

FORENSIC AUDIT: ADAPTING TO CHANGING ENVIRONMENT

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Expectations from Forensic Auditors have sky rocketed after the revelation of many large value scandals, which have rocked corporate India in the last decade. The latest one relating to the LOU scam has crossed over Rs 11,000 crores! Not only the affected banks, enforcement agencies, and the regulatory bodies, but even the hitherto unaffected banks and even blue chip companies have started doing a lot of deep diving exercises to ascertain whether they have been abused in any way. Thus, experts in forensic accounting services are being sought out to perform this massive task which is unprecedented in terms of size and scale.

In this backdrop, the challenges to forensic auditors are huge. Perpetrators of financial crimes and fraud have evolved with stronger capabilities and are armed with technology to launch lethal attacks. This is further compounded by the growing complexities in business operations. The nature of the business transactions sometimes are so technical that they are not easy to comprehend for even technically qualified experts, and to do a thorough forensic audit in such circumstances needs a huge amount of patience and perseverance apart from the expertise. Therefore, to do a good forensic audit in the days to come, forensic auditors will need to adapt. In the theory of evolution, it is believed that the species which survives the longest is not the one which is the strongest, nor that which is the most intelligent, but that which is able to adapt to the changing environment. Forensic auditors need to do exactly that. They will have to adapt to the environment which poses such new challenges.

The process of adapting will be greatly facilitated if forensic auditors bring in creativity and imaginative thinking. The following suggestions may facilitate a forensic auditor to adapt better and perhaps bring in more penetrative results:

- Firstly, remove complete reliance on standard checklists by customising them to the objectives of the given situation. This can be better understood with a case study. In an investigation assignment in a life insurance company, the forensic auditor had to investigate and report on suspicious death claims based on data and documents given to him for the last one year. He compiled a checklist, which included selection of a test sample of transactions and applying routine processes of vouching and verification of supporting claim documents like the death certificates, crematorium receipts, doctors cause of death reports, application form details, etc. The sample selection was done by using one of the standard sampling methods like statistical sampling. The auditor's entire focus was on completing the work as per his checklist on a statistical sample, and submitting his report. This procedure of applying a statistical sample and then vouching and verifications of documents is certainly important, possibly to gain confidence on the controls and procedures, but may not be sufficient to detect the possibility of fraud. One suggestion is to then reduce complete reliance on standard sampling techniques and apply other kinds of focussed and adapted sampling techniques additionally. The forensic auditor in this case tried this approach. Since he had the full data dump of all the death claims on an electronic spreadsheet, he started thinking about different ways of extracting data samples which could possibly throw up any clues of fraud. That was the key to his success. When one starts looking beyond the routine and tries to visualise various possible ways of exposing a crook, amazing solutions can come from such a thought process. In fact, it is said that a good investigator is one who can think like a fraudster. The forensic auditor, in this case, saw that in the data of death claims, there were many data fields that were not addressed or checked by his audit check list. He realised that fraudsters also realise what auditors check and what they generally don't look at. The forensic auditor spotted two data fields which

caught his eye. Date of birth of the deceased and date of birth of the beneficiary or the claimant. These were not within the focus of the forensic audit at all. The forensic auditor then decided to extract a new sample of data by filtering out those claims paid where the date of birth of the deceased and the date of birth of the claimant were the same. The forensic auditor expected such instances to be nil or very miniscule. Except in the rare situations where the claimant or beneficiary was a twin sibling of the deceased, the date of birth of the beneficiary would be unlikely to be exactly the same as that of the deceased. So out of 13,000 line items, he expected to find no more than 4-5 such transactions where the date of birth of the deceased and the beneficiary would be exactly the same. The data was filtered to those transactions where the dates of birth were matching and to his surprise he found 82 transactions where the date of birth matched exactly for the deceased and the beneficiary. Now the forensic auditor had a new direction of investigation and he started examining them in greater detail. He made inquiries as regards which branch offices had originated and paid these claims, who were the claims' approving officers, which period during the year were these claims paid and even how fast they were paid. He then grouped the sample data appropriately branch wise, officer wise. The results were spectacular. 77 of the 82 claims with the common dates of birth came from only one specific branch in North Mumbai. A claims officer Mr. M. Thanvir was the common authorising claims officer for all these claims. These claims were paid off 50 % faster (in number of days after lodgement). Now the original checklist for document examination was again used to vouch and verify in detail the claims of these 77 deaths. As expected, solid evidence of falsified death certificates and other documents was found and a major insurance fraud in the North Mumbai branch was exposed! Thus customising the sampling technique, and applying appropriate additional checks based on the revelations, did the trick. In other words adapting and innovating was the key to the forensic auditor's success.

