RESEARCH REVIEW JOURNALS
Volume-03
Issue-04
April-2018

ISSN: 2455-3085 (Online)
RESEARCH REVIEW International Journal of Multidisciplinary
www.rrjournals.com [UGC Listed Journal]

Forensic Auditing: *A surgical strike on financial malfeasance*

*Dr. Vikas Singh

Assistant Professor, Dept of Commerce, S. S. Khanna Girls P.G. College, University of Allahabad, Allahabad, UP (India)

ARTICLE DETAILS

Article History
Published Online: 02 April 2018

Keywords
Forensic audit, embezzlement, white-collar crime, financial & system analysis, malfeasance

***Corresponding Author**
Email: vshree.research[at]gmail.com

ABSTRACT

Umpteen numbers of accounting irregularities and economic scams have churned out business entities, national and global markets many times. The increasing number of Financial Frauds and White-Collar Crimes has hit most of the Indian Companies, Banks, Public Sector and Governments and the increasing trend has become a serious area of concern. These have become a real threat against the development agenda for developing and emerging nations.

Now the emerging modus operandi of such frauds is giving serious concerns to all the stake holders involved. Forensic auditing is focused on the recognition, understanding, and communication of the evidence of underlying strategic economic and reporting events.

This paper is a theoretical research compilation which considers the roles of forensic auditors in combating fraudulent activities, distinction of forensic auditor and statutory auditor and the statutory requirement of the audit.

Forensic audit is used wherever an entity gets a financial dent. Therefore, it is used in cases of suspected embezzlement or fraud, to determine tax liability, to investigate allegations of bribery, among other reasons.

Forensic audits are performed by the professionals who have competence in both, criminology and financial accounting as well. An expert, who dux in money trail, keeps track of financial malfeasance in actual position statements and income statements. Forensic Auditing is a concept that comprises three key ingredients: thinking forensically; forensic audit procedures - both proactive and reactive and appropriate use of technology and data analysis. Techniques and tools adopted to do this audit involve financial comparative statements analysis, ratio analysis, system analysis and many others.

1. Opening

The incessant tax related fraud and malfeasance resulting to corporate collapse and the failure of the statutory audit to detect and prevent fraudulent activities which had led to the impoverishment of investors had given rise to the need for forensic audit. Adversely affecting the trust in mechanism of trade, finance, and investment, having destabilizing effect on commercial institutions, affecting national progress and putting strain on national resources are some of the reasons of giving birth to this stream. Impacts of frauds & malfeasance on corporate performance has led to the need for multi-dimensional relationship (that is interrelationship between the audit committee, the external auditor and the management) in corporate governance as to protecting the interest of shareholders and other market participants with the common goal of improving oversight function and ensuring good corporate governance (*Deloitte and Touch, 2006*).

Also, a myth that forensic auditing would be required only for the giant corporates has overruled because of petty frauds and misappropriations being reported recently. Recent researches suggest that small businesses suffer the largest median losses due to employee misappropriation as they typically employ lesser anti-fraud controls when compared to larger organization. Fraud or employee misappropriation is also one of the major reasons for losses and closure of small businesses. Hence, it's important for small businesses to have routine forensic audits to create a culture of fraud prevention within the organization and train employees on preventing fraud.

Forensic auditing is focused on the identification, interpretation, and communication of the evidence of underlying strategic economic and reporting events (*Smith & Crumbley, 2009*).

Forensic audits are performed by a class of professionals with skill sets in both criminology and accounting who specialize in following a money trail, keeping track of fraudulent and actual balance sheets and checking for inaccuracies in overall and detailed reports of income or expenditures. If they find discrepancies, it may be the auditor's job to investigate and determine the reason for it, or it may be the job of a separate financial investigator (*Hirby, 2017*).

The objective of forensic audit is to relate the findings of audit by gathering legally tenable evidence and in doing so the corporate veil may be lifted (in case of corporate entities) to identify the fraud and the persons responsible for it (a criminal offence).

2. Objectives of the Study

Continuous growing greed and art of camouflaging of accounting facts and figures through deception by indulging in fraud and manipulation is the urge of having forensic auditing.

Cases of frauds and financial scams in India require more professionalism in accounting and auditing. Investigative audit has always been there, it is only the techniques involved that has been changing in line with sophistication of the financial fraud involved (*Dhami, 2015*).

What is necessary at this juncture is the need to stress that all normal statutory audit should contain some element of forensic enquiry (*Enyi, 2009*).

In view of the above problem this study considers the following:

A. To understand the theoretical construct of forensic auditing and to discriminate it from the statutory auditing, forensic accounting.
B. To understand the relevance of forensic auditing.

3. Methodology

This paper is a theoretical construct of forensic audit and covers a study on the application of forensic audit and investigation in resolving fraud and malfeasance. Also, it involves the secondary source, making use of available literature on forensic auditing with respect to resolving fraud and malfeasance. The study is a theoretical research which considers the roles of forensic auditors in combating fraudulent activities, distinction of forensic auditor and statutory auditor, and impact of forensic auditor on the governance of a concern.

