

Lights, Camera, Investigation – An Insight to World beyond Reports in Forensic Investigations

A PRESENTATION FOR WIRC-ICAI
02/07/2021

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Forensic Audits –Appointment Authorities

- Banks
- Insurance Companies
- Government Departments: SEBI, EOW, ED, CBI, SFIO Etc.
- PSUs
- Corporates
- Others
- Normally have wide Coverage than Transaction Audits under IBC, 2016

INDICATIVE CONTENTS FOR FORENSIC AUDIT REPORTS

- INDEX
- ABBREVIATIONS
- BACKGROUND
- DISCLAIMER
- EXECUTIVE SUMMARY
- DETAILED REPORT ON TRANSACTIONS
- SUMMARISATION OF OBSERVATIONS
- CLASSIFICATION & OPINION
- PHOTOGRAPHS & VIDEOS
- SUPPORTING ANNEXURES

THE PROCESS

- Invitation from Appointment Authorities for Quotation or EOI
- Submission of Quotation / EOI
- Appointment & NDA Signing
- Forensic Audit Process
 - Managing the Promoters and KMPs / the Auditees
 - Data Integrity
 - Offsite Audit
 - Onsite Audit
 - Third Party / Sources Information
 - Benchmarking of Transactions
 - Interviews & Key point discussions
 - Classification of Transactions
- Draft Report Preparation & Submission
- Presentation Before Appointment Authorities
- Final Report
- Further Legal Hurdles

INVITATION FOR EOI / QUOTATIONS

- How to get the Invitation ???
 - If you are in IBA List
 - If you are in Consortium Leader's Bank wise Empanelment List
 - If you are empanelled with other Investigative Agencies like SEBI/ED/SFIO/EOW etc.
 - If you are not empanelled with any agency
- Does the Auditor need special qualification like CFE / FAFD / CISA?
- Formats of Invitation Letters
 - Scope of Audit
 - Period of Audit
 - Locations of the Auditee and Books of Accounts
 - Restrictions on Assignment Acceptance

SUBMISSION OF QUOTATION / EOI

- Reading of the Invitation Letter in depth
- Understanding the Sections Quoted in Invitation letter
- Quotation / EOI Format
 - Cover Letter
 - Firm's Back ground
 - Details of Assignments Handled in past (Appointment Letters copies can be Annexed)
 - Re-drafting the Scope in your proposal
 - Audit Methodology
 - Schedule of Audit
 - Proposed Team Structure
 - Deliverables
 - Fees Structure
 - Expenses Reimbursement
 - Fees Validity
 - Declaration
- Submission by Post / Email
- Presentation before Appointing Authorities
- Fees Negotiations

APPOINTMENT & NDA SIGNING

- Issue of Appointment Letter
- In-depth Study of the Terms and Conditions
- **Precaution for** : Need to ensure Additional Works are not to be Included under same fees proposed
- Understanding the requirements of Audit and the expanded scope
- Renegotiation with Appointment Authorities
- NDA Signing
- Arbitrary Clauses in NDA and denial of them
 - **Example: Auditor needs to be responsible for secrecy of all documents received during audit for all time.**

MANAGING THE PROMOTERS AND KMPs

- Promoter is highly networked with Big Politicians.
- Promoter has not done any thing wrong. But all the investments done in foreign countries have gone in vain due to policy changes there.
- Promoter is no more traceable.
- Main promoter resigned from Directorship before Account was declared NPA. Now his relatives are Directors. How promoters can be linked for any mishappening in Audit Period?
- Can Auditor enjoy few hospitalities from Promoters?
- KMPs resigned or retrenched way back when account was declared NPA
- Mishappening took place in family of KMP and he rushed to native place, never came back during the time of audit being conducted
- Managing the Promoters and KMPs is not only an art but it is also needed to have a better report, it is good only for the Auditor for his report not later on to face legal hurdle
- Consent for longer period than mandated (to avoid difficulties of mid year dates for commencement of audit period)
- Determine the Status of Cooperation: Cooperating / Non Cooperating/ Partially Cooperating Promoters

