Module 17 · Forensic Audit P17 · topics 17.1–17.5

SM pp. 727–762. **56 marks in 7 papers. Q5(b), 7 marks, in every paper since Dec'23** (cash embezzlement case, need and procedures, CFE code, techniques, investigation methodology, corporate fraud causes) plus an MCQ. Answers are SM lists: learn them in SM order.

Paper	Q5(b) · MCQ	Paper	Q5(b) · MCQ
Jun'23	Q10 **whistle-blowing policy** (8) · MCQ fraud tree	Jun'25	**forensic audit of finance + techniques**
Dec'23	**embezzlement of cash receipts: forensic approach** · MCQ management red flag	Dec'25	**investigation methodology** · MCQ primary objective
Jun'24	**need for forensic audit + procedures**	Jun'26	**corporate fraud: meaning and causes**
Dec'24	**code of ethics for CFEs**	Dec'26?	**meaning + common areas** (MQP Q5(b)) · **constituents** (PTP Q5(b)) — never asked

17.1 Forensic audit: meaning, methodology, need, areas · Jun'24, Dec'25 Q5(b)

- SM WORDS A forensic audit is an **analysis and review of the financial records** of a company or person to **extract facts, which can be used in a court of law**. It is an **independent, comprehensive, and scientific approach**; unlike financial audit (statutory compliance), it **investigates to derive evidence of fraud** for legal proceedings. The auditor may be an **expert witness**; it also covers bankruptcy disputes, business closures, divorces. [SM 727]
- Process = audit planning, gathering evidence, report + **possible appearance in court**. [SM 727]
- **Need** (Jun'24): (I) **theft of business information** or hacked systems; (II) issues from **whistle-blowers**; (III) **reconciliations with unidentified material differences**; (IV) **suspicion of fraud** or illegal activity; (V) turnover with negative balances. [SM 730]
- **Procedures**: with **professional scepticism** and a scientific approach, looking at **incentives**, **attitude** (rationalising) and **opportunity**. [SM 730]
- **Common areas** (MQP): **asset misappropriation**, **corruption**, **extortion**, **financial statement fraud**, **conflict of interest** (white-collar crime). [SM 731]

INVESTIGATION METHODOLOGY (DEC'25 Q5(b))

1. **Accepting the investigation**: an independent firm checks it has the **tools, skills and expertise** (fraud detection and legal framework) before accepting.
2. **Planning**: the key step; goals: identify the **type of fraud**, how long and how concealed; the **fraudsters**; **quantify the loss**; **evidence** for court; advice to **prevent recurrence**. Use the **fraud triangle**: pressure (motive), opportunity, rationalisation.
3. **Gathering evidence**: public documents and background checks · **detailed interviews** · trustworthy (confidential) sources · **surveillance** (physical or electronic) · **going undercover** (last resort) · analysing financial statements · analysing evidence.
4. **Reporting**: findings; summary of evidence; loss suffered; how the fraud was planned and unfolded; the trail of events; suggestions to prevent it.
5. **Court proceedings**: present facts simply and objectively.

[SM 727–730]

The nine-step fact-finding method: accept the engagement · evaluate the allegations · due-diligence background · preliminary investigation · assume **litigation** will follow · external investigation · gather proofs · report · court. [SM 731]

CONSTITUENTS OF FORENSIC AUDIT (PTP Q5(b))

1. assess **fraud risk factors**; evaluate internal controls and standards;
2. compare fraud **schemes** to devise controls;
3. develop **off-setting controls** to limit or prevent them;
4. **data analysis** to find high-risk transactions;
5. evaluate controls; plan audits using information systems;
6. evaluate financial and programme **risk**;
7. apply **evidence-gathering techniques**;
8. **justify the conclusion** of fraud with evidence for legal staff;
9. **document** the evidence and the process.

[SM 755]

CORPORATE FRAUD · WHY IT HAPPENS (JUN'26 Q5(b))

- SM WORDS Corporate fraud consists of **illegal or unethical and deceptive actions** committed either **by a company or an individual acting as its employee**; often complicated accounting schemes to **inflate apparent profits**; may take years to detect; much of the money is never recovered. [SM 731–732]
- **Causes:** (a) **greed** and the desire to **attract or retain investors** (look more profitable); (b) hiding **problems or defects with products** (e.g. drug side effects). Regulators: SEBI, the SEC. [SM 732]
- **Cases: Enron** (with Arthur Andersen; led to **Sarbanes-Oxley**); **Waste Management** (survived); **ZZZZ Best** (Ponzi); **Wirecard** (a $2 billion gap, 2020); **Wells Fargo** (sales quotas → fake accounts). India: Mundhra (LIC, 1950s), Harshad Mehta, Ketan Parekh, Sahara, Satyam. [SM 732–733, SM 736]

