

Audit v/s Investigation **ISRO → Appointment**

Basis	Investigation	Audit
Objective	Aims at establishing a fact or a happening or at assessing a particular situation.	Verify whether the F.S. display a true and fair view of the state of affairs.
Scope	Scope of investigation may be governed by statute or it may be non- statutory.	Scope of audit is wide and in case of statutory audit the scope of work is determined by the provisions of relevant law
Periodicity	The work is not limited by rigid time frame. It may cover several years, as the outcome of the same is not certain.	The audit is carried on either quarterly, half-yearly or yearly.
Nature	Requires a detailed study and examination of facts and figures. Investigation is voluntary in nature.	Involves tests checking or sample technique to draw evidences for forming a judgement and expression of opinion. It is mandatory for companies.
Inherent Limitations	No inherent limitation owing to its nature of engagement.	Suffers from inherent limitation.
Evidence	It seeks conclusive evidence.	Audit is mainly concerned with prima- facie evidence.
Observance of Accounting Principles	It is analytical in nature and requires a thorough mind, capable of observing, collecting and evaluating facts.	Is governed by compliance with generally accepted accounting principles , audit procedures and disclosure requirements.
Appointing Agency	Even third party can appoint Investigator	Auditor is appointed by owner/ shareholders of company/ enterprise
Reporting	The outcome is reported to person(s) on whose behalf investigation is carried out.	The outcome is reported to the owners of the business entity.

Steps in Investigation

- Determination of objectives** & establishment of **scope** of investigation.
- Formulation of the Investigation programme.**
- Examination and study of **various records** by reference to appropriate evidence.
- Analysis, processing & interpretation of findings.**
- Preparation of **report** and drawing up of **conclusions.**

Important issues to be kept in mind by the investigator while preparing his report

- Report to not contain anything which is **not relevant** to highlight nature of investigation or final outcome thereof.
- Every word/expression to be used properly. To **minimize possibility of different meaning/interpretation.**
- Facts & conclusions should be properly **linked with evidence.**
- Basis & assumptions to be explicitly stated.** Should be reasonable & not in conflict with the objectives of investigation.
- Report should clearly **spell out** nature & objective of assignment, its scope & limitations.
- Report should be made in **para form** with headings for paragraphs
- Opinion** of investigator in **final paragraph** of report.

Special Issues in Investigation

(a) Whether an investigator is required to undertake a % verification approach or whether he can adopt selective verification
 Safer to go by **statistically recognised sampling methods** than to depend on **so-called "test checks"** where circumstances permit selective verification.
Cash defalcation - examine all cash vouchers

(b) Whether the investigator can put reliance on the already audited statement of account -

- If statements of a/c produced before investigator were **not audited by a qualified accountant**, then of course there arises a **natural duty to get** figures in accounts properly **checked & verified**
- However, when accounts produced to investigator have been specially **prepared by a professional accountant**, who knows or ought to have known that these were prepared for purposes of investigation, he could **accept them as correct relying on the principle of liability to third parties.**
- Nevertheless, it **would be prudent to see first that such accounts were prepared with objectivity** and that **no bias** has crept in to give advantage to the person on whose behalf these were prepared.

Whether the investigator can put reliance on the already audited statement of account - If the **investigation has been launched** because of **some doubt in the audited statement of account, no question of reliance** on the audited statement of account **arises.**

However, if the investigator has been requested to establish value of a business or a share or the amount of goodwill payable by an incoming partner, ordinarily the **investigator would be entitled to put reliance on audited materials** made available to him unless, in the course of his test verification, **he finds** the audit to have been carried on very casually or unless his terms of appointment clearly require to test everything afresh"

(c) Whether an investigator necessarily requires assistance of expert

- Written general consent** of his client
- Settle the question of costs for obtaining the views and other related implications.

(d) Investigation out of disputes and conflicting claims

- should **remain above** disputes or conflicting claims
- be alert to the possibilities** of the information or documents made available to him to **be prejudiced.**
- Should **keep the interest** of all the involved parties high degree of maturity and experience.

