


# STUDENTS' ECONOMIC FORUM

A monthly publication from South Indian Bank

*To kindle interest in economic affairs...  
To empower the student community...*

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 [ho2099@sib.co.in](mailto:ho2099@sib.co.in)



**JULY 2016**

Theme 296

**FORENSIC AUDITING**



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South Indian Bank is a member of BCSBI and is committed to treat customers in a fair, transparent and non-discriminatory manner.

**Theme No: 296: FORENSIC AUDITING**

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A well informed customer will make the policy makers as well as organization which produce goods and services more responsive to the customer needs. This will also result in healthy competition among organization and improve the quality of goods and services produced. The “SIB Students’ Economic forum” is designed to kindle interest in the minds of younger generation.

Technological advancement has led to different ways in masking the financial fraud. . Conventional auditing methods are not enough to find out the details of such transaction In such a scenario, the organisation needs to go for forensic auditing instead of normal auditing. The forensic investigators will drill the matter using the technology and will decipher the complex financial transaction. This month we discuss about forensic auditing.

**What is forensic auditing?**

Forensic auditing is a blend of traditional accounting, auditing, and financial detective work. The technology has an important role to play in the forensic auditing. A forensic auditor does the identification, interpretation, and communication of the evidence of economic transaction and reporting events. There is complex data analysis techniques employed to spot the areas which needed further investigation. It is a continuous process. Finally the same refers to specific procedures carried to provide evidence on a particular fraud.

**What is the need of forensic auditing?**

The forensic auditing offers a toolset to detect and investigate various financial discrepancies and diversion of funds/fund mismanagement. It will help in identifying the vulnerabilities in financial resource.

In normal auditing, the auditor’s concerns include providing reasonable assurance, and no material misstatements exist. In case if any material misstatements exist, they are detected and disclosed. The forensic auditing on the other hand includes relatively narrow boundaries, detailed development of factual information.

There will be assessment of loss or damages on the examination of the evidence. It also provides recommendation for deterrence against such instances in future.

**What are the differences between a financial audit and forensic audit?**

The major differences between financial audit and forensic audit are the following

<b>Financial audit</b>	<b>Forensic audit</b>
Examine financial statement as per the accounting standards	It deals with fraudulent financial reporting and misappropriation of assets
Financial statements is taken as a whole	Highlights the awareness of specific irregularities
Serves public interest	Serves the interest of the parties who hire them
Auditor’s work stands on its own	Forensic auditors supports the work of the legal counsel or the board.
Auditor express opinion	Forensic auditor recommends changes
More concerned with errors and irregularities;	Concerned with distinction between errors of judgement & deliberate misrepresentations
Relationship of auditor with client is cordial	Relationship of forensic auditor with client is adversarial
The auditor presumes the validity of documents and information	The forensic auditor ensures the validity of documents and information
The auditor determines the nature, scope and extent of audit	The client determines the scope of forensic audit
Financial audit is not disruptive The audits are rule based	Forensic audit tends to be disruptive The forensic audit is principle based

**What are the advantages of forensic auditing?**

The major advantages are as follows

- It protects business against financial crimes that could threaten the viability of the business by strengthening control mechanism.
- The forensic auditing will help to have a better regulatory compliance and make the processes more robust.
- Forensic auditing will help corporates to have a better representation of facts in case of legal disputes.
- It helps in better utilisation of resource.
- It helps to provide the detection of potential conflicts of interest.

### **What are the disadvantages of forensic auditing?**

The major disadvantages are as follows

- A poorly managed forensic audit could consume excessive management time which result in distraction of business.
- There should be higher allocation of budget for a comprehensive forensic audit across all verticals.
- Some clients/people can interpret a proactive forensic audit as a slight on their integrity, rather than as a means to improve control procedures for the benefit of the business.

### **What are the basic requirements needed for a forensic auditors**

A forensic auditor should have

- Fair knowledge of the industry for which he does forensic auditing.
- A good understanding of corporate and its practices, procedures etc.
- Knowledge of GAAP (Generally accepted accounting practises ).
- Excellent Financial, technical and communication Skill.
- Independence , integrity, objectivity and logical analysis.
- Analyse, evaluate, and investigate the details to arrive at possible conclusion.
- A mindset of detective/ researcher.

### **What is the importance of forensic auditing in banks?**

With the rising corporate frauds, the banks need to have a policy and framework in place for detection, reporting and monitoring of frauds. RBI had come up with early warning signals which may lead to frauds, and framed policy guidelines in this regard. The processes of representing a well structured and systematic procedure to ensure proper focus on typical fraud event is in processes. The major frauds are related to submission of forged documents, over valuation of mortgaged assets, frauds in housekeeping, over invoicing of invoices, frauds in granting loan against hypothecation of stocks etc. Thus, for the banks, it is necessary to incorporate the following

- Detection and reporting of frauds.
- Corrective action.
- Prevention and punitive action

The forensic auditing in banks will be successful if it has zero tolerance towards a fraudster and fraudulent activities and has strong preventive, detective and corrective capability.

### **What are the elements in proactive forensic auditing?**

- Statutory audit

- Regulatory compliance.
- Diagnostic tool.
- Investigation of allegation.

### **Explain the steps in forensic auditing in a corporate fraud**

The major steps in forensic auditing in case of corporate fraud are listed below:

- Develop a theory of the case.
- Identify the sources of information
- Procurement of data and documents.
- Interrogation of key persons.
- Assessing the evidence.
- Determine violation of law.

### **What are the responsibilities of forensic auditors?**

The responsibilities of a forensic auditor are as follows

- Conducting investigation-The investigators will be conduct the investigation with the help of software and hardware tools.
- Analysing financial transaction- A forensic auditor should detect errors, fraudulent activities and omissions. Forensic auditor is a fraud detector who has the capabilities to analyse financial transaction which will help him to easily detect errors, fraudulent activities and omissions that may be presented for litigation or sent to the audit committee.
- Reconstruction of incomplete accounting records- The forensic auditor will reconstruct incomplete accounting records as to settle insurance claims, over inventory valuation, proving money laundering activities by reconstructing cash transactions.
- Unwinding the entire suspected activities and find out any fraudulent activity or misappropriation.

The forensic auditing is almost like intuitive processes with an analytic methodology. It is an art and science. It is necessary for the forensic auditor to think and act like a fraudster so as to find the loopholes in the system. In short, a forensic investigation is a special type of engagement, which requires highly skilled team members who have experience not only of accounting and auditing techniques, but also of the relevant legal framework and technological competence.

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