

# Maintaining Professional skepticism and Forensic Audit

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# Professional Skepticism

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- An attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence
- Professional skepticism → Professional judgement

# being skeptical....

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# Why be skeptical...

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- Cos. Act - defines fraud (Section 447), - lays down severe penalties and accords statutory status to SFIO
- SA 200- *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing*
- Other Standards of Auditing....on *risk assessment & response to assessed risk...*
- Recent Bank loan frauds...question various accounting & business practices...
- Changing regulatory & business landscape...

# Auditors responsibility...defined in Co's act...

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- **Section 143(12)** -- Statutory auditors reporting for fraud or suspected fraud committed against the company by the officers or employees of the firm.
- **Section 138 – Internal auditor appointments**
- Assessing reporting requirements **on operative effectiveness** of controls...
- Internal audit report can be an **evidence in Courts** especially when Reports indicated failure of Management & Board inactions
- A Risk based audit approach... **Complements** requirements of S. 138 of Companies Act, 2013

# At what stage be skeptical....

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- Acceptance of engagement
- Audit planning
- Assessing risk of material misstatement from error or fraud  
(SA 315 --Identifying and Assessing Risks of Material Misstatement through Understanding the Entity and its Environment)

Opinion – true & fair, operative effectiveness of Internal controls

## *Consideration of....*

*-- Management / Company credibility?*

*-- News in public domain/ Continuing non compliances...*

*-- Additional audit tests – High risks  
eg IT based environment(eg. Cyber risk),  
Enhanced analytical procedures, complex  
group transactions*

*-- Appropriateness of audit evidence received*

## Emerging use of technology in Audits...

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- Automating time-consuming tasks to focus on business risks and High level compliance and reporting risks.
- Application of Data Analytic tools
- Audit moving to a continuous monitoring –online information of public documents and events...

# Risk Based Audits – Identify Errors & Fraud





## Audit prevention / detection tests includes...

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- Adopting Risk Based audit --- process walkthroughs, documenting Process level Risk
- Ranking business functions being vulnerable ...Ongoing monitoring of High risk areas for fraud/error risks
- Application of Data Analytic tools ...Excel too has multiple functions...eg.. --  
-Vlook up / Pivot etc.
- Desktop search – Publicly filed documents / Company News / Vendor news etc.
- Lab test / third party confirmation/field visits ---- for suspicious/unusual transactions

## Professional Skepticism – in a misstatement from a Material Error

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Fair valuation of Instruments – Assumptions

Revenue from Contracts – “Commercial substances in contract”

## Professional Skepticism – in a misstatement from a Material Error

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### Assessing sufficiency of audit evidences and Documentation.

#### Examples...

- **Related Party transactions:** Disclosed correctly ? Arms length ? -- performing Desktop check, Rationalizing valuations...
- **Management estimates** --- useful life - Fair & Reasonable ? --Evaluating representation, estimate rationale, industry norm ...
- **Going concern Assessment** –Disclosures? Possibility? - Debt repayment capability
- **End use of loans** – Correctness of Reporting? ---Source of funds assessment
- **Consolidation** – Correctness? Compliances? --- Obtaining Referral documents, assessing principles adopted in GAAP translations ...

# Professional Skepticism - Red Flags

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Risk Based audits (Processes giving frequent High risk grade)



Regular Revision of critical controls in processes & operations



Write off of advances without rationalizations ...



Uncorrected Misstatements (SA 450 – Evaluation of misstatements identified during the audit)... when auditor has accumulated and not being corrected...