(e) Basis of opinion of an investor

Investigator should **refrain** from issuing **speculative opinion.** He should **confine his opinion to the established facts** and nothing more.

(f) Whether an investigator can make futuristic statements

- should **refuse** to be futuristic

(g) Whether to retain working papers or not

- Take representation letter** from the appointing authority.
- To give evidence in a court of law to support his figures;** for quite often the conclusions of the accountant are challenged by parties.

Factors to be considered while studying Economic & Financial position of business:

- Adequacy of **fixed & working capital.** Are these sufficient for growth of business?
- What will be **trend of sales & profits** in future? Establishing trend of sales, product-wise & area-wise will ordinarily help in drawing a conclusion on whether the trend will be maintained in future.
- Whether the **profit** which the business could be **expected to maintain in future** would yield adequate return on capital employed?
- Whether **business is operating at its 100 % capacity** or improvements can be made to reach at full productivity?

Factors while Assessing Future Maintainable Turnover

- Competition** - Is **demand for competitor's products** increasing? Is the Co's share in total trade constant or fluctuating?
 - Political & economic considerations** - Are **policies of govt.** likely to extend market of goods to other countries?
 - Trend** - Whether in **Past sales** increasing consistently or fluctuating.
 - Marketability** - Is it **possible to extend sales** to new market or they have been fully exploited?
- CPT → Marketability.*

Investigation on behalf of an Incoming Partner

- Ascertainment of **history of the inception and growth** of the firm.
- Study of **provisions of deed of partnership** - composition of partners, their capital contribution, drawing rights, etc.
- Scrutiny of **record of profitability of firm's business** over a suitable No. of years, with usual adjustments that are necessary in ascertaining true record of business profits.
- Examination of **asset and liability position** to determine tangible asset backing for the **partner's investment**, appraisal of the value of **intangibles** like goodwill, know how, patents, etc.
- In case of **firms rendering services**, question of tangible asset backing usually is not important.
- Reasons for offer** of admission to new partner & whether **any senior partner is retiring** at same time.
- Various important **contractual and legal obligations** should be **ascertained** and **their nature studied**. It may be the case that the **firm has standing agreement** with the employees as regards salary and wages, bonus, gratuity and other incidental benefits. **Full impact of such standing agreements** be considered.
- Study composition and quality** of key personnel employed by the firm and any likelihood of their leaving the organisation in near future.

Investigation in Valuation of shares of Pvt. Co.

In respect of equity shares, there are two main methods of valuation

First Method: Net Worth

- **Value per Share = Amount of net worth / No. of shares of ESC.**
- Goodwill of business, & non-trading assets (like investments) based on estimated future maintainable profit, is included among the assets to arrive at amount of net worth.
 - (i) Each asset should be revalued on Going Concern assumption.
 - (ii) Value of goodwill of a business is primarily dependent on its capacity to earn super-profit & period over which these are expected to arise

Second method: Yield basis

- **Avg. profit** earned by business during preceding 5 to 7 years is computed.
- On the assumption that same would continue to be earned in future, value of business is calculated by capitalising it at a reasonable rate of interest.

High Rate of Interest ->	Smaller Value of Business
Low Rate of Interest ->	Higher Value of Business

Investigation on behalf of a Bank/ Financial Institution Proposing to Advance/Loan to a Company

1. **Purpose** for which the loan is required and the manner in which the borrower proposes to invest the amount of the loan
2. **Financial standing and reputation for business integrity** enjoyed by directors and officers of the company.
3. **History of growth and development of the company & its performance** during the **past 5 years**
4. **Schedule of repayment** of loan submitted by the borrower
5. Whether the **company is authorised by the MOA or AOA to borrow money** for the purpose for which the loan will be used.
6. Whether any **loan application to any other Bank or Financial Institution was made**, & if so, the **reasons for rejection** thereof.
7. How the **economic position of the company would be affected by economic, political and social changes** that are likely to take place during the period of loan.

