

Study on Investigative Audits

(Revised 2021 Edition)



The Institute of Chartered Accountants of India
(Set up by an Act of Parliament)
New Delhi

Study on Investigative Audits

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Internal Audit Standards Board
The Institute of Chartered Accountants of India
(Set up by an Act of Parliament)
New Delhi

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Foreword

In today's technology driven environment where everything is digitalized, Investigative auditing is all the more essential as it helps to unveil the objective with which any corporate misdeeds, such as, embezzlement, extortion, fictitious transactions, kickbacks and conflict of interest has taken place. Thus, Investigative auditing is a helpful tool for the management to prove allegations or provide concrete evidence of a fraud that can be presented before the regulators.

Investigative Auditing involves the examination of accounts and the use of accounting procedures to discover financial irregularities and to follow the movement of funds and assets in and out of organizations. In that way, it is kind of specialised audit that secure and protect interest of various stakeholders associated with the business. With their education and training, chartered accountants possess specialised skills to detect fraud, collect evidence, writing reports, and understand legal scope of evidence.

I am happy to note that the Internal Audit Standards Board of the ICAI is issuing this Revised Study on Investigative Audit. I appreciate the efforts of CA. Charanjot Singh Nanda, Chairman, Internal Audit Standards Board, ICAI and other members of the Board for bringing out this Study on Investigative Auditing.

I am sure that this publication would be of immense help for our members.

July 6, 2021
New Delhi

CA. Nihar N Jambusaria
President, ICAI

Preface

Enhanced regulatory enforcement, big data and complexities in business transactions, quicker response towards allegations necessitate to conduct Investigative audit. Investigations Audit are generally conducted to determine existing internal control weaknesses, identify the fraud vulnerability areas and assist in risk management in determining the amount of loss and finally assist the investigated entity offering them recommendations on the corrective measures to prevent subsequent occurrences.

Formulating appropriate strategies for the prevention and detection of fraud, planning and execution of investigative audit requires academic and professional expertise. Chartered accountants has high abilities & skillsets for applications of professional prudence, may develop strong documented procedures beyond checklist used in compliances, has ability to generate high level Industry and Company knowledge through Market surveillance, Expert advisory opinions, Industry Research, Government & Trade Publications, Accounting reports etc.

Keeping this in mind, the Internal Audit Standards Board of the Institute “Study of Investigative Audit” has issued in 2011 as an attempt to share various facets of an investigative process at a basic level with readers. Topics such as, types of fraudulent act, accountability for fraud detection, corporate fraud control plan, investigative tools and techniques, diagnosing fraud behaviour, external/ in-house investigations, pre-requisite of a good investigation, managing investigative assignments, interview process, investigation report, legal action, investigative audit and allied services, market scenario for investigative work, and way forward were covered in this publication. Now, the Board has revised the publication to provide more guide to members in additional areas like strengthening control environment, setting up an investigative audit cell, investigative audit practice guide, engagement practices, engagement conduct, reporting norms, document retention and handover norms, background checks in forensic assignments,, code of governance, regulatory expectations on fraud reporting. This publication provides an insight into the specific aspects concerning Fraud prone Areas, Role of Management, CARO, Fraud detection, how to initiate Investigative Process. This publication provides a brief overview of industry and regulatory framework applicable to the industry. Reporting Norms being

an important aspect of the investigative Audit has been covered in detail including fundamentals, general reporting standards, report content, review process and key components of an engagement contract. Regulatory Expectations on Fraud Risk Reporting has also been dealt in this publication.

At this juncture, I wish to place on record my sincere thanks to all the members of the study group formed viz., CA. R. Srivatsan (Convenor), Shri Karithanam J Thomas, Shri Mukesh Bajaj, Shri Anil Chiplunkar, Shri Ashok Asawale, CA. S. Bhaskar, CS. J. Kannan, CA. Parthasarathi De, CA. Prasanna Bharatan, CA. Rahul Lotlikar, CA. Jitendra Kalwar, CA. Yashwant Bharati and CS. Anuradha Srivatsan for taking time out of their pressing preoccupations and contributing in preparation of this Publication.

I would like to thank to CA. Nihar N Jambusaria, President, ICAI and CA. (Dr.) Debashis Mitra, Vice-President, ICAI for their continuous support and encouragement to the initiatives of the Board. I must thank my colleagues from the Council at the Internal Audit Standards Board, viz., CA. Anil S. Bhandari, Vice Chairman Internal Audit Standards Board, ICAI, CA. Tarun J Ghia, CA. Nandkishore C Hegde, CA. Chandrashekhar V Chitale, CA. Shriniwas Y Joshi, CA. Aniket S Talati, CA. Dayaniwas Sharma, CA. G Sekar, CA. M P Vijay Kumar, CA. Ranjeet Kumar Agarwal, CA. Pramod Kumar Boob, CA. Manu Agrawal, CA. Prakash Sharma, CA. Kemisha Soni, CA. Satish Kumar Gupta, CA. Pramod Jain, CA. (Dr.) Sanjeev Kumar Singhal, CA. Prasanna Kumar D., CA. Durgesh Kabra, Shri Gyaneshwar Kumar Singh, Mrs. Ritika Bhatia, Shri Chandra Wadhwa, Co-opted members CA. Manoj Kumar Jain, CA. Rakesh Agarwal, CA. Manish Baxi, CA. Kamlesh Amlani, CA. Huzeifa Unwala, CA. Bhavin Shah, CA. Parvinder Singh, CA. Nitin Alshi, Special Invitees CA. Sanjay Agarwal, CA. Pradeep Tyagi, CA. Gavish Uberoi and Shri D.K. Sekar for their vision and support and their invaluable guidance and also their dedication and support to the various initiatives of the Board. I wish to express my sincere appreciation for CA. Arti Bansal, Secretary, Internal Audit Standards Board, ICAI for her efforts in giving final shape to this publication.

I am hopeful that this publication would prove as a useful reference material to the members for carrying out investigative audits.

June 25, 2021
New Delhi

CA. Charanjot Singh Nanda
Chairman
Internal Audit Standards Board, ICAI

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Chapter 1

Introduction

Chapter Summary

The introductory chapter provides an insight into various facets of fraud risk and an overview of the contents in the book. An attempt has been made to avoid technical jargons making the contents understandable to the readers. Management perceptions about fraud risk and the specific exclusions from this book are elaborated. The book is meant for Chartered Accountants to strengthen their role as chief financial officers, internal auditors, chief investigating officers, statutory auditors or representing senior management positions in an organisation.

1.1 A Chartered Accountant in accordance with his professional knowledge base is an efficient coordinator in the conduct of investigative assignments and is ably supported by analytical skills, working knowledge in process evaluation and requisite documentation, especially for investigation involving financial crimes. He is, therefore, in an advantageous position to play the role of a strategist in carrying out investigations. While this study is meant to supplement the role of practicing Chartered Accountants, it would be an eye opener to the management as how they can engage the Chartered Accountants.

1.2 Aspirations, goals, stretch targets, execution excellence and sustained growth are prerequisites for any growing organization. Chartered Accountants do play a major role in strengthening risk assessment process, in capability assessment through performance reviews, ensuring value added services, customer focus and support to management in ensuing effective corporate governance that are of significant importance to organizations. An effective governance mechanism encompasses integrity in dealings which needs to be well ingrained in the organizational core values.

1.3 While it takes ages to build a business empire, it takes just a few mistakes to bring down the same. One can learn innumerable lessons on how successful corporations decay and very few are lucky to have a resurgence. For this reason, the tone at the top of the management hierarchy on sound value system is of prime importance and the same must percolate

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down to the entire organization. 'To this end, the management defines its core values through a code of conduct for its employees.

There is a thin line that divides a genuine mistake from a fraud and hence it becomes difficult for the management to identify the real intent of such actions. The thumb rule is to ascertain whether there is a deception and whether the same has caused damage to the organisation, irrespective of gains to the person practicing such deception.

There is always a need for this caution in managing the risk of fraud before, during and after the event has occurred. A fraudulent activity may not necessarily be a single event and, therefore, there are chances that an alert management is able to notice the leads that are available to identify suspected frauds before extensive damage is done to the organization. The diagnostic review for assessing vulnerabilities to fraud is a step towards deterrence of fraud.

There is a general reluctance in establishing an in-house investigation department considering the impact it has on the morale of the employees and a perceptible negative influence in the minds of the employees towards the internal audit team. The advantage of an in-house investigative team is cost effectiveness. The information remains internal to the organization safeguarding the market image. However, for reasons mentioned above, there is a greater tendency to outsource the investigative assignments as there is a greater independence and acceptance of results of investigations carried out by outsourced firms vis-à-vis in-house internal audit teams.

For the management and the internal audit fraternity, it is important to ensure service differentiation between internal audit function and investigative assignments.

In internal audit assignments, to confirm whether a fraudulent act has occurred, the auditor should consider whether there is an element of deception, whether the damages arising to the organisation as a result of the wrongful act is determinable and whether sufficient evidence or trail exists that suggest the involvement of persons to the happening of such wrongful act. The basic requirement of such a situation where internal audit may take the form an investigative assignment is to seek a referendum from the Chief Audit Executive or a designated authority.

1.4 It is the fundamental principle of any investigation that the methodology used for investigation to unearth the truth cannot be fraudulent.

In any investigative assignment, the rights available under the law of the land must be respected and, therefore, a Chartered Accountant conducting such investigations must ensure that methods used do not circumvent any legal requirement or infringe on the rights of other persons.

As a matter of principle, the ability of the firms in conducting investigation is of paramount importance in awarding an investigative assignment. Similarly, it is essential that the private investigators accept assignments for which they have the domain expertise.

1.5 The principles that apply to conduct of business efficiently and ethically in a social environment apply to managing the investigative assignments. Apart from the effectiveness of internal controls, the management representatives and the investigating authorities must understand the social, political, cultural and legal environment in which the assignments are handled. The planning of any investigation involves being aware of the local customs, practices and power centers in the client work environment. These factors do influence the outcome of any investigation. In investigative assignments though technically, the Chartered Accountant would be able to gather evidence or reach a conclusive result, he/ she should be sufficiently aware of the control environment. He/ she should exercise diligence to safeguard his/ her interest and interest of the client on whose behalf such investigation is conducted in presenting the findings and evidence gathered. These are important factors that may be relevant to the investigative process. These depend on the prevailing situations and circumstances in which the alleged irregularities have occurred, the profile of the alleged perpetrator(s) and the way the investigation progresses.

1.6 This study attempts to share with the reader various facets of an investigative process at the basic level. Readers are requested to use their discretion on the case-to-case basis and use the information in an appropriate manner by adapting and/ or limiting the initiatives to be taken in the conduct of their assignment. Readers may take an independent view on legal advice in managing these kinds of assignments. The term investigation has been used in this publication with reference to investigation of financial frauds.

1.7 The use of specialised software (licensed), proprietary methods and use of gadgets (including specifications), report formats and questionnaires, proprietary methodology of investigative firms are excluded from the purview

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of this publication. Similarly, investigation in public sector, government offices, quasi-government bodies and vigilance cells in banks and financial institutions, etc. are excluded from the scope of this publication. At times, investigative assignments may go beyond books of account and involve activities such as, background checks, gathering of business intelligence, shadowing of targeted individuals etc., that would be beyond the domain expertise of Chartered Accountants and, therefore, involve the support of specialists. This study addresses the need for caution where Chartered Accountants engage services of specialists during investigation.

Readers may also refer to other publications of ICAI, other information that are accessible in the public domain for further enrichment of their knowledge on the subject. Appropriate references are given at the end of this publication.

In no event the publisher or the author will be liable for any damages, including any loss of profits, injury to any person or property or any other incidental or consequential damages arising out of the use or inability to use the book, or for any claim by any other party.

For third party content, website references, best practices in industry and methodologies followed in leading in class global accounting, auditing and consulting firms, it is hereby clarified that this technical guide is for general reading for dissemination of knowledge, not prescriptive and is a shared learning experience, wherein individual readers would need to exercise their discretion to adapt to any given situation, demonstrating due professional care tuned to the code of conduct of the Institute of Chartered Accountants of India.

Chapter 2

Types of Fraudulent Act

Chapter Summary

A Chartered Accountant while conducting financial investigation assignments should be familiar with fundamental concepts with reference to what constitutes a financial fraud. The connotations on wrongful practices may vary across organisations. The knowledge of internal processes, policies, procedures and documentation requirements are a prerogative in the conduct of investigations. Similarly, the Chartered Accountant should be familiar with the laws of the state in which investigations are conducted, that would enable him to seek expert opinion from legal counsel as to whether based on facts any wrongful act has been committed, before a report is submitted to the client. Such expert legal opinion would enable the Chartered Accountant to exercise caution at each stage of the investigation process to prevent him from getting entrapped in controversies with legal ramifications, that may result in deviation from the core object of investigation.

This chapter elucidates the types of fraudulent acts and the common types of frauds in a corporate entity.

Fraud

2.1 Fraud is defined in Standard on Internal Audit (SIA) 11, "Consideration of Fraud in an Internal Audit" as an intentional act by one or more individuals among management, those charged with governance, or third parties, involving the use of deception to obtain unjust or illegal advantage. A fraud could take form of misstatement of an information (financial or otherwise) or misappropriation of the assets of the entity.

The following are, essentially, the components in a fraudulent activity:

- A dishonest intention
- Use of deception
- Personal advantage or loss to a third person
- Generally results in financial/asset loss to an organization and may involve financial misstatements.

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2.2 A common example of a fraudulent activity is availing of multiple loan transactions with several financial institutions by gross misrepresentations against the same asset. The value of the asset financed, or income of the applicant is misstated to increase the eligibility norms, or make up for no down payment resulting in generation of cash proceeds for the perpetrator of fraud, profiting him at the cost of the company (entity).