Common addresses/Directors of vendors, Management Conflicts of Interest

***And Others....***

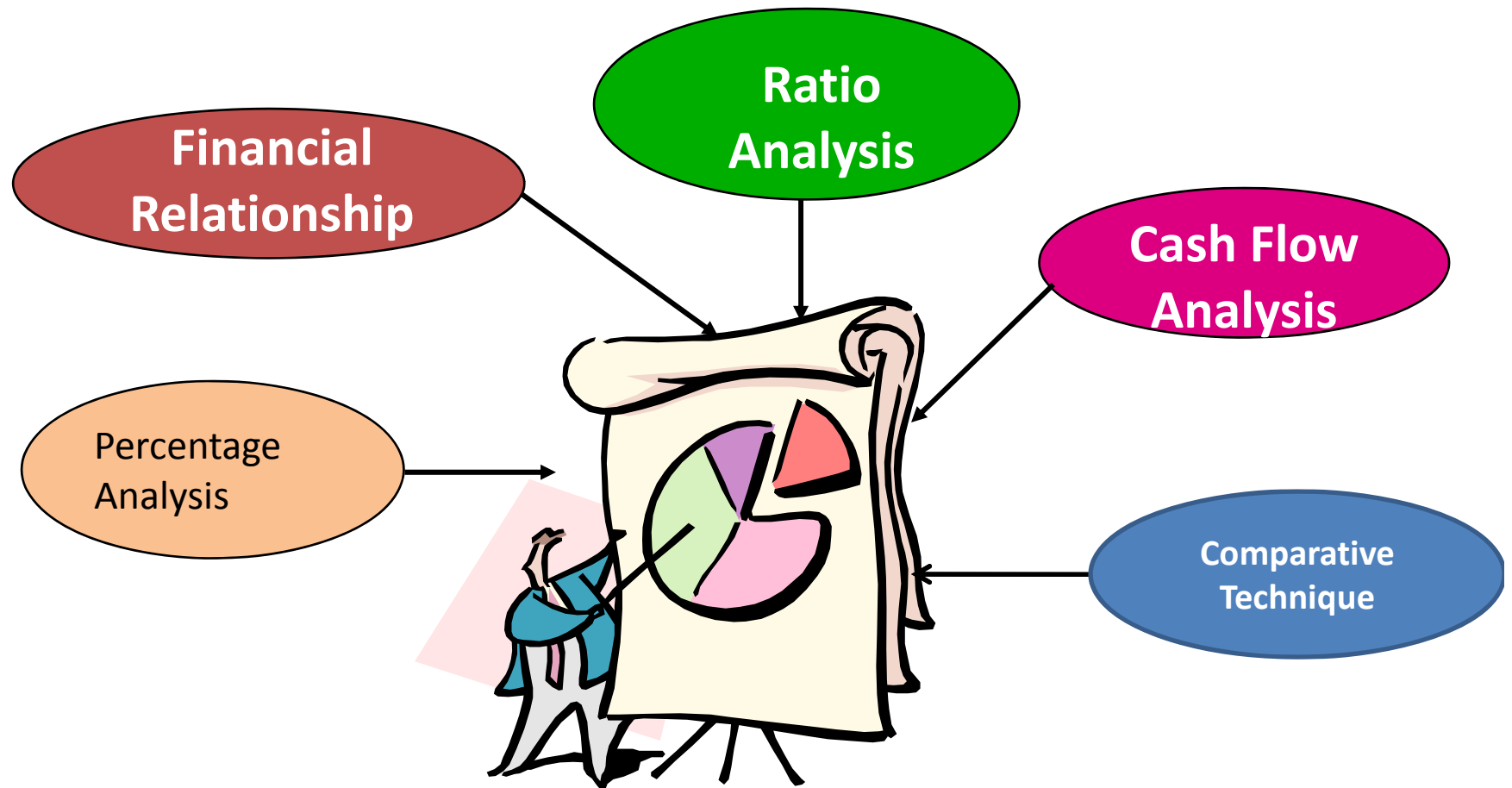
# Approaches to financial statement analysis

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# Techniques to financial statement analysis

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# General relations in financial statement analysis

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**SALES VERSUS  
ACCOUNTS  
RECEIVABLE**

**SALES VERSUS  
INVENTORY**

**ASSETS VERSUS  
LIABILITIES**

**PROFIT MARGINS**

**SALES VERSUS COST  
OF GOODS SOLD**

# Understanding financial relationship

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❑ Understanding general relationship between certain financial statement balances.