To investigate the **profitability of the business** for judging the **accuracy of the schedule of repayment** furnished by the borrower, as well as the value of the security in the form of assets of the business already possessed and those which will be created out of the loan, the **investigating accountant should take the under-mentioned steps:**

- (a) Prepare a **condensed income statement from the Statement of Profit and Loss for the previous 5 years**, showing separately therein various items of income and expenses
- (b) Compute the under-mentioned **ratios** separately and then include them in the statement to show the trend as well as changes that have taken place in the financial position of the company:
 - 1) Current Assets to Current Liabilities
 - 2) Quick Assets to Quick Liabilities
 - 3) Equity to Long Term Loans
 - 4) Sales to Book Debts
 - 5) Return on Capital Employed
 - 6) Sales to Average Inventories held
 - 7) Sales to Fixed Assets
 - 8) Equity to Fixed Assets
- (c) Enter in a separate part of the statement the **break-up of annual sales product-wise to show their trend**.

Steps involved in verification of assets & liabilities included in B/S of borrower company which has been furnished to Bank

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Investigation on behalf of an Individual or Firm Proposing to Buy a Business

(A) In case of proprietary concerns or partnerships -

- (i) **Reasons for sale** of business & **effect on** turnover and profits.
- (ii) **Length of lease** under which **premises** are held, prospects of its renewal or extension.
- (iii) **Unexpired period** of any **patents**.
- (iv) **Age of present managerial staff & prospects of continuing** in service under **new proprietorship & possible liability, not already provided for-** Gratuity, Retrenchment compensation.
- (v) If **bulk of sales are made to customers whose number is small**, profitability of business would be greatly shaken on withdrawing their support. This should be investigated as it might affect future profitability.

(B) If the business belongs to a limited company

- (i) **Authorised & issued capital** of Co.
- (ii) **Uncalled liability on shares**.
- (iii) If **capital is divided into different classes** of shares - **Rights attached** to each class.
- (iv) **Particulars of dividends paid in past & amounts** thereof which are in **arrear** (on cumulative preference shares).
- (v) **Mortgages/ charge** created **on assets** in company's books. **Inspect Register of Charges**.
- (vi) Price at which shares are being offered.
 - a. Public co - Quoted Price
 - b. Pvt co - valuation

Investigation in connection with review of Profit/Financial Forecasts

There are many investigations which involve an **examination of future profits** like,

- 1) **Profit reports** - can be required as part of a general investigation into the **purchase of a business** or,
- 2) **By banks and financial institutions with regard to project cash flow and profitability statements for appraisal of loan applications** submitted by the intending borrowers.

All forecasts depend, to a large extent, on the **nature of the business** with its numerous and substantial uncertainties.

Therefore, such **forecasts are not capable of verification by the accountants** in the same way as financial statements which present the results of a completed accounting period.

Normally, such **situations involve special review** as these depart from the auditor's role of expressing an opinion in relation to past

Investigation of Frauds

Fraud at Operational Level Employees

- 1) **Cash Misappropriation:** Cash is misappropriated after the accounting entries are already passed in the books
- 2) **Teeming and Lading:**
- 3) **Fraudulent Disbursements:** Issuing or submission of false bills, or personal expense bills being converted into official expenses bills.
- 4) **Expense Reimbursement Schemes:** Employees may get reimbursed by third parties (such as distributors) as well as by claiming these expenses from the company. Multiple expense claims based on duplicate bills or photostat copies.
- 5) **Payroll Fraud:** Payment to non-existent employees or in a contractual arrangement inflating of the manpower resources than those actually deployed while billing the client.
- 6) **Commission Schemes:** salesman exaggerates the sales through fictitious billings to earn higher commission or alter the sales prices of the products sold from those stipulated by the company
- 7) **Tampering of Cheques/Drafts/On-line payments/receipts:** Tampering of cheques, payee name being altered, or preparation of cheques without the same being issued to payee, etc., are methods that may also lead to falsification of accounts.
- 8) **Off Book Frauds:** Fraud perpetrator misappropriates the cash before these are recorded in the books or before the sale is recorded in the books.