2.3 Fraudulent activities are likely to be committed through the use of several mediums including cleverly drafted policy document to cover up follies, entering into fabricated agreements, usurping undue powers in the guise of structured delegation, interpretation of conflict of interest in normal business dealings, misrepresentation of documents, photographs, use of pre-printed stationery, such as, letter heads, etc., mails, telegrams, telephone, and internet (computer crime and internet fraud). The difficulty of checking the identity and legitimacy online, the ease with which hackers can divert browsers to dishonest sites and steal credit card details, the international dimensions of the web and ease with which users can hide their location, all contribute to making internet fraud, the fastest growing area of frauds.

2.4 A false document made wholly or in part by forgery is designated as “a forged document”. Fingerprint analysis are assigned to specialists who are persons having requisite qualification as recognized by the Government. As of now, there are no private institutions in India which are entitled to offer qualifications in this field.

Further, the certification by a handwriting expert is not considered conclusive evidence and, generally, has to be backed by circumstantial evidence. At best such certificate can be construed only as supporting evidence in the eyes of law. The statement of a handwriting expert as witness may be admissible in litigation but not considered sufficient to prove a case. To solicit the services of a handwriting expert, the investigator may probably be able to identify the appropriate person through the offices of the ‘Government examiner of Questioned Documents’ (located at Shimla, Kolkata, Hyderabad, Delhi under the aegis of the ‘Central Fingerprint Bureau’).

Fraud for Personal Gain

Bribery

2.5 Money, gift or other favours offered to procure (often illegal or dishonest) action or decision in favour of the giver is termed as “Bribe”. Many

organizations have laid down strict rules of not paying/ receiving bribes and employees are forewarned of disciplinary action in the event of deviations. These are relatable to contract frauds or procurement frauds and are, generally, out of books transactions. The internal auditor, normally, conducts a propriety audit over the veracity of the transactions and review of any undue favours to vendors.

Conflict of Interest

2.6 There are circumstances wherein the officials are in a position of trust and in discharge of their duties face a competing professional or personal interest. Such conflicting interest results in impartial discharge of his/ her duties. A conflict of interest can create an appearance of impropriety that can undermine the confidence in that person or in his professional abilities. Thus, conflict of interest may arise from family interests, in which a spouse, child, or other close relative is engaged in a competing business or where goods or services are purchased from such a relative or a firm controlled by a relative. For this reason, many employment applications ask if one is related to a current employee or insist on self-declarations.

2.7 The following are some ways to remove/ mitigate conflict of interest:

- Avoidance of conflicting roles
- Disclosure of conflict
- Abstain from decisions involving role conflicts
- Third party evaluations
- Code of ethics.

(i) Avoidance of Conflict

The best way to handle conflicts of interests is to avoid them entirely. For example, Under Section 226 of the Companies Act, 1956, a person holding any security (instrument carrying voting rights) of a client company is disqualified to be a statutory auditor.

(ii) Disclosure

Certain professionals are required either by rules related to their professional organization, or by statute, to disclose an actual or potential conflict of interests. In some instances, the failure to provide full disclosure is a crime.

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(iii) Abstention

Those with a conflict of interests are expected to abstain themselves from decisions where such a conflict exists. The imperative for recusal varies depending upon the circumstance and profession, either as common-sense ethics, codified ethics, or by statute.

(iv) Third-party Evaluations

Third-party evaluations can be used as proof that transactions were, in fact, fair (“arm’s-length”). For example, a corporation that leases an office building that is owned by the Chief Executive Officer (CEO) might get an independent evaluation showing what the market rate is for such leases in the locale, to address the conflict of interests that exists between the fiduciary duty of the CEO (to the stockholders) and the personal interest of that CEO (to maximize the income that the CEO gets from owning that office building).

(v) Codes of Ethics

Generally, codes of ethics forbid conflicts of interests. Often, however, the specifics can be controversial. Codes of ethics help to minimize problems with conflicts of interests because they can spell out the extent to which such conflicts should be avoided, and what the parties should do where such conflicts are permitted by a code of ethics (disclosure, recusal, etc.). Thus, professionals cannot claim that they were unaware that their improper behavior was unethical. As importantly, the threat of disciplinary action helps to minimize unacceptable conflicts or improper acts when a conflict is unavoidable. However, a code of ethics cannot cover all situations and would need appropriate interpretations and monitoring mechanism.

Corporate Frauds/ Irregularities

Advance Billing

2.8 Advance billing is a situation where the company officials indulge in booking fictitious sales in anticipation of actual sales. This results in misrepresentation of revenue in the books thereby misleading financiers and stakeholders. When the management treats borrowings from money lenders as customer advances in the books against sale orders or for adjusting bills receivables, the fraudulent act gets unnoticed for an extended period. This situation results in a death knell for the corporation as the company is dragged into an irredeemable debt trap.

2.9 In public companies, improprieties in disclosure requirements or “window dressing” involving inflated revenues or costs can amount to fraud and investigations are typically launched by government oversight agencies, such as the Securities and Exchange Board of India, Office of the Comptroller and Auditor General of India, Central Vigilance Commission, and Central Bureau of Investigation, etc.

2.10 Use of Shell Company, false vendors, purchases of personal nature booked as official expenses enable falsification of accounts and diversion of funds for purposes other than what is intended for. These could be mechanism for employees or cartel of employees engaging in personal gain at the cost of the company. The former incident could be termed as management fraud.

Shell/ Dummy Company Schemes

2.11 Generally, a shell or dummy company represents a fictitious company or a ‘paper company’ to transfer profits or funds from the main company. This could involve fictitious bills (mostly for services rendered or consultancy charges that cannot be corroborated) which are used in the name of dummy companies diverting the funds taken from banks and financial institutions. Such a shell company could be floated by employees too to siphon off funds from their legitimate company. The perpetrator could be preparing the payment vouchers or in some cases may be authorized to approve cheques. This could include procurement of goods, such as, for project work that is routed through a shell company to enable diversion of profits.

The books of accounts could be falsified by wrong classification of expenses, inflating the expense claims, fictitious expenses or multiple reimbursements. A review of controls, normally, leads to uncovering of expense booking that are prima facie not incurred.

Money Laundering Activities

2.12 Section 3 of the Prevention of Money Laundering Act, 2002 defines offence of money laundering as under:

“Whosoever directly or indirectly attempts to indulge or knowingly assists or knowingly is a party or is actually involved in any process or activity connected with the proceeds of crime and projecting it as untainted property shall be guilty of offence of money laundering.”

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2.13 The person indulging in money laundering looks for avenues with weak banking controls for converting illegal money through the banking system. Any excess credit in the bank accounts that does not belong to the customer or is parked for a temporary period should raise suspicion of such activities. This person indulging in money laundering activity looks for avenues to enter into 'benami' (could be called name lending) transactions. Companies with extensive cash handling and inadequate identification process of source of money or about the remitter are susceptible to money laundering activities.

Anti-Money Laundering Measures

2.14 Financial institutions are, generally, required to monitor, investigate and report transactions (up to a defined limit) of a suspicious nature to the financial intelligence unit of the central bank in the respective country. For example, a bank must perform due diligence by having proof of a customer's identity and ensure that the use, source and destination of funds do not involve money laundering.

Fraud at Operational Level by Employees

Tampering of Cheques

2.15 Tampering of cheques and in any digital mode of payment and activity that leads to misrepresentation such as payee name being altered, or preparation of cheques or payments in system without remittance or issue of the cheques to entitled payee, etc., are methods that may lead to falsification of accounts. The name of the payee in the cheque or other digital mode of payments issued for payment could be fabricated to wrongly codify and book against an improper account head. This is difficult to uncover unless balance confirmations are obtained from the vendors.

2.16 A person draws cheque or payment voucher in system fraudulently in his name or converts a cheque drawn on a third party to his advantage. This could have been done through forgery in signature of the drawer, or misuse of blank cheques (could be even signed cheques or post-dated cheques) retained at the back office of the company providing easy access to the perpetrator of the fraud, improper retention of cancelled or time barred cheques, forged endorsement, altering the name of the payee, involve concealed cheque schemes or authorised maker schemes, etc. These cheques or use of other digital mode could either be drawn or altered

favouring the perpetrator of fraud or use for cash withdrawal, or to an accomplice later on sharing the amount misappropriated or in the name of a fictitious entity or a person who could be influenced to part with the amount at a later date.

2.17 Absence or lack of control in preparing the bank reconciliation statements or malicious software application programmes results in employees resorting to wrong coding of cheques to inactive accounts. The person preparing the bank reconciliation statement should preferably be different from the person printing and issuing the cheques. A lack of control in this area can lead to fraudulent encashment or issue of multiple cheques that can be covered up by the 'subject' through an improper accounting process. The use of BOTs and artificial intelligence is gaining ground that can make tracing of the wrongful activities difficult leading to audit risk or control risks.

Off Book Frauds – Skimming

2.18 In skimming the fraud perpetrator misappropriates the cash before these are recorded in the books or before the sale is recorded in the books. These frauds are difficult to unearth as the cash or collection is taken off before the accounting entries are made in the books. This situation arises especially in unorganized markets and in rural economies where banking habits are relatively underdeveloped. The process gaps allow an employee to divert the cash collected to his personal account under the pretext of safeguarding organization's cash.

These are difficult to be established due to absence of audit trails and are more prevalent in businesses that have extensive cash dealings. These are difficult to be uncovered as the means adopted may include printing of receipts/ bills outside the system. For example, in a trading business of used cars, where the employee or the franchisee outlet manages to sell the car without inward stock and notifying or recording the sales in the books and diverts the amount collected from the customer to his personal account. Such a practice is called skimming.

2.19 The above schemes can be established based on circumstantial evidence or validation through external sources such as, customer balance confirmations (where feasible) and customer copy of the receipts or other documents that are retained by them. These are further supplemented by external evidence in the form of background checks and surveillance

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mechanism. Such misrepresentations are noticeable in non-government organizations and by unscrupulous agents who collect donations from gullible donors and have embezzled the amount for their personal use using unauthorised receipts that are never accounted in the books.

Sales could be understated through offering of heavy discounts, subventions or commissions that are netted off before recording the sale in the books. This is another form of scheme where employees convert the difference between sale amount and notional discount offered into off book diversion of income for personal gain. Contrary to the above, the booking of purchases without accounting for vendor rebates is another form of off-book diversion of funds.

Cash Larceny

2.20 Ind AS 7 deals with Submission of Cash Flow Statement. Diversion of cash from a business to fund the loss or on personal account is a common factor in most bank Non-Performing Assets. Cash or funds mis-appropriated after the accounting entries are already passed in the books is an age-old practice that has manifested into innovative means in the digital era. In traditional audit checks, these are identified through surprise checks and through shortages in cash balances. These occur when there are delays in accounting of cash collections and there are no laid down cash flow controls. In cash intensive businesses these are covered through adequate insurance cover to ensure that claims are lodged once theft of cash is reported. This can be noticed through altered or forged cash deposit pay-in- slips.

The cash/ collection shortage is covered up by declaring and accounting the shortage as cash/ cheque in transit. Thus, taking advantage of the communication gap that existed between the central office and remote locations regarding accountability in use of fund transfers. Another form of larceny is pilferage of cheques/ drafts that are in transit and endorsing them in personal names. This carries more risk where companies retain postdated cheques for fund transfers and do not ensure timely independent bank reconciliation statement.

Teeming and Lading (also known as Lapping)

2.21 This is achieved through cash deposits or cheques collected from customers being overlapped with the collections from subsequent customers and the amount collected is diverted to personal account. The ageing of

receivables is not a constant factor and, therefore, this makes the task of identifying the leakage of collections unless all the customer accounts are reconciled at a single point of time.

Fraudulent Disbursements

2.22 Fraudulent disbursements or reimbursements take place either by issuing or submission of false bills, or personal expenses bills being converted into official expenses bills.

Cash or fund shortages are adjusted through false disbursal entries tallying the cash balance in the cash register. These are called fraudulent register disbursements that may either involve excessive refunds or void sales. The excessive refunds could be by declaring false sales returns. This will result in excessive inventory that will be reflected during physical inventory verification. Alternatively, the customer is not issued a receipt post sale and when the customer leaves the counter; the sale is reversed in the books. The amount collected is misappropriated. This anomaly surfaces through shortage in physical stock, and the perpetrator of fraud may either resort to destruction of registers or corruption of data or adjusting stock records where he has access in the system. Generally, these frauds are evident where inventory verification is not done for substantial periods. The other method that is resorted to by the perpetrators of fraud is to inflate the refunds due to a customer and skim the excess refunds.

Expense Reimbursement Schemes

2.23 These fraudulent schemes involve employees resorting to treating their personal expenses as incurred for business purpose and claiming reimbursement. For example, buying stationery for school kids and claiming it from the employer, travels bills claims that are subsequently cancelled without notifying the company, claiming medical or gift expenses that were not incurred or employees travelling together in a single cab but indulging in multiple claims individually, etc. In some cases, employees may get reimbursed by third parties such as, dealers as well as by claiming these expenses from the company. Multiple expense claims may be based on duplicate bills or photostat copies. These types of frauds are, generally, of lesser magnitude in terms of damages and are managed through in-house investigations.

Payroll Fraud

2.24 The payroll fraud could include payment to non-existent employees or in a contractual arrangement inflating of the manpower resources than those deployed while billing the client. It may include showing higher pay than actual disbursement to employees/ workers, etc.

Commission Schemes

2.25 The 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 or share the sales volumes achieved with other employees to share higher commission.

Chapter 3

Accountability for Fraud Detection

Chapter Summary

This Chapter assesses the role of management, internal auditor, and statutory auditor in managing risk of fraud with reference to Standard on Internal Audit (SIA) 11, Consideration of Fraud in Internal Audit, Clause 49 of the Listing Agreement of Stock Exchange and CARO requirements. The auditor's responsibilities relating to fraud in an audit of financial statements dealt with as per Standard on Auditing (SA) 240, The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements as issued by the Auditing and Assurance Board of the ICAI.