❑ Answers to these questions are foundation for financial analysis.



If sales increase, how should the cost of sales respond?



If commission expense decreases, what would be expected of sales?





# FRAUD RISK, INDICATORS, MITIGATION

**FRAUD**

“Fraud is any intentional act or omission designed to deceive others, resulting in the victim suffering a loss and / or the perpetrator achieving a gain ”

# PRESENT VIEW OF FRAUD RISK

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- Fraud risk and controls a part of organizational **Control Framework**
- Board cannot evade fiduciary duty by **relying on** Audit/ Management Report
- Fraud **awareness** necessary
- Fraud perceived to be due to **internal control failures**

# FRAUD STATISTICS

Percentage of companies affected by listed types of fraud		
	2013	2012
Theft of physical assets	28%	24%
Information theft	22%	21%
Management conflict of interest	20%	14%
Vendor, supplier or procurement fraud	19%	12%
Internal financial fraud	16%	12%
Regulatory or compliance breach	16%	11%
Corruption and bribery	14%	11%
IP theft	11%	8%
Market collusion	8%	3%
Misappropriation of company funds	8%	—
Money laundering	3%	1%

Source : 2013/2014 Global Fraud Report - Kroll

# ASSESSING FRAUDS PROCESS WISE

Process perceived as most vulnerable to fraud risks  
(Ranks are based on total score. Rank "1" indicates most vulnerable process)

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PROCUREMENT	01
SALES & DISTRIBUTION	02
INVENTORY	03
FINANCE/PAYMENTS	04
ADMINISTRATION	05
TREASURY	06
HR	07