Indicators of Fraud

- (i) **Discrepancies in Accounting Records** including non-recording or partial recording or incorrect recording or delayed recording of amounts, misclassifications, etc.
- (ii) **Conflicting or missing evidence** including missing documents, altered documents, significant unexplained items in reconciliations, discrepancies between entity's records and confirmations received etc.
- (iii) **Unacceptable management responses** such as - denial of access to records/facilities/employees, undue time pressure to resolve complex issues, unusual delays in providing requested information, denial for use of Computer Assisted Audit Techniques, unwillingness to address identified deficiencies in internal control etc.
- (iv) **Other indications** such as - Accounting Policies in variance with Industry Norms, Frequent changes in accounting estimates etc.

Fraud Diamond

Four Elements of Fraud:

1. **Incentive:** I want to, or have a need to, commit fraud.
2. **Opportunity:** There is a weakness in the system that the right person could exploit. Fraud is possible.
3. **Rationalization:** I have convinced myself that this fraudulent behaviour is worth the risks.
4. **Capability:** I have the necessary traits and abilities to be the right person to pull it off. I have recognized this particular fraud opportunity and can turn it into reality.

Auditor's ability to detect fraud depends on such Factors

- **Skilfulness of the perpetrator**
- **Frequency & extent of manipulation**
- **Degree of collusion** involved
- **Relative size of Individual amounts** manipulated; and
- **Seniority of those individuals** involved.

Steps involved in verification of assets & liabilities included in B/S of borrower company which has been furnished to Bank

- a) **Fixed assets:**
 - a) A full description of each asset, its gross value, rate of depreciation, Revaluation.
 - b) In case any asset is encumbered, the amount of the charge & its nature should be disclosed
- b) **Inventory:** value & basis of valuation
- c) **Trade Receivables, including bills receivable:** Their composition should be disclosed, whether any debts are considered bad or doubtful.
- d) **Investments:** schedule of investments - date of purchase, cost and the nominal and market value
- e) **Secured & Unsecured Loans:** the amounts outstanding for payments along with due dates of payment.
- f) **Provision of Taxation:** P.Y. up to which taxes have been assessed or assessment order received should be **ascertained**
- g) **Other Liabilities:** All the liabilities, **actual & contingent**, are correctly disclosed
- h) **Contingent Liabilities:** Proper disclosed.

Ways of Committing Fraud	Investigation Procedure
<p>Cash Receipt</p> <ol style="list-style-type: none"> Showing a larger cash discount than actually allowed Adjusting a fictitious credit in the account of a customer for the value of goods returned by him. Adjusting a cash sale as a credit sale, and raising a debit in the account of the customer. Writing off a good debt as bad and irrecoverable. Issuing a receipt to the payee for the full amount collected and entering only a part of the amount on the counterfoil Amount collected has been misappropriated. Under-casting the receipts side of the Cash Book or over-casting the payment side. 	<ol style="list-style-type: none"> Cash sales should be vouched in detail. Recoveries from customers and sundry parties should be checked with the copies of receipts issued to them Paying-in-slips from the bank the details of cash deposited on each day should be compared with those shown in Cash Book. All withdrawals from the bank should be checked by reference to corresponding entries in the bank pass book. Income received from different sources should be scrutinized, e.g., inventory, sales summaries, rental registers, correspondence with customers

Ways of Committing Fraud	Investigation Procedure
<p>Inflate Cash Payment</p> <ol style="list-style-type: none"> Making double payment of an invoice or paying a false invoice Paying personal expenses out of the business by falsifying details. e.g., showing betting losses as advertisement charges. Withdrawing unclaimed credit balances of customers or amounts falsely credited in the accounts of parties. Falsely adjusting a refund in the account of a customer and withdrawing the credit balance. Wrong totalling of the wage sheets and misappropriating the excess amount withdrawn from the bank for payment of wages. 	<ol style="list-style-type: none"> All the evidence as regards cash payments made, including acknowledgement by parties, should be carefully scrutinized. All payments by bearer cheques should be examined. The system of recording of wages should be reviewed, specially as regards possible over-totalling of wage sheets, and entries in them of dummy workmen. Petty Cash Book should be vouched and totaled. All withdrawals from the bank should be checked by reference to entries in the bank's pass book. All BR/BP should be checked by reference to the Bills Books.