4. Literature Review

The present paper is of conceptual nature and purely based on information from secondary sources. For this purpose various articles on forensic accounting at national and international level, working papers, e-papers, and reports on newspapers are reviewed carefully. Following are some of the vital manuscripts referred to satiate the purpose of writing this paper:

The review of literature has been classified into two in accordance with the objective of this paper. They are as follows: (1) The Concept of Forensic Auditing and (2) Need of Forensic Auditing.

4.1. The Concept of Forensic Auditing:

The 'Forensic' means' suitable for use in a court of law' and it is to that standard and potential outcome that forensic accountants generally have to work. Referring to *Dahli* (2008) to have a global conceptual evolution of the term 'forensic' he states that the word has been derived from the Latin word which signifies '*for public'* and specifically to '*forum'*. The forum was where the Ancient Romans were taught to do business and settle disputes among other things. He further buttressed that forensic relates to the application of knowledge to legal problems such as crimes. Forensic is as old as history but its usage got little attention in the past. It is now becoming prominent because of increase in financial scandals.

Joshi (2003) ascribed the origination of forensic accounting to *Kutilya*, the first economist whom he said mentioned 40 ways of embezzlement centuries ago.

In one of the electronic article by Apurva Joshi accessed on a Management Consulting Web, Riskpro a very technical concept about the forensic audit was found. According to this article, Forensic Audit is a term which is not defined anywhere. However, since the object is to relate the findings of audit by gathering legally tenable evidence and in doing so the corporate veil may be lifted (in case of corporate entities) to identify the fraud and the persons responsible for it (a criminal offence). Typically forensic accounting is used as the synonym to the forensic audit. However there is a small difference in these two concepts. In forensic accounting engagements, the accountant knows that fraud exist whereas in the forensic audit, the auditor is engaged to find out if the fraud exists or not? (*Joshi, 2017*)

4.2. Need of Forensic Auditing:

Smith and Crumbley (2009) have made it very clear that forensic audit is the need of an hour not even in the corporates of the state like America. According to them to successfully exercise good corporate governance, there is a need for internal controls and one aspect of these controls relates to financial oversight. Unfortunately the number of financial frauds that have been continually perpetrated has raises serious questions as to whether traditional financial controls are working. "Is the traditional audit model still doing its share in providing oversight over financial activities?" Today the answer might be, "not very well, but what other choice is there?" Questions about the ability of the audit-reporting model to provide reasonable financial oversight and the broader acceptance of principles-based accounting methods have the potential to create a new approach to risk assurance. Forensic auditing, which is based on the practices of forensic accounting, is the best choice for reducing financial malfeasance in a principles-based accounting world.

Owojori and Asoula (2009) affirms that the Failure of Statutory audit to prevent and reduce misappropriation of corporate fraud and increase in corporate crime has put pressure on the professional accountant and legal practitioner to find a better way of exposing fraud in business world.

Omodero (2015) states that the forensic auditing has improved management accountability, strengthened external auditor's independence and assisting audit committee members in carrying out their oversight function by providing them assurance on internal audit report have impacted positively to corporate governance, thereby reducing tax related fraud and malfeasance.

5. Theoretical construct - Forensic Auditing

To understand *Forensic Auditing* it is very important to discriminate the terms which are used as synonyms incorrectly. Firstly, the terms forensic accounting and forensic auditing need to get discriminated. It is not so that forensic accounting involves a critical examination and same is followed in forensic auditing. The purpose of having each of the subjects needs to be understood exclusively. Secondly, financial or statutory auditing is to be considered as the mother of having forensic auditing. It is the limitations of financial or statutory auditing that compelled to have forensic auditing for the corporate houses.

6. Forensic Auditing vs. Forensic Accounting

Collocation of forensic accounting and forensic auditing suggests that the two are not exactly the same or even similar. While forensic accounting does involve elaborate inquiry and investigation into the transactional typicality of the connected issues and events, the job of forensic audit is to provide a double check on the consistency issues, questions that the counsel may ask in the context of arguing in courts.

As the definition of audit underlines, forensic audit lays the stress on regular and systematic review and appraisal of the factors and forces contributing to the preparation of the papers, the brief, for assisting counsel in presenting his arguments (*Chattopadhyay*, 2014).

The integration of accounting, auditing, and investigative skills yields the specialty known as *Forensic Accounting* which focuses very closely on detecting or preventing accounting fraud. On the other hand, the term *Forensic Auditing* covers a broad spectrum of activities, with terminology not strictly defined in regulatory guidance. The construction of documents from the tidbits of evidence that the forensic accountant may have done could as well be an inadequately framed document, leaving gaps with respect to the numerous accounting, auditing and management accounting standards which the counsel may not be prepared to accommodate in the brief that he seeks to prepare.

Forensic accounting is typically used in the course of an investigation. The goal of which would be to detect fraud and provide evidence which can be used in a court of law. The proceedings are not always criminal but often times civil and also require a valuation of assets (as in a divorce case). Forensic accountants, also known as fraud examiners, are not constrained by generally accepted accounting concepts like materiality. Regardless of dollar amount, any inconsistency can be the tip of an iceberg in fraud terms. Auditors involved in an independent audit may refer "red flag" observations for investigation by forensic specialists.

