower policy
- Test controls
- Document results

Compliance with Laws

- List out laws applicable
- Examine compliance of various laws
- Document any variation
- Test seriousness of variation

Audit Evidence

- Compile and document evidence collected
- Analyse and Evaluate utility of individual evidences
- Corroborate and counter verify
- Analyse Substance over form

Reporting Standards

- Title
- Addressee
- Subject Matter
- Objectives and Scope
- Main Report
- Legal basis and timeliness
- Signature and date

Disclaimer

- The above presentation is compiled with data inputs from
 - India Forensic Research Centre, Pune
 - Wikipedia, the free encyclopedia
 - Fraud Examiners Manual by ACFE, USA
 - The Journal of Forensic Accounting
 - Auditing Standards from INTOSAI.
 - Prof. Jagbans Singh
 - Standards issued by European Court of Auditors, AICPA, IAASB and ISSAIAnd ideas and inputs from various writers, friends and well wishers
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