Ways of Committing Fraud	Investigation Procedure
<p>Supplier Ledger</p> <ol style="list-style-type: none"> Adjusting fictitious or duplicate invoices as purchases in the accounts of suppliers and subsequently misappropriating the amounts when payments are made to the suppliers in respect of these invoices. Suppressing Credit Notes issued by suppliers and withdrawing corresponding amounts not claimed by them. Withdrawing amounts unclaimed by suppliers, for one reason or another by showing that the same have been paid to them. Accepting purchase invoices at prices higher than their market prices and collecting the excess amount, paid in cash, from the suppliers. 	<ol style="list-style-type: none"> Purchase Journal should be vouched by Goods Inward Book and suppliers invoices. All suppliers should be requested to furnish statements of their accounts to see whether or not any balance is outstanding or due so as to confirm that allowances or rebates given by them have been correctly adjusted and were duly authorized. Examine system of IC in relation to purchase orders issued and identify possibilities of collusion with suppliers.

Ways of Committing Fraud	Investigation Procedure
<p>Customer Ledger</p> <ol style="list-style-type: none"> By 'teeming and lading' method, i.e., misappropriating amount collected from a customer and crediting his account by the amount paid by him only when an amount is subsequently collected from another customer; repeating this practice with several items collected and depositing back the amount so misappropriated before the close of the year. Misappropriating amount collected from a customer and adjusting his account by crediting the amount on account of allowance or a rebate. Crediting amount received from a customer to the account of another customer and subsequently withdrawing the amount wrongly credited. 	<ol style="list-style-type: none"> Confirm that accounts of customers have been debited in respect of goods supplied to them, entries in the Order Book should be cross-checked with those in Sales Day Book Special attention should be paid to allowance adjusted - on account of goods returned or difference in price or on any other account as well as to amounts written off as bad debts. Obtain confirmation of customers in respect of the amounts standing in their accounts. Those of them who have no balance in their accounts should be requested to confirm the statement of their account.

Inventory Frauds
<ol style="list-style-type: none"> Employees may simply remove goods from the premises. Theft of goods may be concealed by w/o as damaged goods, etc. Inventory records may be manipulated by employees who have committed theft so that book quantities tally with the actual quantities of inventories in hand. Inflating quantities issued for production Stocks actually dispatched but not entered in sales/ debtor's account.

Procedure for Verification of Defalcation of Inventory/ Investigation Procedure
<p>Inventory thefts usually are possible through collusion among no. of persons. Therefore, entire system of receipts, storage and dispatch of all goods, etc. should be reviewed.</p> <p>The determination of factors which have been responsible for theft and establishment of guilt would be difficult in the absence of:</p> <ol style="list-style-type: none"> a system of inventory control, and existence of detailed record of the movement of inventory, or availability of sufficient data from which such a record can be constructed. <p>First step in such an investigation is to establish the different items of inventory defalcated and their quantities by checking physically the quantities in inventory held and those shown by Inventory Book.</p>
<p>Defalcations of inventory, sometimes, also are committed by mgt, by diverting a part of production and the consequent shortages in production being adjusted by inflating the wastage in production; similar defalcations of inventories and stores are covered up by inflating quantities issued for production.</p> <p>For detecting such shortages, should take assistance of an engineer.</p> <p>Guidance can also be taken from past records showing the extent of wastage in production in the past. Similarly, he would be able to better judge whether the material issued for production was excessive and, if so to what extent.</p>

Composition and Quality of Key Personnel



History

Contracted & Legal

Reason for Offer



A/Z



JOIN US!



Standard Agreement

Study the Provision of Deed