FORENSIC AUDIT PROCESS

- **DATA INTEGRITY**
- **Access to Accounting Soft-wares**
- **Tally data can be manipulated any time**
- **SAP access normally not obtained**
- **Pirated Accounting Software or License expired**
- **Master Reports**
- **Audit Log of Files received**
- **Confirmation on Control Totals**
- **Storage of Data in secured places**
- **Promoter later on says the staff providing data has given wrong data**
- **Role of Statutory Auditor in Data Integrity**
- **Data is Evidence and Protection of Evidence key to Transaction Audit**
- **Hierarchy of Integrity of Data flow**
- **Direct Access, Email, We Transfer, Secured Server Uploading**

FORENSIC AUDIT PROCESS

- **OFFSITE AUDIT**
- **Training to Audit Staff**
- **Audit Program**
- **List of Documents Drafting**
- **Background Check**
- **Related Parties Determination**
- **Analysis of Bank Statements**
- **Analysis of Ledgers**
- **Analysis of Fund Trail, Tax Documents**
- **Master Agreements**
- **Documents Analysis**
- **Balance Confirmation Letters, Sampling (80:20 formulae)**
- **Report Drafting**
- **Benefits: Cost Optimisation, Secrecy of Audit Strategies**
- **Losses: Time is Crucial, Real time Query Solving**

FORENSIC AUDIT PROCESS

- **ONSITE AUDIT**
- **Physical Verification – People, Assets, System, Stock**
- **Logistics Documents – Key for Transaction Audit**
- **Original Documents Accessing**
- **Case Study:**
 - **One Company had a big supplier and a big customer. All three have registered office in same building where promoter resides. All three have go-downs in same block. Transactions were huge; more than thousand crores sales / thousand crores purchases among these three parties**
- **Interaction with Staff of the Auditee**
- **Interviews**
- **Benefits: High Level of Interaction, On the spot Query Resolution, Less chances for Delay in Report Delivery**
- **Losses: Cost of Audit shoots up, Probable Collusion of Audit Team Members with Promoters / KMPs**

FORENSIC AUDIT PROCESS

• **THIRD PARTY / SOURCES INFORMATION**

• Social Media :

Related Parties, Life Styles of Promoters,
Networking

• Government Websites: MCA, GSTN, RBI, IBBI etc.

• Press & Media: News on Activities

• Desktop Research: Google, Bing etc.

• Market Research: Field Verification / Benchmarking

FORENSIC AUDIT PROCESS

- **BENCHMARKING OF TRANSACTIONS**

- Purchases: Purchase Rate Verification
- Sales: Sales Rate Verification
- Loans taken: Interest Rate Verification
- Loans given: Opportunity Lost
- IPR Acquisitions: Market Value of Similar Acquisitions from third parties of Brands, Goodwill, Copy Right, Trademarks, Patents etc.
- Labour: Staff Turnover in similar industry to ascertain level of operations vis-a-vis actual employment
- Business Agreements: Not in interest of the company
- Doubtful Transactions: Bogus, Circular, Fraud, Suspected to be Fraud, Illegal
- Other Transactions: On Case to Case basis

INTERVIEWS & KEY POINT DISCUSSIONS

- Preferably 2 interviews at least
- Agenda for Discussion
- Major Issues Observed
- First Interview – General Discussions & Informing further Requirements
- Legal Representation – Rights of Auditee
- Exit Interview- Final Discussions & Query Resolution
- Audio / Video Recording of Interview
- Confession / Declaration Signing
- Email Confirmation of Details post interview
- Photographs of Attendees
- Rights to access Basic Amenities for Auditee
- Place of Interview
- Interviews of Suppliers, Transporters, Customers etc.