Accountability for Fraud Detection

3.1 The primary responsibility for prevention and detection of frauds is that of the management of the entity. The internal auditor should, however, help the management fulfil its responsibilities relating to fraud prevention and detection. Thus, accountability on detection of fraud is with the management and they may engage the services of internal auditors as facilitators. Similarly, the role of statutory auditors on matters relating to reporting on fraudulent is defined under Standard on Auditing (SA) 240 "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements".

Role of Management

3.2 Standard on Internal Audit (SIA) 11, "Consideration of Fraud in an Internal Audit" provides that:

- (i) The *control environment* sets the tone at the top in an entity and greatly impacts the effectiveness of internal controls. It includes the following:
 - The policies and procedures established by the management to communicate and enforce the culture of integrity and ethical values in the entity.

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- management's commitment to competence.
 - management's philosophy and operating style.
 - organizational structure.
 - assignment of authority and responsibility.
 - human resources policies and practices.
- (ii) The *entity's risk assessment process* includes the policies and procedures adopted by the management to identify risks that can affect the achievement of the objectives of the entity and to distinguish risks from opportunities. In the context of prevention of frauds, the entity's risk assessment process would include the policies and procedures of the management to identify and assess the risk of frauds, including the possibility of fraudulent financial reporting and misappropriation of assets.
- (iii) The *information system and communication* refer to the policies and procedures established by the management to identify, capture, and communicate relevant information to the concerned persons in the entity to enable them to make timely and effective decisions and discharge their responsibilities efficiently. In the context of frauds, such policies and procedures could take form of whistleblower policies and mechanisms, ethics help lines and counseling, training of employees, etc.
- (iv) The *control activities* refer to the policies and procedures established by the management to ensure that the risks identified are responded to as per the policy or the specific decision of the management. In the context of frauds, the control activities include actions taken by management to prevent or detect and correct the frauds or breach of internal controls.
- (v) *Monitoring* refers to continuous supervision and assessment of the internal controls to identify instances of any actual or possible breaches therein and to take corrective action on a timely basis.

Role of Internal Auditor

3.3 Paragraph 3.3 of the Standard on Internal Audit (SIA) 2, "Basic

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Principles Governing Internal Audit” as issued by the Internal Audit Standards Board of ICAI states as follows:

“The Internal Auditor shall exercise due professional care and diligence while carrying out the internal audit. “Due professional care” signifies that the Internal Auditor exercises reasonable care in carrying out the work to ensure the achievement of planned objectives.

The Internal Auditor shall pay particular attention to certain key audit activities, such as establishing the scope of the engagement to prevent the omission of important aspects, recognizing the risks and materiality of the areas, having required skills to review complex matters, establishing the extent of testing required to achieve the objectives within specified deadlines, etc.

“Due Professional Care”, however, neither implies nor guarantees infallibility, nor does it require the Internal Auditor to go beyond the established scope of the engagement.”

3.4 An internal auditor should, therefore, use his knowledge and skills to reasonably enable him to identify indicators of frauds. However, the internal auditor cannot be expected to possess the expertise of a person with specialized knowledge and skills in detecting and investigating frauds.

A fraud normally occurs in situations where there is an incentive or a pressure to commit fraud, an opportunity to commit fraud or a rationalization for committing fraud. Although, normally, an internal auditor is not expected to possess skills and knowledge of a person expert in detecting and investigating frauds, he should have reasonable knowledge of factors that might increase the risk of opportunities for frauds in an entity and exercise reasonable care and professional skepticism while carrying out internal audit. In addition, the understanding of the design and implementation of the internal controls in an entity would help the internal auditor to assess the risk of frauds.

3.5 The following paragraphs discuss the approach of the internal auditor in matter of assessing fraud risks:

- (i) The internal auditor should obtain an understanding of the various aspects of the control environment and evaluate the same as to the operating effectiveness.

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- (ii) The internal auditor should obtain an understanding of the policies and procedures adopted by the management to identify risks that can affect the achievement of the objectives of the entity and to distinguish risks from opportunities and evaluate the effectiveness of these policies and procedures. In the context of prevention of frauds, the internal auditor should specifically evaluate the policies and procedures established by the management to identify and assess the risk of frauds, including the possibility of fraudulent financial reporting and misappropriation of assets.
- (iii) The internal auditor should assess the operating effectiveness of the policies and procedures established by the management to identify, capture and communicate relevant information to the concerned persons in the entity to enable them to make timely and effective decisions and discharge their responsibilities efficiently.
- (iv) The internal auditor should assess whether the controls implemented by the management to ensure that the risks identified are responded to as per the policy or the specific decisions of the management, as the case may be, are in fact working effectively and whether they are effective in prevention or timely detection and correction of the frauds or breach of internal controls.
- (v) The internal auditor should evaluate the mechanism in place for supervision and assessment of the internal controls to identify instances of any actual or possible breaches therein and to take corrective action on a timely basis.
- (vi) The internal auditor should carefully review and assess the conclusions drawn from the audit evidence obtained, as the basis for his findings contained in his report and suggest remedial action. However, in case the internal auditor comes across any actual or suspected fraud or any other misappropriation of assets, he should immediately bring the same to the notice of the management.
- (vii) The internal auditor should document fraud risk factors identified as being present during the internal auditor's assessment process and document the internal auditor's response to any other factors. If during the performance of the internal audit fraud risk factors are

identified that cause the internal auditor to believe that additional internal audit procedures are necessary, the internal auditor should document the same.

Difference between Internal Audit and Investigation

3.6 It is important for management and the internal audit fraternity to ensure service differentiation between internal audits and investigative assignments. While the skill sets required in executing these assignments may be similar, the objective and scope of coverage in these assignments may vary and, therefore, there is a need for greater understanding between the management and the internal auditors for any further action on any matter arising out of the audit observations.

3.7 The scope of review in an internal audit is, generally, restricted to what is reported in the books of account, while in an investigation the scope of review may extend beyond the books of account. Internal audit may be a trigger to commence an investigation. The following are some major differences between internal audit and investigation:

Internal Audit	Investigation
• Audits are planned in advance.	• Investigations are, generally, in response to events or occurrences.
• Materiality in reporting facts is a dominant factor.	• Gathering of evidence is a more dominant factor. Materiality may not be relevant.
• Primarily governed by statute.	• Governed by specific mandate as decided by management.
• References are to basic working paper documentation.	• In addition to working papers, there could be an element of background checks to corroborate evidence/ facts.
• Role of reviewing operations, recommending improvements or review costs to determine these are reasonable.	• Traditional role in investigation is to search for civil/ criminal/ ethical violations.

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3.8 Auditors and Investigators vary in terms of need for training needs, work approach and deliverables. The mode of conducting interviews in an internal audit differs from that of an investigation. A toolkit used in an investigation may not be used in a normal internal audit assignment. e.g., voice recorders, bugs, cameras, or other visual representations, etc. The mode of communicating their work activities and results can vary between an audit and an investigation assignment.

Benefits of Co-ordinated Effort by Auditor and Investigator

3.9 There are occasions where audit and investigative engagements need special expertise. Auditors can and commonly do provide financial auditing expertise to investigating staff in various types of white-collar crime inquiries. Similarly, investigating officers can be of assistance to auditors in tracking down business relationships which may be essential to the audit, such as determining whether there is common control or ownership among companies which potentially results in inter- company transfers with excess profits or bid rigging or result in diversion of funds.

The commercial officer in a company had acquired clout in the local unit due to his proximity to the plant head. Having won the confidence of his boss, he formed a network of important people in the locality and with other employees in the plant as an 'honest person' reaching out to people when they most need him. Under the influence of outside elements, he started indulging in unethical practices on a small scale. As his confidence grew, his greed overtook his needs and he started indulging in activities clandestinely, which were not in the best interests of the company. This was evident from disgruntled employees within the plant and from the control gaps highlighted by the internal auditors. As a management representative what would be an important step in ascertaining the facts in this matter?

Based on the internal audit findings, the investigating officer could easily diagnose the problem. He could accordingly plan his strategy by seeking the list of active and non-active contracts, and was able to use the information available in the internal audit report regarding the key findings arising out of ledger scrutiny of billings and payments schedules, ascertaining the level of activities at the plant, the terms of contractual engagement and most importantly the reason for some of the

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contractors being discontinued. An interaction with the internal auditor would be useful in defining the objective, scope of coverage and time targets within which the investigative assignments could be completed.

3.10 An internal auditor was apprehensive of certain irregularities relating to the lifestyle of the 'auditee' vis-à-vis his income levels. However, he considered this beyond his scope of review and, therefore, highlighted his concerns to the management. The Chartered Accountant was called in and the scrutiny of the internal records with the external background checks revealed that the suspect had amassed wealth that was disproportionate to his income, through inappropriate means.

In an internal audit of the payroll function, an auditor stumbled upon falsification of wage records by the management with a view to evade taxes and non-payment of statutory dues. The scope of audit was restricted up to this point by resorting to review of the swipe card entries, review of workstation level labour records, and gate records. Any attempt in gathering external evidence to highlight non-existent employees may involve physical inspection, background checks outside the office premises, residence checks, neighbour checks, interviews with fellow employees, etc., and so. the later part can be termed as investigative in nature.

3.11 During the audit of a treasury function, physical verification of the key security documents revealed that certain term deposit certificates were not traceable. The auditor pointed out the lacunae in the verification process and highlighted the matter to the management. The matter was referred for investigation and it was noticed that these certificates were pledged, and borrowings were adjusted against receivables in the books to tide over the rising level of receivables.

An Information Technology (IT) company in its first year of its operation wanted to project a healthy result. The company had a sub-entity created abroad and the entity was used as a front-end company to build up a healthy balance sheet. The internal auditors were required to complete the audit based on the documents and declarations submitted by local management. The auditors had to rely on the contracts signed between the two companies and the fund flow from such entities. The internal auditor had to limit the audit review to the photostat copies of the documents and soft entries in the system of the operations between the

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main company and the 'front' company. The existence of the ultimate customer was questionable and not verifiable by the internal auditor as the audit of the 'front company' was not within the purview of internal audit engagement'. To maintain confidentiality, the auditor had to return the supporting documents and contracts to the management to safeguard customer specific information and was not allowed to retain even the Photostat copies lest the information is leaked out to competitors.

The same auditor was managing the audit of a banking entity. The project work on getting the financing done for the management was offered to an independent consulting firm at the behest of the audit firm. The management as a confidence building exercise with the auditors, assigned, a consultancy assignment to define the business process, the accounting manual and to carry out a due diligence exercise to such consulting firm in lieu of arranging of the finance.

The bankers of the company wanted a due diligence exercise to be carried out to establish the credibility of the company operation. This called for an investigation into the billing and realisations of the IT company. The billing was classified into deputing manpower, the process support in developing and customisation of software and implementation of the software. The customer confirmation was received from the front company and the remittances were recorded against each of such billings in a sequential manner. Do you see any conflict in the role of the audit firm? Do you believe this could be a management fraud? How would you carry out this assignment?

3.12 Standard on Auditing (SA) 240 "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements" issued by the Institute of Chartered Accountants of India, lays down the objectives of the auditor as follows:

- (a) To identify and assess the risks of material misstatement in the financial statements due to fraud;
- (b) To obtain sufficient appropriate audit evidence about the assessed risks of material misstatement due to fraud, through designing and implementing appropriate responses; and
- (c) To respond appropriately to identified or suspected fraud.

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The auditor shall make inquiries of management regarding:

- (a) Management's assessment of the risk that the financial statements may be materially misstated due to fraud, including the nature, extent, and frequency of such assessments.
- (b) Management's process for identifying and responding to the risks of fraud in the entity, including any specific risks of fraud that management has identified or that have been brought to its attention, or classes of transactions, account balances, or disclosures for which a risk of fraud is likely to exist;
- (c) Management's communication, if any, to those charged with governance regarding its processes for identifying and responding to the risks of fraud in the entity; and
- (d) Management's communication, if any, to employees regarding its views on business practices and ethical behaviour.

An effective internal audit team can be extremely helpful in performing aspects of the oversight function. Their knowledge about the entity may enable them to identify indicators that suggest fraud has been committed.

The Companies (Auditor's Report) Order, 2020

3.13 The Central Government, in exercise of the powers conferred, under sub-section (11) of section 143 of the Companies Act, 2013 (hereinafter referred to as "the Act"), issued the Companies (Auditor's Report) Order, 2020, (CARO 2020/ "the Order") vide Order number S.O. 849(E) dated 25th February 2020. CARO 2020 was initially applicable for audits of financial year 2019-20 and onwards. Subsequently, vide notification dated 24th March 2020, its applicability has been deferred by one year. Accordingly, CARO 2020 is applicable for audits of financial year 2020-21 and onwards. CARO 2020 contains certain matters on which the auditors of companies (except auditors of those categories of companies which are specifically exempted under the Order) have to make a statement in their audit reports. For text of the CARO 2020 refer to Appendix I to the Guidance Note on The Companies (Auditor's Report) Order, 2020. With reference to fraud reporting the following needs attention:

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Whether any fraud by the company or any fraud on the company has been noticed or reported during the year, if yes, the nature and the amount involved is to be indicated; [Paragraph 3(xi)]

Consider when whistle-blower complaint is received or have been identified, during the course of the audit, whether fraud assessment done in accordance with Guidance Note on Reporting on Fraud under Section 143(12) of the Companies Act, 2013 issued by ICAI.