17.2 Fraud risk management · red flags · s.447 · Jun'23, Dec'23 MCQs

- **Fraud**: a **deliberate act (or failure to act)** to obtain an **unauthorized benefit** by deception, false suggestion or suppression of truth. Examples: embezzlement; forgery; altering computer files; fraudulent reporting; misuse of resources; paying for goods not received; unearned wages; conflict of interest. [SM 734]
- **Fraud triangle: opportunity** (weak internal controls: supervision, separation of duties, approval, system controls) · **pressure** (financial problems, addictions, unrealistic targets) · **rationalization** ("I'll pay it back", "they owe me"). **Breaking** it — above all removing **opportunity** through internal control — deters fraud. [SM 734–735]
- **Employee red flags:** lifestyle changes; heavy debt; behaviour changes; high turnover; **refusal to take vacation**; no segregation of duties. [SM 735]
- **Management red flags** (Dec'23 MCQ): frequent **override of controls**; decisions dominated by one person or a small group; disrespect for regulators; undocumented policies; weak control environment; many bank accounts; year-end transactions; refusal to use serially numbered receipts; missing documents; disputes with auditors; **frequent changes of auditors**; assets sold below market value. [SM 735–736]
- A suspecting employee should **not confront** the suspect or investigate personally. [SM 736]
- The 2013 Act: a separate definition of fraud in **s.447** and the **SFIO** under **s.212**. s.447 combines IPC s.405 (criminal breach of trust), 415 (cheating), 463 (forgery), 477A (falsification of accounts). Elements: act, omission, concealment, abuse of position with **intent to deceive**, gain undue advantage or injure, whether or not there is wrongful gain or loss. [SM 736–737]
- Fraud of at least **INR 10 lakh** or **1%** of turnover, whichever is lower: imprisonment **six months** to **10 years**; fine not less than the fraud amount; offence **cognizable, non-bailable, non-compoundable**. **s.446A** factors: size of company, nature of business, injury to public interest, nature of default, repetition. [SM 737]
- **s.143(12)**: auditors report fraud to the CG. **SEBI LODR** amendment from **October 08, 2020**: a listed entity discloses the **initiation of a forensic audit** (who, why) and the **final report** with management's comments — **no materiality threshold**. [SM 737–738]

*Jun'23 MCQ: the classification of frauds is the **fraud tree** (SM MCQ 14).* [SM 762]

17.3 Financial forensics and techniques · Jun'25 Q5(b), Dec'23 Q5(b) case

- **Financial forensics** combines **accounting and investigation** to find evidence of financial crime and recover losses; also values businesses. Cases: **financial theft** (e.g. from the cash register), **securities fraud**, **money laundering**, **valuation disputes**, **tax evasion**. [SM 739]
- Forensic accounting cross-checks records for fraud and gives court-ready analysis; it also cuts losses and improves efficiency. **Qualities:** logical mind; attention to detail; moral principles; **question everything**; spontaneity; understanding of transactions. [SM 740]

TECHNIQUES (SM ORDER)

1. reviewing **public documents** and background checks;
2. conducting **detailed interviews**;
3. information from **trustworthy sources** (protect identity);
4. analysing the **evidence** gathered;
5. **surveillance** (physical, electronic: e-mails, messages);
6. **going undercover** (last resort);
7. analysing the **financial statements**.

[SM 740–741]

Cash-embezzlement case (Dec'23): plan with the triangle; compare receipts books, bank deposits and ledgers; interview cashiers; check serial numbers and missing receipts; trace lapping; analyse the evidence; report loss, method, persons and control fixes. [SM 728–730]

17.4 Code of conduct · CFE standards and code of ethics · Dec'24 Q5(b)

ACFE CODE OF PROFESSIONAL STANDARDS

- Binds all **Certified Fraud Examiners** of the ACFE; Associates should follow it. [SM 749]
- **A. Integrity and objectivity**: never compromise integrity; screen and disclose **conflicts of interest**; objectivity; nothing discreditable; no false statement on oath; obey lawful court orders. **B. Competence**: accept only what one is competent for; continuing education. **C. Due care**: diligence, critical analysis, **professional scepticism**; evidence relevant, competent, sufficient; planning; supervision. **D. Understanding** with client on scope and limits. **E. Communication** of significant findings. **F. Confidentiality**. [SM 749–751]
- **Examination**: legal, thorough; consider **exculpatory and inculpatory** evidence; **chain of custody**. **Reporting**: oral

CODE OF ETHICS FOR CFEs (8) · THE DEC'24 ANSWER

1. commitment to **professionalism and diligence**;
2. no illegal or unethical conduct or **conflict of interest**;
3. highest **integrity**; accept only assignments he can complete **competently**;
4. comply with **lawful court orders**; testify truthfully, without bias;
5. obtain **evidence** for a reasonable basis; **no opinion on guilt or innocence**;
6. no disclosure of **confidential information** without authorization;
7. reveal all **material matters** discovered;
8. keep increasing **competence**.

[SM 751–752]

or written; not misleading; **no opinion on legal guilt or innocence**. [SM 751]

A CFE's three roles: identify evidence; interview and report; proactively evaluate **fraud risk**. [SM 752]

17.5 Professional opportunities · SM exercise

- Need: cyber-crime, regulators missing scams, failing co-operative banks; forensic accounting finds the **what, why and how** behind figures. **Maurice E. Peloubet** coined "forensic accountant" in **1946**. ICMAI runs an **Advanced Diploma in Forensic Audit**. [SM 753–754]
- ACFE 2018 Report to the Nations: **2690** cases from **125** countries, more than $7 billion lost; **72** from India. [SM 753]
- Indian cases listed by the SM: Vakrangee, Manpasand, Gitanjali (fake LCs), DHFL, IL&FS, Yes Bank, CG Power, ICICI Bank and others; solved case: **Harshad Mehta** (about ₹1,000 crore siphoned; ₹3,500 crore manipulated). [SM 754–756]

SM EXERCISE KEYS (SM 762)

1 forensic accounting = investigative and analytical skills to court standards · 2 fraud · 3 **juxtaposition test** · 4 senior management · 6 **phishing** · 7 **shot gunning** · 8 and 15 **rationalization** · 9, 11 **red flag** · 10, 12 **green flag** · 14 **fraud tree** (= Jun'23 MCQ) · 17 forgery · 18 ratio analysis: correct · 19 **3D vision**: time and space dimensions · 20 bank-fraud definition by **RBI** · 21–22 red flags, uncovering fraud → **forensic audit** · 23 fraud triangle · 24 fraud defined in **s.447** · 25 reporting duty **s.143(12)**. [SM 762]