CLASSIFICATION OF TRANSACTIONS

- **Mensrea is important consideration**
- **Evidences Available**
- **Legally Sustainable**
- **Clear Identification , No ambiguity, Conclusiveness (RBI Circular 5th June 2019)**
- **Adequately Discussed**
- **Interpretations should not be disclosed to Auditee**

IDENTIFY THE TRANSACTIONS

- Loans and advances repayment to related / other parties vs. payment to secured lenders
- All assets transferred to creditors, secured/unsecured lenders
- Unsecured loans repaid vs. Payment to Secured lenders
- Analysis of Journal Entries for Adjustment Entries among Debtors -Creditors
- Preferential Payment to Specified Suppliers from Non-consortium bank accounts
- Ageing analysis of creditors for preferential payment
- Identify Loss Making Products & Customers: GP Ratio product wise / customer wise
- Selling Price Rate Analysis among Customers
- Benchmarking of Transactions
- Ledger Accounts (discounts, rebates, material rejection, etc.) to identify adjustments in debtor accounts, highlighting subsequent reduction in sales consideration.
- Ledger Accounts to see Gift, Business Promotion, Staff welfare expenses etc.
- Background check and site visit of suspected entities/parties.
- Financial or Operational debt raised in covered period
- Terms & conditions of such debt (interest rate, repayment terms, security interest etc.)
- Background check of creditors: Whether related parties or not
- Availing of credit facilities by overstating assets, sales, income and profit by submitting false/manipulated financial statement.
- Drawing from cash credit account by submitting false/inflated/manipulated stock statements.
- Assets to be financed not purchased and funds borrowed from bank mis-utilised / misappropriated for the purpose other than for which bank has sanctioned the funds.

OTHER AREAS OF AUDIT

- Disposal/removal of assets pledged/ hypothecated/ mortgaged, without knowledge of bank.
- Utilization of short term working capital for long term purposes, not in conformity of sanction terms.
- Transferring borrowed funds to subsidiaries/group companies or other corporates for non-business purposes or in contravention of sanction terms.
- Sale to related parties and subsequently debts written off.
- Other Fraudulent Practices
- Money trail analysis of all bank accounts of the corporate debtor in order to understand nature of flow of transaction.
- Identify hidden bank account used by CD for diversion of funds, if any.
- Detailed analysis of financial statements of the company and comment on suspicious areas of manipulation, if any.
- Excessive provisioning / write offs / losses which are not in the ordinary course of business and are unusual in nature.
- Non-recurring expenditure incurred by the company.
- Check whether revenue is booked as per the applicable GAAP
- Non-moving creditors & debtors.
- Physical verification and valuation of inventory.
- Background check of major customers and vendors of the company to establish if they are the shell companies of the promoter.
- Other Areas of Concern – Case to Case basis

PRESENTATION BEFORE APPOINTMENT AUTHORITIES

- Compact Presentation with Robust Explanations
- Graphs and Analysis Statements for Transactions
- Emphasis on Impact of Transactions
- Pursue your Observation, Do not Argue
- Willingness to Rectify Report where Evidences are not conclusive
- Explanation for Cost Escalations
- Additional Time requests for making the Changes suggested by Appointment Authorities

FINAL REPORT

- Additional Audit Procedures after Draft Report Submission
- Effective Changes and Re-Discussion among Audit Team
- Additional Interview with Promoters if Interpretation changes on submission of new records
- Promoters try maximum to drop all audit observations
- Final Report with ICAI UDIN
- Deliverables as per Quotation / EOI/ Engagement Letter
- Preserving Evidences under Safe Custody

FURTHER LEGAL HURDLES

- Help to Lawyers appointed by Appointment Authorities for Understanding the Case & Evaluation of Evidences
- Appearance before Statutory Investigation Agencies like CBI / ED/ SEBI / Courts etc.
- Budget for Legal Cost of Self, Audit team members, Appearance charges normally not reimbursed by Appointment Authorities unless it is stated in your Appointment Letter or Contract – **Be Cautious**



THANK YOU

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