- (a) Under this clause, the responsibilities of the auditor have been widened by removing the words “officers or employees”. This clause requires the auditor to report whether any fraud has been noticed or reported either on the company or by the company during the year and is not limited to frauds by the officers or employees of the company. If any fraud is noticed / reported, the auditor is required to state the amount involved and the nature of fraud. This clause does not require the auditor to discover such frauds on the company and by the company. The scope of auditor’s inquiry under this clause is restricted to frauds ‘noticed or reported’ during the year. The use of the words “noticed or reported” indicates that the management of the company should have the knowledge about the frauds on the company or by the company that have occurred during the period covered by the auditor’s report. It may be noted that reporting under this clause does not relieve the auditor from his responsibility to consider fraud and error in an audit of financial statements. In other words, irrespective of the auditor’s comments under this clause, the auditor is required to comply with the requirements of SA 240, “The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements”. Further, the auditor is required to comply with the requirements of section 143(12) of the Companies Act, 2013. In this context, the auditor should have regard to the “Guidance Note on Reporting on Fraud under Section 143(12) of the Companies Act, 2013”, issued by ICAI.
- (b) The term ‘fraud’ as defined in explanation to section 447 of the Act in relation to affairs of a company or any body corporate, includes any act, omission, concealment of any fact or abuse of position committed by any person or any other person with the connivance in any manner, with intent to deceive, to gain undue advantage

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from, or to injure the interests of, the company or its shareholders or its creditors or any other person, whether or not there is any wrongful gain or wrongful loss. The term “fraud” is defined in SA 240 as “An intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage”. The definition of fraud as per SA 240 and the explanation of fraud as per section 447 of the Act are similar, except that under section 447 of the Act, fraud includes ‘acts with an intent to injure the interests of the company or its shareholders or its creditors or any other person, whether or not there is any wrongful gain or wrongful loss.’ However, an auditor may not be able to detect acts that have intent to injure the interests of the company or cause wrongful gain or wrongful loss, unless the financial effects of such acts are reflected in the books of account/financial statements of the company. For example, an auditor may not be able to detect if an employee is receiving pay-offs for favoring a specific vendor, which is a fraudulent act, since such pay-offs would not be reflected / recorded / traced in the books of account of the company. However, the auditor should report all such frauds under this clause noticed or reported to him while conducting the audit. It will cover frauds which may have an indirect impact on financial statements of the company.

- (c) The auditor is required to report separately on the nature and amount involved for (i) fraud on the company (ii) fraud by the company. Further, the auditor should consider the frauds noticed or reported while performing audit.
- (d) Although fraud is a broad legal concept, the auditor is concerned with fraudulent acts that cause a material misstatement in the financial statements. Misstatement of the financial statements may not be the objective of some frauds. Auditors do not make legal determinations of whether fraud has actually occurred. Fraud involving one or more members of management or those charged with governance is referred to as "management fraud"; fraud involving only employees including officers of the entity is referred to as "employee fraud". In either case, there may be collusion with third parties outside the entity. In fact, generally speaking, the

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“management fraud” can be construed as “fraud by the company” while fraud committed by the employees or third parties may be termed as “fraud on the company”.

- (e) Two types of intentional misstatements are relevant to the auditor's consideration of fraud - misstatements resulting from fraudulent financial reporting and misstatements resulting from misappropriation of assets.
- (f) Fraudulent financial reporting involves intentional misstatements or omissions of amounts or disclosures in financial statements to deceive financial statement users. Fraudulent financial reporting may involve:
 - (i) Deception such as manipulation, falsification, or alteration of accounting records or supporting documents from which the financial statements are prepared.
 - (ii) Misrepresentation in, or intentional omission from, the financial statements of events, transactions, or other significant information.
 - (iii) Intentional misapplication of accounting principles relating to measurement, recognition, classification, presentation, or disclosure.
- (g) Misappropriation of assets involves the theft of an entity's assets. Misappropriation of assets can be accomplished in a variety of ways (including embezzling receipts, stealing physical or intangible assets, or causing an entity to pay for goods and services not received); it is often accompanied by false or misleading records or documents in order to conceal the fact that the assets are missing.
- (h) Fraudulent financial reporting may be committed by the company because management is under pressure, from sources outside or inside the entity, to achieve an expected (and perhaps unrealistic) earnings target particularly when the consequences to management of failing to meet financial goals can be significant. The auditor must appreciate that a perceived opportunity for fraudulent financial reporting or misappropriation of assets may exist when an individual believes internal control could be circumvented, for example, because the individual is in a position

of trust or has knowledge of specific weaknesses in the internal control system.

Audit Procedures and Reporting

- (a) While planning the audit, the auditor should discuss with other members of the audit team, the susceptibility of the company to material misstatements in the financial statements resulting from fraud. While planning the audit, the auditor should make inquiries of management to determine whether management is aware of any known fraud or suspected fraud that the company is investigating.
- (b) The auditor should examine the reports of the internal auditor with a view to ascertain whether any fraud has been reported or noticed by the internal auditor. The auditor should examine the minutes of the audit committee, if available, to ascertain whether any instance of fraud pertaining to the company has been reported and actions taken thereon. The auditor should enquire from the management about any frauds on the company that it has noticed or that have been reported to it. The auditor should discuss the matter with other employees including officers of the company. The auditor should examine the minutes book of the board meeting of the company in this regard.
- (c) The auditor should obtain written representations from management that:
 - (i) it acknowledges its responsibility for the implementation and operation of accounting and internal control systems that are designed to prevent and detect frauds and errors.
 - (ii) it believes the effects of those uncorrected misstatements in financial statements, aggregated by the auditor during the audit are immaterial, individually and in the aggregate, to the financial statements taken as a whole. A summary of such items should be included in or attached to the written representation.
 - (iii) it has disclosed to the auditor all significant facts relating to any frauds or suspected frauds known to management that may have affected the entity; and

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- (iv) it has disclosed to the auditor the results of its assessment of the risk that the financial statements may be materially misstated as a result of fraud.
- (d) Because management is responsible for adjusting the financial statements to correct material misstatements, it is important that the auditor obtains written representation from management that any uncorrected misstatements resulting from frauds are, in management's opinion, immaterial, individually and in the aggregate. Such representations are not a substitute for obtaining sufficient appropriate audit evidence. In some circumstances, management may not believe that certain of the uncorrected misstatements aggregated by the auditor during the audit are misstatements. For that reason, management may want to add to their written representation words such as, "We do not agree that items constitute misstatements because [description of reasons]." In such situation, the auditor shall carry out the procedures laid down in SA 450, "Evaluation of Misstatements Identified During the Audit" for uncorrected misstatements and consider its materiality including its impact on the auditor's opinion.
- (e) The auditor is required to report whether he has considered whistle-blower complaints, if any, received during the year by the company. The auditor should be mindful while performing the procedures under this clause and consider complaints received under whistle blower mechanism. The auditor should consider whether additional procedures are required to be performed under SA 240 in this regard.
- (f) The auditor is required to consider whether any transactions not recorded in the books of account have been surrendered or disclosed as income during the year in the tax assessments. The auditor should consider such voluntary surrender of income and assess if the company has intentionally not accounted income in any of the previous years and has offered it to taxes at the time of assessment. It may be an indicator that the company had misstated the results which may lead to fraudulent financial reporting. The auditor should make necessary inquiries from the management in this regard.

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- (g) The auditor should consider if there are any adverse findings noticed by him, which requires the auditor to provide details if the quarterly returns or statements filed by the company with banks or financial institutions for sanctioned working capital limits are not in agreement with the books of account of the company.
- (h) Where the auditor notices that any fraud by the company or on the company has been noticed or reported during the year, the auditor, apart from reporting the existence of fraud, is required to report, the nature of fraud and amount involved. For reporting under this clause, the auditor may consider the following:
 - (i) Frauds noticed or reported during the year shall be reported indicating the nature and amount involved.
 - (ii) While reporting with regard to the nature and the amount involved of the frauds noticed or reported, the auditor may consider the principles of materiality outlined in Standards on Auditing.
- (i) The following is an example of reporting: “We have been informed that the accountant of the company had misappropriated funds amounting to rupees ten lakhs during the preceding year and the year under audit. Investigations are in progress and the accountant has been dismissed and arrested. The company has withheld his terminal benefits and it is estimated that the amount misappropriated may not exceed the terminal benefits due to the accountant. The company is adequately covered by fidelity insurance cover.”

Comments on Form of Report

3.14 The Order requires that the auditor should make a statement on all such matters contained therein as are applicable to the company. The Order further provides that where an auditor is unable to express any opinion on any such matter which is applicable to the company, he is required to indicate in his report such a fact, together with the reasons as to why he is unable to express any opinion. The auditor is required to give reasons for any unfavourable or a qualified answer.

3.15 A question may arise whether it is necessary for the auditor to include in his report, the management's explanation for any matter on

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which he makes an unfavourable comment. Normally, such an explanation need not be included but there may be circumstances where the auditor feels such inclusion is necessary. Examples of such circumstances would be:

- (a) to make the comment itself more meaningful and complete. For example, physical verification of inventories, though planned, may not have been carried out because of a strike or a lockout. An unfavourable comment without this explanation could be misleading;
- (b) to explain the fact why despite an unfavourable comment, the true and fair view of the financial statements is not vitiated. For example, physical verification of a part of the inventories at the year-end may not have been carried out, but there is sufficient other evidence produced by the management, which satisfies the auditor regarding the existence, condition, and value of the inventories.

3.16 If any of the comments on matters specified in the Order are qualified/unfavourable, the auditor should consider whether his comments have a bearing on the true and fair view presented by the financial statements and, therefore, might warrant a modification in the report under sub-sections (2) and (3) of section 143 of the Act.

3.17 If the auditor is of the opinion that any of the unfavourable comments on matters specified in the Order results in a qualification under sub-sections (2) and (3) of section 143 of the Act, the manner of reporting would have to be in accordance with the principles enunciated in SA 705(Revised), "Modifications to the Opinion in the Independent Auditor's Report".

3.18 Even where there are no unfavourable comments under the Order, it may be advisable for the auditor to preface his report under sub-sections (2) and (3) of section 143 of the Act with the words: "Further to our comments in the Annexure, we state that....."

3.19 It should not, however, be assumed that every unfavourable comment under the Order would necessarily result in a qualification in the report under sub-sections (2) and (3) of section 143 of the Act. Firstly, the unfavourable comment may be regarding a matter which has no relevance to a true and fair view presented by the financial

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statements, for example, the failure of the company to deposit provident fund dues in time or to comply with the requirements regarding acceptance of public deposits. Secondly, while the non-compliance may be material enough to warrant an unfavourable comment under the Order, it may not be material enough to affect the true and fair view presented by the financial statements. Finally, the non-compliance may be in an area which calls for remedial action on the part of the management, and may be important for that reason, but may not be sufficiently important in the context of the report under subsections (2) and (3) of section 143 of the Act. In deciding, therefore, whether a qualification in the report under sub-sections (2) and (3) of section 143 of the Act is necessary, the auditor should use his professional judgement in the facts and circumstances of each case.

3.20 It is important to note that replies to many of the requirements of the Order will involve expression of an opinion and not necessarily statement of facts. It is necessary, therefore, that this is indicated when making the report under the Order. This can be done in either of the following ways: (a) by a general preface to the comments under the Order on the following lines:

“In terms of the information and explanations sought by us and given by the company and the books of account and records examined by us in the normal course of audit and to the best of our knowledge and belief, we state that.....” or (b) by a preface to individual comments, for example: “In our opinion” or “In our opinion and according to the information and explanations given to us during the course of the audit...”

3.21 The Order requires that where the answer to a question is unfavourable or qualified, the auditor’s report should state the reasons for such unfavourable or qualified answer. While it is not necessary for the auditor to give very detailed reasons for an unfavourable or qualified answer, he is expected to explain the general nature of the qualification or unfavourable comment in clear and unambiguous terms. The auditor may consider the principles enunciated in SA 705(Revised) while explaining the reasons for such unfavourable or qualified answer.

3.22 Similar considerations would apply when the auditor is unable to express an opinion. In such circumstances, he should clearly state the

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reasons why he is unable to express an opinion, for example, because records or evidence necessary for his examination have not been produced before him.

3.23 In expressing an opinion or giving any statement, the auditor should evaluate as to whether the circumstances of the case warrant an unfavourable answer or whether his opinion/statement can be expressed subject to a qualification. The auditor's report under sub-section (3) of section 143 of the Act is required to state whether the auditor has sought and obtained all the information and explanations, which to the best of his knowledge and belief, were necessary for the purposes of his audit, and if not, the details thereof and the effect of such information on the financial statements. The term "audit" would include the reporting requirements under the Order. Therefore, when making his report, the auditor has to consider whether he has sought and obtained the information and explanations needed, not merely for the purposes of audit, but for the purpose of reporting in terms of the Order. If he has sought but not obtained the information and explanations necessary for reporting in terms of the Order, he should mention that fact, when reporting on the specific question in the Order and consider the impact of such non-receipt of the information on the auditor's report under section 143(3)(a) of the Act. Board of Director's Report

3.24 Section 134(3)(f) of the Act requires that the board of directors shall be bound to give in its report, all the information and explanations regarding every reservation, qualification or adverse remark or disclaimer contained in the auditor's report. The auditor's comments in terms of the Order form part of his report and, therefore, the Board will be bound to give in its report all the information and explanations regarding every unfavourable comment or qualification therein.

3.25 The auditor's comments in terms of the Order may be in respect of matters of fact or they may be an expression of opinion. It is necessary that there should be no inconsistency in the facts as stated by the auditor and as explained in the board's report. It is, therefore, suggested that wherever possible, a draft report should be submitted by the auditor to the Board to verify and confirm the facts stated therein.

3.26 It is, however, possible that, on the same facts, there may be a genuine difference of opinion between the auditor and the Board. In such

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a case, each of them is entitled to hold his or its view. Therefore, the expression of a different opinion in the Board's report should not be regarded as any reflection on the opinion expressed by the auditor.

Fraudulent financial reporting involves intentional misstatements or omissions of amounts or disclosures in financial statements to deceive financial statement users. Fraudulent financial reporting may involve:

- Deception such as manipulation, falsification, or alteration of accounting records or supporting documents from which the financial statements are prepared.
- Misrepresentation in, or intentional omission from, the financial statements of events, transactions, or other significant information.
- Intentional misapplication of accounting principles relating to measurement, recognition, classification, presentation, or disclosure.