*Source : 2013/2014 Global Fraud Report - Kroll*

# IMPLEMENTING ANTI-FRAUD FRAMEWORK

**Everybody** responsible to prevent, detect and investigate fraud.

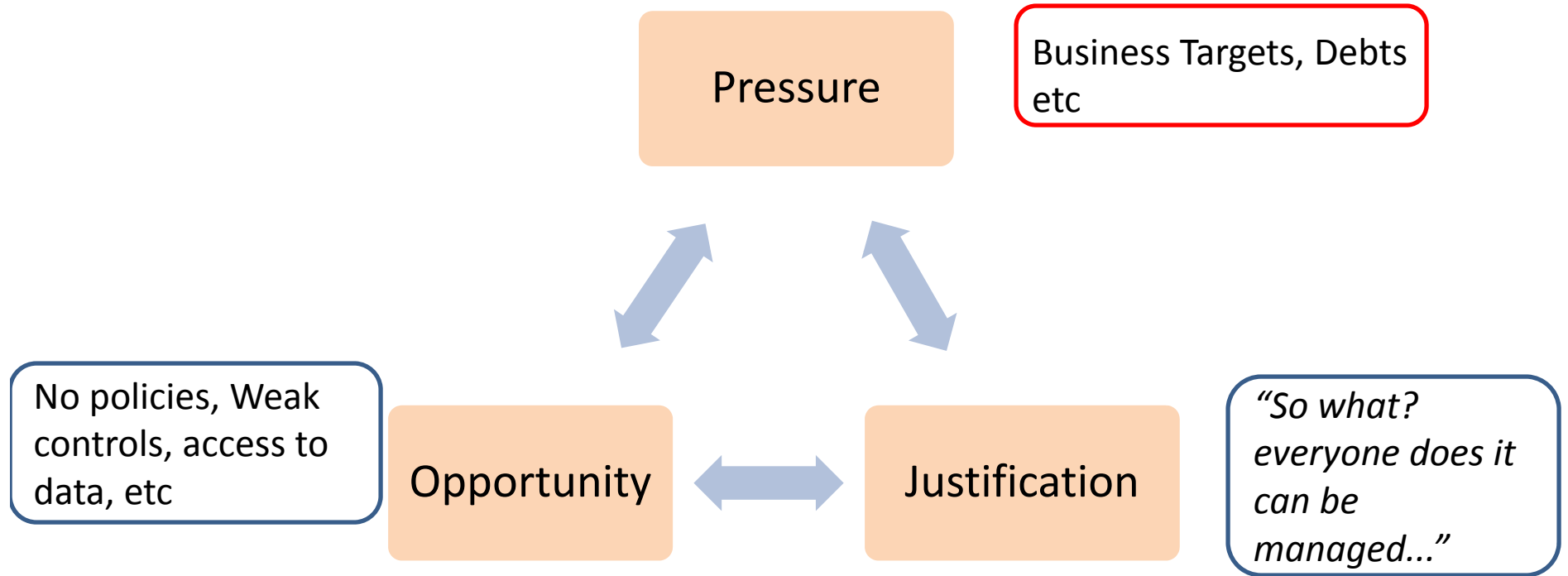


**Top Management** is **ultimately responsible ...**

- Top Management Initiatives - Define Monitoring and reporting framework
- Identify the roles and responsibilities of leadership
- Ongoing Risk Assessment programs – Prevention, Detection, Investigation

# BREAKING FRAUD TRIANGLE IN AUDIT

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**Removing any one of above elements ... Likely to reduce fraud risks**

# Forensic Audit...

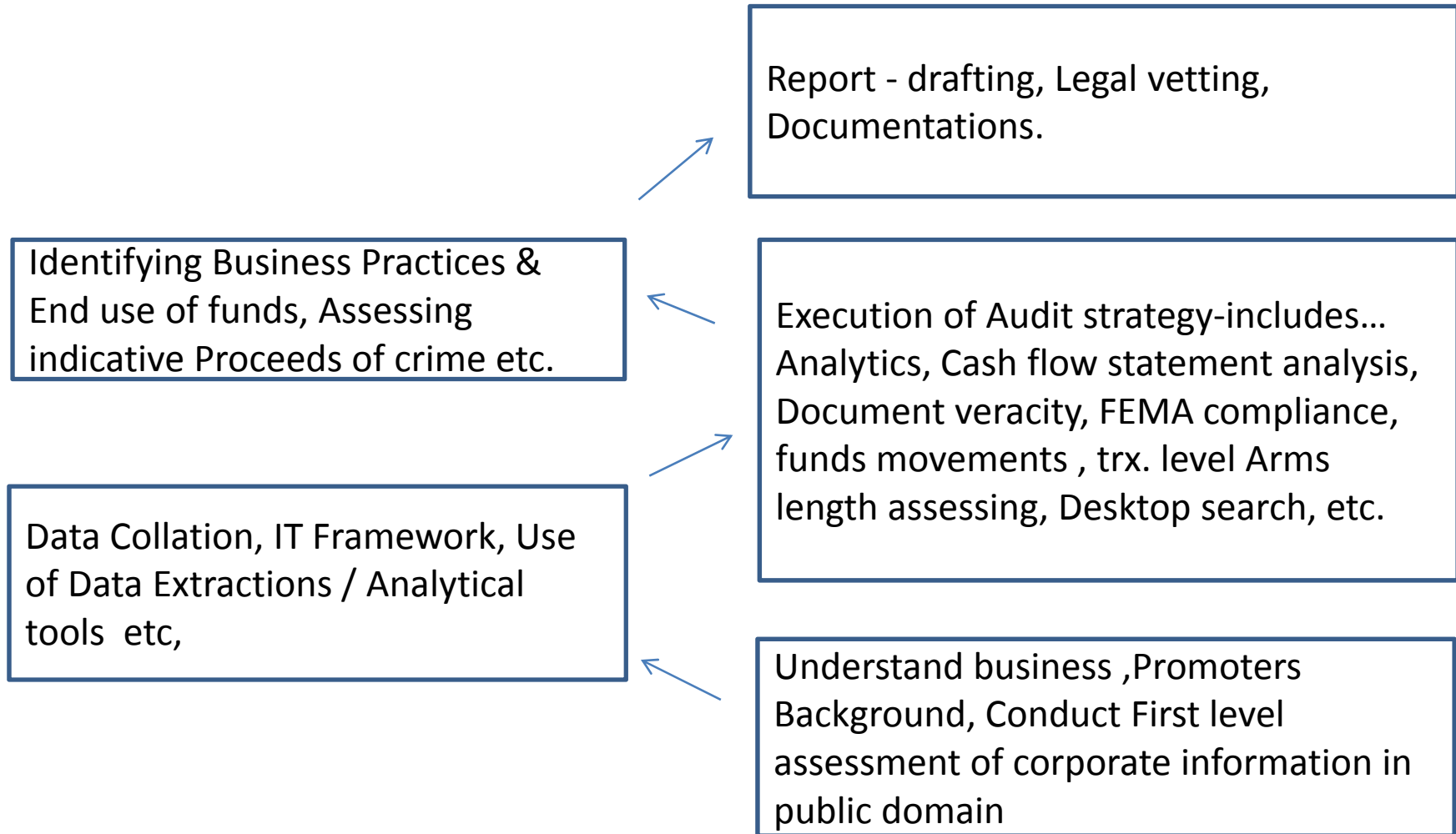
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- **Forensic audit** - an examination and evaluation of a firm's or individual's financial information for use as evidence in court.....
- Economic frauds on high over the years...evidence in court
- **Certain Fraud prone concerns today...**
  - Cyber - data theft (eg...aadhar, zomato)
  - Anti Money Laundering – overseas transactions through accommodating arrangements, Proceeds of crime etc...
  - Benami Assets - shell companies