- Secondly, the forensic auditor must constantly do research and look for newer solutions and techniques to address fraud in different situations. If the perpetrators of fraud can take advantage of technology, so can the forensic auditors. A regular visit to websites relating to latest fraud tools, techniques and approaches in fraud investigations can enable a forensic auditor to meet the challenges of business complexities and possibly gain

from experiences of others. In one such investigation assignment when a forensic auditor was stuck with limited findings, he had come to a stage where he had to submit a report and close the matter inconclusively stating there was lack of evidence. He had really worked hard and found that all the documentary checks that he had applied were not yielding any significant results, but there were plenty of warning bells and other indicators which seemed to suggest that fraud existed. But he had no hard core evidence. Of the many matters which were not resolved, he had one major doubt in his mind that the credit card number that had been furnished as evidence for payment was false, but he had no way to verify its correctness. He did not give up hope and his patience and perseverance paid off. He surfed through the internet looking for solutions for credit card frauds and with a little effort he came across an algorithm called the Luhn's algorithm. This algorithm was able to ascertain whether a credit card number was a valid credit card number. However, the algorithm in the form available on the internet was difficult to use, so painstakingly the auditor prepared an electronic spreadsheet incorporating the functions of algorithm and he was able to use it to prove that the credit card number given as evidence of payment for an expense was an invalid number. This forensic auditor was thus able to achieve the objective only by doing research and adapting the forensic audit to the needs of the situation.

While these two suggestions stated above are possible approaches for solutions, there are other measures too which not only forensic auditors, but all professionals should take. One, do not allow 'a stale procedures syndrome' to set in. This stale procedures syndrome is nothing but a term for 'getting used to', or 'taking for granted'. In our every day work we often get complacent when we do the same or similar tasks again and again. There was a very interesting fraud investigation case where an auditor was auditing the financial statements of a college for 2 decades. He was doing a reasonably good audit and generally the audit reports issued were clean and unqualified. Unfortunately, he died and a new auditor was appointed. The new auditor brought a fresh new wave of thought processes and he started examining data with a completely new checklist, which was compiled after a thorough understanding and evaluation of the activities and operations of the college. One of the items in the financial statements which caught his eye was the huge balance of students deposits lying with the college.

These were amounts deposited by the students at the time of admission such as library deposit, caution money deposit, etc. These deposits could be collected by the students only when they left the college, which was usually about 4 years after their date of admission. Most students would forget to collect these deposits for various reasons and consequently over a period of time the college balance sheet disclosed a huge amount of unpaid students deposits. The earlier auditor never gave much attention to this deposit amount since this was not a part of the college's revenue and it was merely an unclaimed liability payable only when requested for by the students. Nevertheless, the new auditor painstakingly studied the deposit collection and refund procedure and performed some checks on them as a part of his new audit checklist. While he was examining the refund procedure, something unusual caught his eye. The ledger account of deposit repayments showed repayments for each date person wise, amount wise strangely *in an alphabetical order*. To his surprise, he found that almost throughout the entire year (barring some random exceptions) deposits were repaid to students in an alphabetical order of their names.

This was not only queer but also absurd. It was unthinkable that students would come to claim their deposit refund in an alphabetical order. The new auditor called a few of the students who had claimed their refund. All of them confirmed his suspicions that they had not made any request for, nor had they got any refund. It was thus revealed that the repayments were actually effected on forged refund applications prepared and collected by the

cashier himself. The cashier had adroitly taken great care to ensure the forged application forms were prepared with all the necessary supporting details and were attached to the cash payment vouchers, but he made one fatal mistake. He got the names of students from the attendance registers of the college, which were always in an alphabetical order. The previous auditor also would have seen this ledger, but he had been auditing for over two decades and his mind became 'used to' or 'stale' and he did not spot this absurdity. The central lesson in this for all professionals is to combat setting in of such a stale procedures syndrome by having more than a different person to review the work, so as to bring in freshness and a greater alertness to spot any warning bells of fraud.

Thus, in the foreseeable future, forensic audits can increase their chances of success if they try to innovate and adapt. The future holds opportunities for even the middle level and smaller sized professional firms who want to do this kind of forensic auditing work. Presently, that may appear to be difficult, but even smaller firms can and will get a share of the pie. For this purpose, they will have to adapt too by undergoing training and doing intense research. This will be the fundamental need. Once the capability has been achieved, these firms can also get empanelled with Police, Banks, Income Tax, PSUs etc. Very soon the need will be so intense that all companies and potential clients may not wish to go only to giant firms but also to small specialist firms where they would have the benefits of both economical budgets and matching quality. ■

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