3.27 Misappropriation of assets involves the theft of an entity's assets. Misappropriation of assets can be accomplished in a variety of ways (including embezzling receipts, stealing physical or intangible assets, or causing an entity to pay for goods and services not received); it is often accompanied by false or misleading records or documents in order to conceal the fact that the assets are missing.

3.28 Fraudulent financial reporting may be committed by the company because management is under pressure, from sources outside or inside the entity, to achieve an expected (and perhaps unrealistic) earnings target particularly when the consequences to management of failing to meet financial goals can be significant. The auditor must appreciate that a perceived opportunity for fraudulent financial reporting or misappropriation of assets may exist when an individual believes internal control could be circumvented, for example, because the individual is in a position of trust or has knowledge of specific weaknesses in the internal control system.

While planning the audit, the auditor should discuss with other members of the audit team, the susceptibility of the company to material misstatements in the financial statements resulting from fraud. While planning, the auditor should make inquiries of management to determine

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whether management is aware of any known fraud or suspected fraud that the company is investigating.

3.29 The auditor should examine the reports of the internal auditor with a view to ascertain whether any fraud has been reported or noticed by the management. The auditor should examine the minutes of the audit committee, if available, to ascertain whether any instance of fraud pertaining to the company has been reported and actions taken thereon. The auditor should enquire of the management about any frauds on or by the company that it has noticed or that have been reported to it. The auditor should discuss the matter with other employees of the company. The auditor should examine the minute book of the board meeting of the company in this regard.

3.30 The auditor should obtain written representations from management that:

- (i) it acknowledges its responsibility for the implementation and operation of accounting and internal control systems that are designed to prevent and detect fraud and error;
- (ii) it believes the effects of those uncorrected misstatements in financial statements, aggregated by the auditor during the audit are immaterial, individually and in the aggregate, to the financial statements taken as a whole. A summary of such items should be included in or attached to the written representation;
- (iii) it has disclosed to the auditor all significant facts relating to any frauds or suspected frauds known to management that may have affected the entity; and
- (iv) it has disclosed to the auditor the results of its assessment of the risk that the financial statements may be materially misstated as a result of fraud.

Because management is responsible for adjusting the financial statements to correct material misstatements, it is important that the auditor obtains written representation from management that any uncorrected misstatements resulting from fraud are, in management's opinion, immaterial, individually and in the aggregate. Such representations are not a substitute for obtaining sufficient appropriate audit evidence.

3.31 The Ministry of Corporate Affairs issued the Companies (Auditor's Report) Order, 2020 (CARO 2020) on 25th February 2020 which would be applicable for statutory audits of financial statements for periods beginning on or after April 1, 2020. CARO 2020 contains several important changes including many additional reporting requirements vis-à-vis CARO 2016 to further enhance overall quality of reporting by the auditors. It is essential that the members are fully abreast of these changes while discharging their professional responsibilities. The Auditing and Assurance Standards Board of the Institute of Chartered Accountants of India (ICAI) has issued the Guidance Note on the Companies (Auditor's Report) Order, 2020 providing detailed guidance to the members on various aspects and provisions of CARO 2020. (Refer to the ICAI publication on "Multiple Choice Questions (MCQs) on Guidance Note on the Companies (Auditor's Report) Order, 2020")

- (a) The nature of fraud and amount involved is required to be reported, even where fraud is noticed by the auditor. The nature and amount involved in frauds on the company and frauds by the company are required to be reported on separately. Misstatements can result from fraudulent financial reporting or misappropriation of assets.
- (b) Fraudulent financial reporting may involve deception such as manipulation, falsification, or alteration of accounting records or supporting documents from which the financial statements are prepared. While planning the audit, the auditor should discuss with other members of the audit team, the susceptibility of the company to material misstatements in the financial statements resulting from fraud. Materiality can be considered while reporting under this clause. It is important that the auditor obtains written representation from management that any uncorrected misstatements resulting from frauds are, in management's opinion, immaterial, individually and in the aggregate. Where any fraud has been reported by the auditor after the date of financial statements but up to the date of issuance of auditor's report, the same needs to be reported under clause (xi)(b).

The Listing Agreement

3.32 It is a requirement of the Stock Exchange that the Issuer shall submit a listing agreement duly executed along with an application for

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admission and continued admission of the securities to dealings on the Exchange and it shall comply with the following:

- (i) SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 and other applicable regulations /guidelines/circulars as may be issued by SEBI from time to time.
- (ii) the relevant byelaws / regulations / circulars / notices / guidelines as may be issued by the Exchange from time to time.
- (iii) such other directions, requirements and conditions as may be imposed by SEBI/ Exchange from time to time.

The Listing Agreement *inter alia* requires the CEO, i.e., the Managing Director or Manager i.e., the whole time Finance Director or any other person heading the finance function shall certify to the Board that:

- (a) They have reviewed financial statements and the cash flow statement for the year and that to the best of their knowledge and belief:
 - (i) these statements do not contain any materially untrue statement or omit any material fact or contain statements that might be misleading;
 - (ii) these statements together present a true and fair view of the company's affairs and are following existing accounting standards, applicable laws, and regulations.
- (b) There are, to the best of their knowledge and belief, no transactions entered by the company during the year which are fraudulent, illegal, or violative of the company's code of conduct.
- (c) They accept responsibility for establishing and maintaining internal controls and that they have evaluated the effectiveness of the internal control systems of the company and they have disclosed to the auditors and the Audit Committee, deficiencies in the design or operation of internal controls, if any, of which they are aware and the steps they have taken or propose to take to rectify these deficiencies.
- (d) They have indicated to the auditors and the Audit committee
 - (i) significant changes in internal control during the year;

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- (ii) significant changes in accounting policies during the year and that the same have been disclosed in the notes to the financial statements; and
- (iii) instances of significant fraud of which they have become aware and the involvement therein, if any, of the management or an employee having a significant role in the company's internal control system.

3.33 The above relate to the role of internal auditors as facilitators or assessors of internal control. Each company should devise back-up procedures as part of its reporting structure that is appropriate for its management and business. Combination of following activity could be helpful in this respect:

- Request back-up certificate from responsible subordinate officer.
- Review functioning and effectiveness of internal auditor and external auditor.
- Review companies financial reporting system and controls with internal auditor and risk manager.
- Solicit views of audit committee, independent directors, and legal counsel about adequacy of these procedures.
- Document the process used for review of all the above.

Appendix 1 (Ref: Para. A25)

Examples of Fraud Risk Factors

The fraud risk factors identified in this Appendix are examples of such factors that may be faced by auditors in a broad range of situations. Separately presented are examples relating to the two types of fraud relevant to the auditor's consideration – that is, fraudulent financial reporting and misappropriation of assets. For each of these types of fraud, the risk factors are further classified based on the three conditions generally present when material misstatements due to fraud occur:

- (a) incentives/pressures,
- (b) opportunities, and
- (c) attitudes/rationalizations.

Although the risk factors cover a broad range of situations, they are only examples and, accordingly, the auditor may identify additional or different risk factors. Not all of these examples are relevant in all circumstances, and some may be of greater or lesser significance in entities of different size or with different ownership characteristics or circumstances. The order of the examples of risk factors provided is not intended to reflect their relative importance or frequency of occurrence.

Risk Factors Relating to Misstatements Arising from Fraudulent Financial Reporting

The following are examples of risk factors relating to misstatements arising from fraudulent financial reporting.

Incentives/Pressures Financial stability or profitability is threatened by economic, industry, or entity operating conditions, such as (or as indicated by):

- High degree of competition or market saturation accompanied by declining margins.
- High vulnerability to rapid changes, such as changes in technology, product obsolescence, or interest rates.
- Significant declines in customer demand and increasing business failures in either the industry or overall economy.

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- Operating losses making the threat of bankruptcy, foreclosure, or hostile takeover imminent.
- Recurring negative cash flows from operations or an inability to generate cash flows from operations while reporting earnings and earnings growth.
- Rapid growth or unusual profitability especially compared to that of other companies in the same industry.
- New accounting, statutory, or regulatory requirements.

Excessive pressure exists for management to meet the requirements or expectations of third parties due to the following:

- Profitability or trend level expectations of investment analysts, institutional investors, significant creditors, or other external parties (particularly expectations that are unduly aggressive or unrealistic), including expectations created by management in, for example, overly optimistic press releases or annual report messages.
- Need to obtain additional debt or equity financing to stay competitive – including financing of major research and development or capital expenditures.
- Marginal ability to meet exchange listing requirements or debt repayment or other debt covenant requirements.
- Perceived or real adverse effects of reporting poor financial results on significant pending transactions, such as business combinations or contract awards. Information available indicates that the personal financial situation of management or those charged with governance is threatened by the entity's financial performance arising from the following:
 - Significant financial interests in the entity.
 - Significant portions of their compensation (for example, bonuses, stock options, and earn-out arrangements) being contingent upon achieving aggressive targets for stock price, operating results, financial position, or cash flow.¹
- Personal guarantees of debts of the entity. There is excessive

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pressure on management or operating personnel to meet financial targets established by those charged with governance, including sales or profitability incentive goals.

Opportunities

The nature of the industry or the entity's operations provides opportunities to engage in fraudulent financial reporting that can arise from the following:

- Significant related-party transactions not in the ordinary course of business or with related entities not audited or audited by another firm.
- A strong financial presence or ability to dominate a certain industry sector that allows the entity to dictate terms or conditions to suppliers or customers that may result in inappropriate or non-arm's-length transactions.
- Assets, liabilities, revenues, or expenses based on significant estimates that involve subjective judgments or uncertainties that are difficult to corroborate.
- Significant, unusual, or highly complex transactions, especially those close to period end that pose difficult "substance over form" questions.
- Significant operations located or conducted across international borders in jurisdictions where differing business environments and cultures exist.
- Use of business intermediaries for which there appears to be no clear business justification.
- Significant bank accounts or subsidiary or branch operations in tax-haven jurisdictions for which there appears to be no clear business justification.

The monitoring of management is not effective as a result of the following:

- Domination of management by a single person or small group (in a non-owner managed business) without compensating controls.
- Oversight by those charged with governance over the financial reporting process and internal control is not effective.

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There is a complex or unstable organizational structure, as evidenced by the following:

- Difficulty in determining the organization or individuals that have controlling interest in the entity.
- Overly complex organizational structure involving unusual legal entities or managerial lines of authority.
- High turnover of senior management, legal counsel, or those charged with governance.

Internal control components are deficient as a result of the following:

- Inadequate monitoring of controls, including automated controls and controls over interim financial reporting (where external reporting is required).
- High turnover rates or employment of accounting, internal audit, or information technology staff that are not effective.

Accounting and information systems that are not effective, including situations involving significant deficiencies in internal control.

Attitudes/Rationalizations

- Communication, implementation, support, or enforcement of the entity's values or ethical standards by management, or the communication of inappropriate values or ethical standards, that are not effective.
- Nonfinancial management's excessive participation in or preoccupation with the selection of accounting policies or the determination of significant estimates

Known history of violations of securities laws or other laws and regulations, or claims against the entity, its senior management, or those charged with governance alleging fraud or violations of laws and regulations.

- Excessive interest by management in maintaining or increasing the entity's stock price or earnings trend.
- The practice by management of committing to analysts, creditors, and other third parties to achieve aggressive or unrealistic forecasts.

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- Management failing to remedy known significant deficiencies in internal control on a timely basis.
- An interest by management in employing inappropriate means to minimize reported earnings for tax-motivated reasons.
- Low morale among senior management.
- The owner-manager makes no distinction between personal and business transactions.
- Dispute between shareholders in a closely held entity.
- Recurring attempts by management to justify marginal or inappropriate accounting on the basis of materiality.

The relationship between management and the current or predecessor auditor is strained, as exhibited by the following:

- Frequent disputes with the current or predecessor auditor on accounting, auditing, or reporting matters.
- Unreasonable demands on the auditor, such as unrealistic time constraints regarding the completion of the audit or the issuance of the auditor's report.
- Restrictions on the auditor that inappropriately limit access to people or information or the ability to communicate effectively with those charged with governance.

Domineering management behavior in dealing with the auditor, especially involving attempts to influence the scope of the auditor's work or the selection or continuance of personnel assigned to or consulted on the audit engagement.

Risk Factors Arising from Misstatements Arising from Misappropriation of Assets

Risk factors that relate to misstatements arising from misappropriation of assets are classified according to the three conditions generally present when fraud exists: incentives/pressures, opportunities, and attitudes/rationalization.

Some of the risk factors related to misstatements arising from fraudulent financial reporting may be present when misstatements arising from misappropriation of assets occur. For example, ineffective monitoring of

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management and other deficiencies in internal control may be present when misstatements due to either fraudulent financial reporting or misappropriation of assets exist. The following are examples of risk factors related to misstatements arising from misappropriation of assets.

Incentives/Pressures Personal financial obligations may create pressure on management or employees with access to cash or other assets susceptible to theft to misappropriate those assets.

Adverse relationships between the entity and employees with access to cash or other assets susceptible to theft may motivate those employees to misappropriate those assets. For example, adverse relationships may be created by the following:

- Known or anticipated future employee layoffs.
- Recent or anticipated changes to employee compensation or benefit plans.
- Promotions, compensation, or other rewards inconsistent with expectations.

Opportunities

Certain characteristics or circumstances may increase the susceptibility of assets to misappropriation. For example, opportunities to misappropriate assets increase when there are the following:

- Large amounts of cash on hand or processed.
- Inventory items that are small in size, of high value, or in high demand.
- Easily convertible assets, such as bearer bonds, diamonds, or computer chips.
- Fixed assets which are small in size, marketable, or lacking observable identification of ownership.

Inadequate internal control over assets may increase the susceptibility of misappropriation of those assets. For example, misappropriation of assets may occur because there is the following:

- Inadequate segregation of duties or independent checks.
- Inadequate oversight of senior management expenditures, such as travel and other re-imbursements.

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- Inadequate management oversight of employees responsible for assets, for example, inadequate supervision or monitoring of remote locations.
- Inadequate job applicant screening of employees with access to assets.
- Inadequate record keeping with respect to assets.