# Forensic audit...Approach

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# EVIDENCE COLLECTION

## HARDWARE

- **Computer Media:** drives, RAM, CDs, DVDs
- **Mobile devices:** phones, PDAs, iPods, GPS
- **Network Infrastructure:** printers, servers, D/S, AD, databases, and logs
- **“Cloud”:** Apple iCloud & MobileMe, Amazon S3, Google Cloud Storage

## DATA

- **Be sure the source is appropriate**
- **Validate data collected or transferred**
- **Metadata can serve as audit trail**
- **Deleted data predominantly is not really deleted**

## BEYOND TECHNOLOGY

- **Human element**
- **-Interviewing**
- **-body language**
- **-writing**

## Recent loan frauds – Transaction level issues....

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- Promoter contributions an eye wash...Routing through related entities
  - Differences in Closing stock of units of goods v/s opening stock of units of goods
  - Valuation approaches of brands offered as loan security- under investigation ...
  - Complex group transactions v/s actual supply of services

# RECOGNISED INVESTIGATIVE TOOLS

## LABORATORY ANALYSIS OF PHYSICAL AND ELECTRONIC EVIDENCE

### ➤ Altered & Fictitious Documents

- Physical examination.
- Fingerprint analysis.
- Forged signatures.
- Ink sampling.

### ➤ Computer Forensics

- Hard disk imaging.
- E-mail analysis.
- Search for erased files.
- Analyze use & possible misuse.



# MOBILE FORENSICS

## ➤ Certain methods of Analysis:

### ✓ Capture Screen info's:

- Use a camera to take pictures of what's on the screen

### ✓ Logical Analytics:

- Extracting the data on the device that you see and can access on the device. No deleted information with this method. Call logs, phone books, sms messages, pictures, email, browsing etc. The “active” information on the device can be extracted using a “Logical” extraction tool. This is the standard method today.

### ✓ Physical Analysis:

- The practice of extracting data from the physical memory of the device, and removable memory. Like PC forensics, you are getting the raw binary / hex data. Requires technical skills

Thank you