So, with this it is now unambiguous that forensic accounting and forensic auditing are two different aspects. Both begin with the critical mind-set but forensic auditing has an inclusive proceeding to report and to mark the malfeasance and the criminal.

7. Financial/Statutory Auditing vs. Forensic Auditing

Now discriminating an audit (financial/statutory) with forensic audit becomes important as this will signify the level and the gravity that a forensic audit possesses. Basically, the objective of financial auditing is to express opinion as to *'true & fair'* presentation. Forensic Audit determines correctness of the accounts or whether any fraud has actually taken place.

Commenting on the techniques which are followed is that techniques used in the financial auditing are more of 'substantive' and 'compliance' procedures. The techniques used in the forensic auditing are analysis of past trend and in-depth and above all the 'conclusive' checking of selected transactions.

Tenure of financial audit is quite exclusive and limited to a particular financial year whereas in forensic audits such limitations become meaningless. Forensic auditors may have to go through the accounts from the beginning to trace the root cause of the malfeasance.

Regarding ascertaining the accuracy in verification and valuation of assets and liabilities financial auditors has a substantive approach. They rely on the management and the documents produced before them. On the other hand the forensic auditors are required to carry out the independent verification of suspected or selected items.

For the reporting, if the financial auditor has adverse findings, he expresses a qualified opinion, with/without quantification. Whereas, the forensic auditors quantify the damages to the clients and is also point the culprit. So the approaches of reporting are widely different in both the cases. Financial auditor highlights the adversity whereas forensic auditor not only highlights the discrepancy but also quantifies and traces the wrong-doer.

So the responsibilities of Forensic Auditors in combating fraudulent activities and malfeasance are tedious. According to *Omedero* (2015) some of the vital responsibilities have been listed below.

a. The forensic auditor does not carry out procedural audit, but carries an audit which conducts investigation as to detect fraud or crime using computer programs or scientific knowledge.
b. The forensic auditor in carrying out his function reconstructs incomplete accounting records as to settle insurance claims, over inventory valuation, proving money laundering activities by reconstructing cash transactions.
c. In carrying out embezzlement investigation and providing documentation, and negotiation of insurance settlements the forensic auditor uses his special skill and experience, thus helping to detect the culprit and amount embezzled.

8. Conclusion

The unrelenting series of embarrassing audit failures over the last half a century has prompted a paradigm shift in auditing. Forensic auditing is the only remedy found to overcome the malfeasance happening these days. Public interest is being overruled by the nexus of management and external auditors. Forensic auditing is the only check and threat for the wrong-doers, an injunction that will hinder them from exercising malfeasance. Also, this science has been found more rigorous in comparison to financial/statutory audit and even forensic accounting. In short, it is *a surgical strike on financial malfeasance.*

References

1. Chattopadhyay P. (2014), *"A Theoretical Construct of Forensic Accounting and Auditing*" The Management Accountant, The Journals for CMAs, Sep. 2014, Vol.49, No. 9, p. 22.
2. Dahli, G. (2008). *"Forensic Accounting and Auditing: Compared and Contrasted to Traditional Accounting and Auditing"* The American Journal of Business Education 4th Quarter Vol. 1 No. 2 p. 10.
3. Dhami S. (2015), *"Forensic Accounting: Signaling Practicing Accountants To Improve Skill set And Forming Regulatory Body For Forensic Accountants In India*" Global Journal For Research Analysis , Volume-4, Issue-5, May-2015, p. 63.
4. Deloittee and Touche (2006), *"Integrity and Quality corporate Governance*", available at https://www.google.com.ng/search?q=Deloittee+and+Touche, accessed on 14th March, 2017
5. Enyi, P., *"Detecting Causes of Variances In Operational Outputs of Manufacturing Organizations: A Forensic Accounting Investigation Approach",* Downloaded from http://ssrn.com/abstract on 10/04/2017
6. Hirby J., Black's Law Dictionary – online article, accessed on 17.03.2017, 02:18 am, url: http://thelawdictionary.org/article/what-is-a-forensic-audit/
7. Joshi, A. (21017), *"Definition and Basics of Forensic Audit*" Accessed on 01.06.2017 @ http://riskpro.co.in/definition-and-basics-of-forensic-audit/
8. Joshi, M.S. (2003), *"Definition of Forensic Accounting"* electronic access @ www.forensicaccounting.com on 25th March, 2017.
9. Omedero, C.O. (2015), *"The Relevance of Forensic Audit and Investigation in Resolving Tax Related Fraud and Malfeasance"* Electronic copy available at: http://ssrn.com/abstract.
10. Ibid.
11. Owojori, A.A. and Asaolu, T.O. (2009), "The *Role of forensic Accounting in solving the vexed problem of corporate world"*. European Journal of scientific Research 29 No (2) P183-187.
12. Smith G.S., Crumbley D.L. (2009), *"Defining a Forensic Audit"* Journal of Digital Forensics, Security and Law, Vol. 4(1), p.61.
13. ibid.