Inadequate system of authorization and approval of transactions (for example, in purchasing).

- Inadequate physical safeguards over cash, investments, inventory, or fixed assets.
- Lack of complete and timely reconciliations of assets.
- Lack of timely and appropriate documentation of transactions, for example, credits for merchandise returns.
- Lack of mandatory vacations for employees performing key control functions.
- Inadequate management understanding of information technology, which enables information technology employees to perpetrate a misappropriation.
- Inadequate access controls over automated records, including controls over and review of computer systems event logs.

Attitudes/Rationalizations

- Disregard for the need for monitoring or reducing risks related to misappropriations of assets.
- Disregard for internal control over misappropriation of assets by overriding existing controls or by failing to take appropriate remedial action on known deficiencies in internal control.
- Behavior indicating displeasure or dissatisfaction with the entity or its treatment of the employee.
- Changes in behavior or lifestyle that may indicate assets have been misappropriated.
- Tolerance of petty theft.

Appendix 2 (Ref: Para. A40)

Examples of Possible Audit Procedures to Address the Assessed Risks of Material Misstatement Due to Fraud

The following are examples of possible audit procedures to address the assessed risks of material misstatement due to fraud resulting from fraudulent financial reporting and misappropriation of assets. Although these procedures cover a broad range of situations, they are only examples and, accordingly they may not be the most appropriate nor necessary in each circumstance. The order of the procedures provided is not intended to reflect their relative importance. Consideration at the Assertion Level Specific responses to the auditor's assessment of the risks of material misstatement due to fraud will vary depending upon the types or combinations of fraud risk factors or conditions identified, and the classes of transactions, account balances, disclosures and assertions they may affect. The following are specific examples of responses:

- Visiting locations or performing certain tests on a surprise or unannounced basis. For example, observing inventory at locations where auditor attendance has not been previously announced or counting cash at a particular date on a surprise basis.
- Requesting that inventories be counted at the end of the reporting period or on a date closer to period end to minimize the risk of manipulation of balances in the period between the date of completion of the count and the end of the reporting period.
- Altering the audit approach in the current year. For example, contacting major customers and suppliers orally in addition to sending written confirmation, sending confirmation requests to a specific party within an organization, or seeking more or different information.
- Performing a detailed review of the entity's quarter-end or year-end adjusting entries and investigating any that appear unusual as to nature or amount

For significant and unusual transactions, particularly those occurring at or near year-end, investigating the possibility of related parties and the sources of financial resources supporting the transactions.

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- Performing substantive analytical procedures using disaggregated data. For example, comparing sales and cost of sales by location, line of business or month to expectations developed by the auditor.

Conducting interviews of personnel involved in areas where a risk of material misstatement due to fraud has been identified, to obtain their insights about the risk and whether, or how, controls address the risk.

- When other independent auditors are auditing the financial statements of one or more subsidiaries, divisions or branches, discussing with them the extent of work necessary to be performed to address the assessed risk of material misstatement due to fraud resulting from transactions and activities among these components.
- If the work of an expert becomes particularly significant with respect to a financial statement item for which the assessed risk of misstatement due to fraud is high, performing additional procedures relating to some or all of the expert's assumptions, methods or findings to determine that the findings are not unreasonable, or engaging another expert for that purpose.
- Performing audit procedures to analyze selected opening balance sheet accounts of previously audited financial statements to assess how certain issues involving accounting estimates and judgments, for example, an allowance for sales returns, were resolved with the benefit of hindsight.
- Performing procedures on account or other reconciliations prepared by the entity, including considering reconciliations performed at interim periods.
- Performing computer-assisted techniques, such as data mining to test for anomalies in a population.
- Testing the integrity of computer-produced records and transactions.
- Seeking additional audit evidence from sources outside of the entity being audited. Specific Responses—Misstatement Resulting from Fraudulent Financial Reporting Examples of responses to the

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auditor's assessment of the risks of material misstatement due to fraudulent financial reporting are as follows:

Revenue Recognition

- Performing substantive analytical procedures relating to revenue using disaggregated data, for example, comparing revenue reported by month and by product line or business segment during the current reporting period with comparable prior periods. Computer-assisted audit techniques may be useful in identifying unusual or unexpected revenue relationships or transactions.
- Confirming with customers certain relevant contract terms and the absence of side agreements, because the appropriate accounting often is influenced by such terms or agreements and basis for rebates or the period to which they relate are often poorly documented. For example, acceptance criteria, delivery and payment terms, the absence of future or continuing vendor obligations, the right to return the product, guaranteed resale amounts, and cancellation or refund provisions often are relevant in such circumstances.
- Inquiring of the entity's sales and marketing personnel or in-house legal counsel regarding sales or shipments near the end of the period and their knowledge of any unusual terms or conditions associated with these transactions.
- Being physically present at one or more locations at period end to observe goods being shipped or being readied for shipment (or returns awaiting processing) and performing other appropriate sales and inventory cutoff procedures.
- For those situations for which revenue transactions are electronically initiated, processed, and recorded, testing controls to determine whether they provide assurance that recorded revenue transactions occurred and are properly recorded.

Inventory Quantities

- Examining the entity's inventory records to identify locations or items that require specific attention during or after the physical inventory count.

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- Observing inventory counts at certain locations on an unannounced basis or conducting inventory counts at all locations on the same date.
- Conducting inventory counts at or near the end of the reporting period to minimize the risk of inappropriate manipulation during the period between the count and the end of the reporting period.
- Performing additional procedures during the observation of the count, for example, more rigorously examining the contents of boxed items, the manner in which the goods are stacked (for example, hollow squares) or labeled, and the quality (that is, purity, grade, or concentration) of liquid substances such as perfumes or specialty chemicals. Using the work of an expert may be helpful in this regard.
- Comparing the quantities for the current period with prior periods by class or category of inventory, location or other criteria, or comparison of quantities counted with perpetual records.
- Using computer-assisted audit techniques to further test the compilation of the physical inventory counts – for example, sorting by tag number to test tag controls or by item serial number to test the possibility of item omission or duplication.

Management Estimates

- Using an expert to develop an independent estimate for comparison to management's estimate.
- Extending inquiries to individuals outside of management and the accounting department to corroborate management's ability and intent to carry out plans that are relevant to developing the estimate.

Specific Responses—Misstatements Due to Misappropriation of Assets

Differing circumstances would necessarily dictate different responses. Ordinarily, the audit response to an assessed risk of material misstatement due to fraud relating to misappropriation of assets will be directed toward certain account balances and classes of transactions. Although some of the audit responses noted in the two categories above

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may apply in such circumstances, the scope of the work is to be linked to the specific information about the misappropriation risk that has been identified. Examples of responses to the auditor's assessment of the risk of material misstatements due to misappropriation of assets are as follows:

- Counting cash or securities at or near year-end.
- Confirming directly with customers the account activity (including credit memo and sales return activity as well as dates payments were made) for the period under audit.
- Analyzing recoveries of written-off accounts.
- Analyzing inventory shortages by location or product type.
- Comparing key inventory ratios to industry norm.
- Reviewing supporting documentation for reductions to the perpetual inventory records.
- Performing a computerized match of the vendor list with a list of employees to identify matches of addresses or phone numbers.
- Performing a computerized search of payroll records to identify duplicate addresses, employee identification or taxing authority numbers or bank accounts.
- Reviewing personnel files for those that contain little or no evidence of activity, for example, lack of performance evaluations.
- Analyzing sales discounts and returns for unusual patterns or trends.
- Confirming specific terms of contracts with third parties.
- Obtaining evidence that contracts are being carried out in accordance with their terms.
- Reviewing the propriety of large and unusual expenses.
- Reviewing the authorization and carrying value of senior management and related party loans
- Reviewing the level and propriety of expense reports submitted by senior management.

Appendix 3 (Ref: Para. A49)

Examples of Circumstances that Indicate the Possibility of Fraud

The following are examples of circumstances that may indicate the possibility that the financial statements may contain a material misstatement resulting from fraud. Discrepancies in the accounting records, including:

- Transactions that are not recorded in a complete or timely manner or are improperly recorded as to amount, accounting period, classification, or entity policy.
- Unsupported or unauthorized balances or transactions.
- Last-minute adjustments that significantly affect financial results.
- Evidence of employees' access to systems and records inconsistent with that necessary to perform their authorized duties.
- Tips or complaints to the auditor about alleged fraud. Conflicting or missing evidence, including:
 - Missing documents.
 - Documents that appear to have been altered.
 - Unavailability of other than photocopied or electronically transmitted documents when documents in original form are expected to exist.
- Significant unexplained items on reconciliations.
- Unusual balance sheet changes, or changes in trends or important financial statement ratios or relationships – for example, receivables growing faster than revenues.
- Inconsistent, vague, or implausible responses from management or employees arising from inquiries or analytical procedures.
- Unusual discrepancies between the entity's records and confirmation replies.
- Large numbers of credit entries and other adjustments made to accounts receivable records.
- Unexplained or inadequately explained differences between the

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accounts receivable sub-ledger and the control account, or between the customer statements and the accounts receivable sub-ledger.

- Missing or non-existent cancelled checks in circumstances where cancelled checks are ordinarily returned to the entity with the bank statement.

Missing inventory or physical assets of significant magnitude.

- Unavailable or missing electronic evidence, inconsistent with the entity's record retention practices or policies.
- Fewer responses to confirmations than anticipated or a greater number of responses than anticipated.
- Inability to produce evidence of key systems development and program change testing and implementation activities for current-year system changes and deployments. Problematic or unusual relationships between the auditor and management, including:
 - Denial of access to records, facilities, certain employees, customers, vendors, or others from whom audit evidence might be sought.
 - Undue time pressures imposed by management to resolve complex or contentious issues.
 - Complaints by management about the conduct of the audit or management intimidation of engagement team members, particularly in connection with the auditor's critical assessment of audit evidence or in the resolution of potential disagreements with management.
- Unusual delays by the entity in providing requested information.
- Unwillingness to facilitate auditor access to key electronic files for testing through the use of computer-assisted audit techniques.
- Denial of access to key IT operations staff and facilities, including security, operations, and systems development personnel.
- An unwillingness to add or revise disclosures in the financial statements to make them more complete and understandable.
- An unwillingness to address identified deficiencies in internal control on a timely basis.

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Other

- Unwillingness by management to permit the auditor to meet privately with those charged with governance.
- Accounting policies that appear to be at variance with industry norms.
- Frequent changes in accounting estimates that do not appear to result from changed circumstances.
- Tolerance of violations of the entity's code of conduct.

Chapter 4

Corporate Fraud Control Plan

Chapter Summary

This Chapter focusses on options available to a corporate entity in managing the risk of fraud. It provides an insight into operations of an investigative cell (in a private entity) and advising the management on creating awareness among employees on fraud alerts through proper code of conduct. The process of escalation of irregularities and reporting to designated authority has been discussed. Finally, there is a discussion on the role of company's legal department in initiating legal action and alternative remedies for settlement of damages. At the end of the Chapter, there is a suggestion on evolving fraud control strategies to management including instilling of confidence and motivation to employees for ethical behaviour post discovery of fraudulent activity.

4.1 Any relationship between like-minded people largely revolves around mutual trust, faith and respect for each other's opinion. Even in day-to-day business matters there is an element of people outwitting one another to prove their point or achieve a desired objective. However, this is different from the use of deceit. It is pertinent to note that the use of deception has been practiced since time immemorial and compels us to believe that we have to live with this risk eternally despite strengthening of controls. There is always a need for this caution in managing the risk of fraud before, during and after the event has occurred. Further, a fraudulent activity may not necessarily be a single event and, therefore, there are chances that an alert management is in a position to notice the leads that are available to identify suspected frauds before extensive damage is done to the organization. Materiality in audit findings is a significant factor for follow-up action by the management. In fraud parlance, this may not always be true as timely detection and remedial action would prevent significant damages. Hence, greater attention would be needed towards fraud risk in the risk management process.

4.2 Most organisations are averse to setting up an in-house investigative cell as the investigation team is exposed to extensive risk that could affect

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physical security. There is, therefore, more dependence on outsourced agencies who are independent or bring the requisite expertise to conduct investigative assignments. There is a tendency to downplay irregularities considering that it carries a reputational risk to the organisation. Therefore, where there are internal investigative assignments, trail is destroyed when it is detrimental to the larger business objectives. In a weak control environment with inadequate internal audit system, there is a greater probability of fraud occurrence. From this perspective, let us examine what management ought to do to tackle this menace.

4.3 A CEO faces the task of constantly differentiating the good, bad and the ugly from his most trustworthy team of comrades. He has to run the business in the most pragmatic manner where mutual trust reigns supreme. When an auditor, whistleblower or informer points the needle of suspicion, the concern is manifold; there exists the risk of targeting the wrong person and one cannot rest till action is taken on the erring person. There is a need to draw the right inferences at each stage of investigation and forming an opinion on who are all involved. At times, the scapegoat tends to be the person who is at the front end of the fraudulent act and the person who masterminds the act is never in the picture. He remains unscathed, and thereby is emboldened to continue with for fraudulent activities or even moves over to another organization before his deeds get unearthed.

Hence, it is essential for an organisation to first ensure that employees are aware of what constitutes a fraud, how they should avoid such acts, stay alert and bring to the notice of the management any deviations that can be construed as fraudulent to the appropriate authority. The management should ensure in-built systems to detect frauds. Once detected, it must ensure further measures to gather evidence against the perpetrators of the fraud.

Fraud Detection and Fraud Deterrence

4.4 Each organization has its own established value systems and, therefore, would like its employees to follow the same through a code of conduct. This provides the management a medium to interact with employees in defining the ground rules to be followed and actions that are not acceptable. This can be termed as adhering to the principles of natural justice in amply clarifying to the employee the work culture in the organization. For the purpose, management must define what types of

conduct may involve conflict of interest (or potential for a conflict of interest) vis-à-vis the official duties. This may or may not involve any pecuniary interest and may extend to any bias towards third persons in the official dealings/ decisions. Hence, non-competitive pricing of products or unjustified commercial dealings could be within the purview of this code of conduct.

4.5 Generally, employees are the first point of contact in noticing a fraudulent activity arising out of certain unusual or abnormal practices. These remain unreported to the superior reporting officer due to lack of training and awareness among the employees. The insecurity among employees is another reason for not escalating the matter to the reporting authority. Therefore, employees must be made aware of their role in detection as well as deterrence to such fraudulent acts and apprise them of the reporting process through appropriate mediums.

4.6 Apart from providing abundant opportunity to the employees within the organization to stay away from fraudulent acts and to report any such deceit to the appropriate authority, it is essential to set up independent monitoring system or devise strategies which work coherently with the following objectives:

- (a) Identification and reporting of unusual activities;
- (b) Isolating deviations and surveillance mechanism in the day- to-day operations;
- (c) Use of computer applications and audit tools in keeping track of unusual transactions;
- (d) A robust accounting and management information reporting system; and
- (e) Effective interaction with the Chief Internal Auditor for appropriate audit reviews.

4.7 It is preferable that there should be an effective incident reporting process normally to a designated official (heading the investigative cell or compliance officer) to whom all the suspected activities will be reported. It should be his responsibility to promptly update the management of such incidents.

The senior management executives need to consistently make an effort in educating the employees and related third parties on how to be alert to

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fraudulent activities, including suspicious activities and the manner in which the same needs to be communicated. In addition, the internal audit observations can be filtered to identify red flags and used as a medium to apprise employees of internal control gaps in prevention or detection of frauds.

4.8 When a financial fraud is suspected, certain immediate steps may need to be taken to prevent loss of evidence or furtherance of such acts. For the purpose, records and documents are taken in safe custody and the persons connected with the activities are generally transferred to other activities till the perpetrator of the fraud is identified. The scope and period of coverage is dependent on judgement by the Chartered Accountant and this in turn would determine the time required to complete the assessment process.

These may relate more to the activities impacted due to fraud including fraudsters' access to records, documents and information. Unravelling the modus operandi of the fraudulent act could be equally complex with reference to identifying and deciphering the trail left by the fraudster and in gathering requisite evidence. This is followed by an assessment of damages arising out of the wrongful act. In case the entity has an insurance cover, the insurer is informed of the incident and thereafter the extent of damages is notified. The management has the option of either proceeding with legal action or can take disciplinary action on the erring employee or third party if the situation warrants. Where the perpetrator is not known steps may be taken for in-depth investigation either by in-house resource or external agencies.

Initiating Investigative Process

4.9 Once a fraud is reported, a preliminary investigation has to be conducted first to assess and verify the enormity of the act and then the next step is to substantiate it with evidence. It is preferred that this is carried out under the aegis of the Compliance Officer (generally, a Chief Financial Officer or a Chartered Accountant in full time employment with the company).

The Compliance Officer should, generally, be a person of integrity and based on his past track record, should have the ability to manage situations of fraud risk. He is, normally, a person who is trusted by the management in safeguarding the reputation and image of the organization.

4.10 To achieve this objective, a Compliance Officer is an official who by the nature of his duties, generally, reports to the senior most officer in the company (CEO or Managing Director) and may derive his power from the audit committee or statutory regulator. The Compliance Officer may seek the support of the internal auditor in discharging his duties on matters relating to the investigation.

The Compliance Officer will conduct a preliminary assessment of each situation and depending upon the magnitude of suspected fraud (which is by and large a matter of subjective judgment) will decide whether he has the resources within the organization to carry out a full-fledged investigation and the extent of outsourcing of the investigative activities.

4.11 The Compliance Officer is, generally, in an advisory role to the senior most officers in the management hierarchy. His role and responsibility may include the following:

- (a) Interaction with the internal auditor of the company.
- (b) Resource mobilization, either internally or outsourced, in engaging the services of chartered accountant firms for conducting investigation.
 - Sequencing of the events and activities for diagnosis of the problem.
 - Internal control assessment in highlighting vulnerabilities.
 - Preliminary assessment on the role of internal and external persons who are suspected to be involved in the alleged irregularities and details thereof.
 - Damage assessment arising out of the reported incident.
 - Collation of information on suspected fraudulent activity.
- (c) Ensuring a reporting format to the senior management or regulators such as, RBI, IRDA, SEBI, NHB, etc.
- (d) Comment on available evidence to form an opinion.

Considering the sensitivities involved in any information that relates to a fraudulent activity, it is essential that adequate confidentiality is ensured in collating such information and reporting. Based on his report management can form an opinion on the future course of action including referral for legal

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action, reporting to police authorities, filing of insurance claims, disciplinary action against delinquent employees, etc.

Managing Fraud Risk

4.12 The role of an investigating Chartered Accountant is different from that of the line functionaries, as his primary concern would be to corroborate facts based on available evidence, within the legal realms. Senior executives must give a free hand to the investigating officer and should not intrude into their investigative approach and methodology. Such intrusion tends to be counter productive. The desired course of management action will depend on the regular updates on the progress made in the investigation. It may be noted that just as the senior management is responsible for initiating the investigation, they have a similar right to call off an investigation.

4.13 Post discovery of a fraudulent activity, the manner in which the enquiry process is conducted may be defined through a policy document. This will include the options available for disciplinary actions that could be explored by the management.

Anti-fraud programs enable the management to identify areas that are vulnerable to potential fraudulent activities. Where such events are inherent to the business environment, counter measures for identification of irregularities and timely action should be ensured.

4.14 Unless warranted by law or regulatory institutions such as, Reserve Bank of India norms, it is the management's discretion as to whether an incident needs to be reported to the police authorities. A weak or inadmissible evidence or reputation risk to the organization is sometimes a reason for not proceeding legally against the erring employees.

The management must ensure that the above incidents are brought to the notice of the Chief Internal Auditor in a timely manner, including management action plan and corrective steps that are to be taken post discovery of the fraud. There should be a standard format in which the management informs the audit committee and the board about the status of frauds reported, persons involved, types of fraud, recoveries, corrective measures and regular updates on investigations in progress.

Management Fraud – From an Audit and Investigation Perspective

4.15 While evaluating the performance of a Chief Executive Officer or reporting of extra ordinary performance by a Chief Financial Officer, there is a need for caution so that such performance does not subsequently turn out to be an abnormality. The consistency in applying the accounting policy is given a greater importance and an error at the outset may remain buried over successive years. The declaratory statements obtained from management akin to a certification of key balance sheet items cannot absolve the auditor from the larger responsibility in the event of a management fraud. The focus of review from an investigation perspective could extend beyond these statements given by the management.

4.16 Since external information is considered a superior form of evidence, it is important that these are not fabricated to convince an auditor. (For example, by operating a fictitious entity in a third party name, funds could be surreptitiously deposited and transferred through a bank account – termed by tax consultants as ‘entry business’). This may involve creating a ‘front company’ as an intermediary between the entity and the bankers or vendors. The perpetrator of management fraud could use an individual’s identity (name lending) or ‘morphed’ document (such as, pledging the fixed deposit receipts or gold purchase and sale transaction of a third party or the purchase or sale of stocks through a sub-broker). This makes the unravelling of management fraud more challenging. It is in these situations that the efficacy of the internal audit function (in the normal course of business) and the experience of the investigator (once a red flag is identified) are of paramount importance.

4.17 Finally, the need for abundant caution is a necessity considering that a poorly conducted investigation or a disciplinary action that is unjustified will affect the organization in terms of its reputation. It can lead to unnecessary defamation suits by the affected person or even lead to destruction of the evidence which is central to an investigation. A poor control environment could lead to inadmissible/ inadequate evidence in a court of law and a temptation for the employees and outsiders to engage in wrongful deeds tarnishing the image of the organization. To avoid this, the management should ensure an effective internal audit function that monitors the effectiveness of the preventive and corrective steps.

Case Studies

4.18 A company had a project office in India for the release of certificates to students for certain courses through a process of e- learning. The billing and collection were remitted electronically outside the country. Thus, the expense projections (budgets) and actual expenditure became the medium for the foreign company to fund the operations in India. The management of the foreign company considering the increased spend on operating expenses, especially, in hiring of lawyers for depending rising consumer complaints took the assistance of Chartered Accountants in ascertaining the facts of the case.

It come to notice that what started as a need to spend the available funds within the time targets became an allurements for the CEO. He resorted to collecting bills and letter heads and used them in padding expenses. To prevent in-house staff being aware of these acts, he switched over to outsourcing of the accounting function. The accountant kept booking the false bills without being aware of the fraudulent act. A scrutiny of the records revealed that the CEO had opened a manpower consultancy firm in the name of his brother-in-law earning commission for each recruitment in the company, entered into a contract with his sister-in-law for hiring of the most expensive of the car for the company (the monthly instalments being equal to the fixed hire rentals paid by the company), and opened bank accounts in the name of other relatives for payment of exorbitant advertisement expenses. This was camouflaged by ensuring namesake participation in exhibition stalls and campus visits. These resulted in extensive personal gains without incurring such expenses. Surprisingly, the letter head of the lawyers was misused by the perpetrator of fraud in the process pocketing litigation expenses too. Thus, a scrutiny of the exception reports and unfavourable trends could have provided ample scope for isolating red alerts.

4.19 In decentralised operations there are compulsions for the management to delegate powers to a regional authority including that of defining policies customised to local needs. Here, such regional managers may not welcome any independent controls or checks on their activities stating that this will hamper their freedom to operate effectively. Primarily the cause of fraud in these circumstances is due to absence of filters in the form of exception reports. The absence of incident reporting mechanism, covering up of anomalies by framing policies at a localised level and special approvals are factors that compound the problem.

4.20 In this web-based world, the perpetrator of fraud can easily trap a target (there are greater avenues for a fraudster to mislead the management) through sending messages to a personal e-mail or to an unused e-mail account that is not in use by a designated authority. He maintains a record of such e-mails including delivered messages as a follow up action. At a later stage when he is caught in the act of wrongful gain, he points the finger at the senior management officials stating that the action was duly notified to the senior management. The perpetrator as a result is able to strengthen his defense and cause impediments during the scrutiny process. Thus, misuse of e-mails can be a medium to impact the reputation of persons by the wrongdoer.

4.21 A company was engaged in wholesale trading of agriculture produce through a panel of brokers, the process of entering into a 'sauda' (deal) was, generally, verbal and later on converted into formal documentation released by the back office. Considering the critical nature of the operations, the company representative had to be a person of high integrity in day-to-day dealings. The supply and demand in the market along with foreign exchange rates influenced the pricing decisions. The terms of payment were dependent on the past business deals with the broker and the volume of business offered. As a result, the most critical of the activities of entering into deals was retained with the Chief Operating Officer. A new broker was empanelled on trial basis as he was operating for the competitors' as well. This was to capture a larger market share by the company. Initially, advance payment was insisted by the company but considering the size of business and performance, the credit facility was extended up to seven days. Immediately on extending the credit facility, the broker defaulted in payment resulting in heavy loss to the company.

The internal auditor was called upon to quantify the extent of damages and study the available documentary evidence. Investigations revealed that the broker's employee had taken advantage of the verbal 'sauda' process. He had managed to collect the cheque dishonour statements from the company's banker preventing the company from being aware of the cheque dishonours in a timely manner and gave a false presumption that the cheque was under clearing. He then managed to divert the stock and absconded with the amount realised. Obtaining of acknowledgement on the 'sauda chitti' (deal Slip) was not a market practice.

4.22. The user acceptance test is a common phenomenon in software customisation process. There was a dedicated official responsible for

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creditors' scrutiny and release of payments to vendors. The official befriended the software developer during the customisation process. In the Technical Committee meeting, he managed to convince the management on need for changes to vendor codes while generating the payment vouchers. The person responsible for signing the cheque used to ascertain the vendor dues by referring to the balance in the vendor account in the system. By changing the vendor codes, the perpetrator of fraud resorted to lapping of cheque payments and diverted the duplicate payments to his personal account.

4.23 A joint venture company had received advance payments from abroad and as per the terms of contract was supposed to export commodities (processed spices) over a three-month period under a forward rate contract. The management noticed that its coffers were empty and the reason for the shortage in funds was not traceable.

The internal auditor was brought in to trace the flow of funds among the various business divisions and group companies. Before initiating the investigation process, the computer system had crashed, and the employees expressed their inability to co-operate in the matter. As a result, a single-entry system was adopted, and details reworked. It was noticed that the advance money was diverted towards payment to rice mills and that the price of 'basmati rice' had dropped down heavily resulting in unviable business option. The advance meant for procurement of spices was no longer available. To maintain their company reputation, the partners to the joint venture had to honour their commitment despite incurring a substantial loss.

4.24 The scrap committee in a company had decided to categorise the conditions for declaration of scrap and defined parameters for segregation. The stores person (an accomplice with the fraudster) advised the scrap dealer that it would not be possible to declare the round bars as scrap as these exceeded the criteria of two feet in length. Further, the reconciliation of project steel scrap was to be done only at the end of the project and in the mean time calibrations were used for issue and consumption of steel to record stock movement. The steel stock differences were pending for reconciliation and consumption estimates seemed to be off the mark.

The operating management stated the prime reason for high consumption to be errors in calibration in recording of conversions of assorted size of steel items, and the overall difference in stock would be within the two percent deviation limits.

An audit review was recommended into the differences that required item-wise updating of stock record at various stages of work-in-progress. While this was a complex exercise, the internal auditor was called in to investigate into the matter. It came to light that the scrap dealer had coerced the stores personnel to ensure that the round bars and other steel scrap fitted into the criteria for declaration as scrap (by cutting the round bars below two ft in size to fit into the scrap declaration parameter). The damages were assessed and reported to the management for further action.

4.25 The company policy required just in time inventory management system. There was a pile of raw material stock that was creating a problem for the local management in offering justification. Under the pretext of better inventory management these were shipped to other plant locations before fresh orders were again placed. Despite prudent measures the cost of procurement remained uncontrolled. The management called in the auditors to undertake a special investigation into inventory movement system.

The inventory module for the purpose of ageing of stock was using a FIFO method and the GRN date was the key field based on which the ageing of inventory was reported. There were two issues that came to light and revealed that the Plant accountants were portraying efficient inventory management system. The inventory remained at the transporter's warehouse for substantial time while it was knocked out from the transferor company. The transferee company was not required to record stock inward in its books as the stock was in transit. The rotation of stock in the system ensured that the ageing of the stock remained below the stipulated level, as decided by the company management, to meet the just in time model.

4.26 The bankers of a private company had a high lending exposure to a closely held group of companies. They were perturbed by the steep rise in loss booked in one of the companies to which major portion of lending was done. Over the past three years while the top line business was showing encouraging results, the cash flow position was not satisfactory with defaults in repayment of loan instalments. The management of the company had yet again forecasted poor performance in the following financial year. The bankers feared that the company would opt for insolvency and apply for restructuring of loan to avail concession in rates of financing as applicable to sick companies. Accordingly, they instituted a special audit akin to a financial due diligence to understand the key concerns.

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The findings of the special investigation revealed that the current year's financial results were above the targeted level of performance. The management, as a matter of strategy, had created a cushion in the form of forced provision for doubtful debts casting doubts on the genuineness of the customer billings. There were several dealings with a group shell company (paper company) wherein the funds from the parent company were diverted. The procurement of raw material was fabricated as the vendors did not exist at the defined address given on the purchase bills. Fictitious labour contracts were prepared to inflate the wage bill. All these factors resulted in higher cost of operation. Extensive insurance policies were taken for stock and assets of the company. In the past several months, several manufacturing companies in the vicinity had incidents of fire where the warehouses were gutted. The bankers appreciated the investigation effort and issued a show cause notice to their client for further action.

Chapter 5

Investigative Tools and Techniques

Chapter Summary

The important factor in an investigation is that a Chartered Accountant has to rely on factual information and available evidence in reaching a definitive conclusion. The client, therefore, requires an assurance about the skill sets and comfort on the methodology adopted in conduct of an investigation and in safeguarding evidence. This chapter deals with the investigation methodology in generating leads, especially, relating to manipulations in financial statements and safeguarding of evidence.

5.1 The investigator and the client should have a mutual understanding on terms and conditions to withdraw at any stage of the assignment especially under circumstances involving threat to physical safety of the investigation team. The conclusions depend on the scope of the assignment, methodology adopted, extent of independence, and available trail of evidence and any other legal constraint in the conduct of the assignment.

The clients tend to be apprehensive about the extent of access to confidential/ classified information that the investigators should be allowed. The time slot for conclusion of any investigative assignment is a factor that is difficult to determine and has a direct relation to the cost of the assignment. The cost of conducting an investigation may vary depending upon the specialist manpower resources deployed.

5.2 The CFOs/ accountants are the gatekeepers of control in any organization and have to exercise due diligence against any false booking of transactions. As a prudent risk management policy, some companies pass on their risk through engagement with distribution network or intermediaries as a cushion to manage their debtors' position/ cash flows or resort to outsourcing of accounting function. However, the following examples illustrate how the control gaps impact the financial statements of such intermediaries:

- (i) To get additional funds/ borrowings the lending agency may review the business performance before disbursement of funds. The sales

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section may indulge in parking the stock with an intermediary and billing them as customers to disclose a positive business performance. As a result, the role of intermediary (in any business) has to be seen with caution whether it be a local broker/ distributor or offshore distribution network. For the purpose, a periodic confirmation from the ultimate customer is desirable on veracity of the billings. The receipt of the consideration amount from the end customer under the circumstances is important. The stock piling with an intermediary should be a cause for concern. At times, the billing and receipts are not backed by physical transfer of the product billed and this may be further explored for any fictitious billing to boost top line.

- (ii) Generally, the seller/ manufacturer does not have control over billing operations of intermediaries and on decision on retail prices. This could be another area of concern in validation of retail and market share. The problem is compounded when an employee indulges in fictitious transactions through a 'front company', 'SMEs', 'consultancy firms', etc. Generally, these may belong to a friend or a relative who does not form part of definition of 'related party' transaction. These may result in teeming and lading of remittances.
- (iii) Generally, competitors may indulge in strategies to subvert the competition by jacking up the demand by pushing fictitious buyers through the distribution network and have a budget to fund these operations. This induces the manufacturer to produce more against demand orders, at a later date the product gets sold in the resale market at a highly discounted price thereby killing competition in a phased manner. Where a push model of sales is followed, the manufacturer ends up with high level of stock and tends to be debt ridden. It is a common practice for CFOs to defend their position by discontinuing the operations or terminating the services of senior employees indulging in abnormalities, to prevent further damage.
- (iv) Fictitious sale, normally, could involve sale and buy back arrangements or bulk deals wherein a third party or a front company is used to inflate the sale projections and billing to overcome depleting sales. Generally, abnormal sales at any time of year or at the time of closure of accounts require special attention.
- (v) The 'off book', debts or borrowings being shown as realization of

debtors is a method of disguising the cash flow position in the books. Generally, these are resorted to get more funding from bankers. Similarly, false sale projections may be indicated by showing these borrowings to be advances received from customers towards sale orders.

- (vi) Sudden change in accounting and operational policies needs to be seen from the point of manipulation of financial statements. The accountants may during their internal review notice difficulties in recovery of dues, especially, for debit notes raised towards incidental service conditions such as, billing the customer for warranties, spares, etc. In order to cover up these deficiencies they may resort to issuing of credit note or pass journal entries for adjusting these dues that sometimes may not be justified. The policy changes may be directed towards removal of audit trail for future by alteration of the terms and conditions with the vendors or customers as the case may be. An external confirmation is highly desirable in these circumstances. The audit trail may have been removed in this manner of detecting any short recovery of dues or adjusting long outstanding advances to vendors.
- (vii) The pre-shipment and post-shipment packing credit is an interesting activity for validating the overseas billing and collection process. The accountant may find himself in a situation where the billings done are resulting in stockpile up at the offshore location that may have remained concealed. If the same is done through a distributor or front company, the risk of non-moving stock is a serious cause for concern. Alternatively, the undisclosed sale of stock while sending a pile of stock is a method to fraudulently divert funds. The concessional rate offered for these transactions may not be available for indefinite period and force the accountants to manipulate the debt covenants. Similarly, the same situation may occur when there is no control over movement of stock or debtors by the manufacturer vis-à-vis dealers/ distributors or intermediaries. Availing of multiple loans or credit against the debtors or stock is an area of fraud risk concern.
- (viii) Outsourcing/ centralization of accounting function is a method at times used for manipulation of accounts as the fraud is committed through the involvement of booking clerk least suspected of manipulation. The booking clerk in this scenario is bereft of the

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ground realities and of the business model and of the control check points. As a result, any fictitious transaction may get processed without evaluation of these control check points. There is a greater reliance on the information supplied by the CFO/ operations team to such outsourced booking clerks.

- (ix) For off-shore operations or fund transfers to remote locations, the cash flow position may be doctored to get additional fund allocation (time- cushion in managing operations) from a central authority. This reflects on lack of planning and improper estimate of cash flow needs by accountants. Thus, this is followed by a rationalization of thoughts by accountants that untimely remittance of funds by head office or central office makes it difficult to manage the operations at the remote locations. To show lower balances at month ends and quarter ends, the accountant may be indulging in window dressing of balances, that may result in blocking of idle funds to avoid any inconvenient questions. The periodicity of the bank reconciliation process, the extent of uncleared cheques could be indicative of such abnormalities. Sometimes, the cheque payments being of identical amounts, induces accountants to indulge in teeming and lading activities. To remove surplus funds, there is a tendency to create fictitious transactions or sharing the surplus of such fictitious transactions with vendors.
- (x) Hidden cushions, secret reserves and unjustified provision for doubtful debts are sometimes used to spread the super profits in a year to the subsequent years, especially, when the future revenues are uncertain. This enables the management to spread the risk of declining revenues over a particular time horizon. Generally, an in-depth scrutiny of the bad debts or doubtful debts is not done in these companies citing external limitations.

Pre-emptive Measures

5.3 The following are some pre-emptive measures that can be taken by investigating team:

- (i) Generally, a lead and lag analysis and scrutiny of accounts over a three-year time horizon would reflect any incident of manipulation by the management.
- (ii) The cash flow analysis with external evidence of source of funds and

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a balance sheet audit with a reality check of true net worth of the company are highly desirable at periodic intervals.

- (iii) Tracking abnormal trends/ high performers, i.e., a zero trauma' test is a good measure to ensure timely detection of irregularities. A zero trauma is a management expectation that there are no pleasant surprises or shocks in disclosure of financial results or operating performance. From an investigative perspective any abnormal unreasonable business trend vis-a-vis industry experience is a factor that can be further explored. This could be followed up with background checks on persons suspected of irregularities in conversely.
- (iv) Ensure independent vendor audits/ dealer audits, external timely confirmations, job rotations which are confidence building measures. Stoppage of the business or dealings for a brief undefined period is a desirable practice to detect abnormalities.
- (v) Stock transfers at month end or inter-unit transfers that are not confirmed in a timely manner are a source of concern in finalization of accounts. The periodicity of such confirmation is of importance in ensuring better controls.
- (vi) Cut-off procedures for operational documents and input documents for accounting of transactions at the quarter or month end are of significance for any abnormal adjustments and these should include independent scrutiny of journal vouchers, credit notes and debit notes raised.

5.4 The following aspects are important while scrutinizing manipulated accounts:

- (i) The change in policy guidelines or operational methodology by management without sufficient justification is another area that is a pointer to a senior management level fraud. Such leads need to be further corroborated with external reviews such as, background checks and identification of possible beneficiaries.
- (ii) The study of board meeting minute books and resolutions are another source of information that provides sufficient leads on any unfavourable decisions, especially, in a closely held company or joint ventures.
- (iii) Where critical accounting entries are centralized with one or two

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persons in the organisation relating to journal entries or closure of books, then this would need a caution in conduct of investigative assignments. The lack of audit trail on cut-off documentation and Re.1 transactions or creating buffer of documents for creation of fictitious sales or inflating top lines are common examples of gathering leads.

- (iv) Encouraging creation of fictitious expense bills for employee reimbursements in lieu of staff welfare expenses.
- (v) The submission and maintaining of multiple books of account in different accounting packages. Operational records not synchronizing with the accounting records, etc., are further practices to gather leads.
- (vi) Surprise independent balance confirmations from banks, vendors, customers, securities and assets or balance sheet audits are effective mechanisms to establish whether the financial statements reflect true and fair view.
- (vii) The procrastination of stock reconciliation, absence of stock summary, debtors' summary, debtors' confirmations or vendor account reconciliation are lead indicators.
- (viii) The 'U' alphabet series in any ledger account is important for unreconciled accounts or suspense account. There may be a tendency to adjust unrelated debit and credit balances under a common head and this is a high-risk area for potential frauds.
- (ix) The preparation of bank reconciliation statement and data entry or updating of the bank register by the same employee without segregation of duty is a risk area for perpetration of fraud.
- (x) The absence of supporting documents on cost grounds are a reason to suspect unauthorized payments such as, absence of itemized bills for telephone bill reimbursement could lead to personal expenses being claimed as official expenses. The use of cash memo bills from stationery shops is a common feature for small denomination expenses frauds. The serial control over these cash memos need to be verified along with other circumstantial factors. Recycling of old bills and invoices through alteration in dates is a common example for fraudulent expense claims. This is prevalent in areas where food

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coupons are distributed to the employees.

- (xi) Proper documentation for registration of patents, trademarks, copyrights and violations in these areas are categorized as high definition frauds and are difficult to unearth and may require the services of specialists. The copyrights are generally, not quantified adequately and reflected in the financial statements that may result in potential litigation.
- (xii) The scrutiny of non-moving ledger accounts and inactive accounts are good lead indicators for detection of fraudulent activities. The carry forward and brought forward balances should be verified across a substantial period for any past period adjustments whether in stock or any other ledger account.
- (xiii) Any inconsistency in accounting practices over corresponding previous period is an area that would need further scrutiny for any justification for changes in accounting treatment. The lack of transparency in accounting or grouping of accounting heads is an area that provides leads to suspected irregularities.
- (xiv) The transition to a new accounting package, improper data migration, delays in passing accounting entries, extensive data entry errors are indicators of fraud prone entities. Conflicting roles in Information Technology department in developing and running of programs are areas that may need engaging of information security specialists.
- (xv) The lack of proper segregation between cash book and bank book is a common area for adjusting shortages in cash balances and contra entries.
- (xvi) The periodic non-reconciled inter-unit balances, contra entries, absence of cheque counterfoils or incomplete entries in cheque counterfoils would need further scrutiny that could turn out to be a lead indicator.
- (xvii) Bribery and corrupt practices within the organisation without adequate checks and balances on such officials extensive appointment of consultants and liaising agents are, generally, indicators of organized fraud. Bestowing of discretionary power at decentralised locations without a monitoring mechanism is an indicator.
- (xviii) Organised white collar crime involves inking of contracts which leads

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to booking of revenue and expenses in different entities. The accounting policy of these entities could be different and, therefore, window dressing is resorted. The cash flow is accordingly managed in a manner that is most beneficial to these organisations. However, these may indirectly result in diversion of funds to entities where a section of the management has beneficial interest. Most of these front companies or sub-contracting entities tend to be closely held companies or partnership firms, Limited Liability Partnerships, AOPs, Non-Profit Organizations, Private Trusts that may not be governed by disclosure norms as applicable to listed corporate entities.

Steps/ Methodologies Involved in an Investigation

Preliminary Assessment

5.5 The primary steps involve extensive planning and brainstorming sessions in getting to a gut feel as to whether there is a risk of fraud in the area under review.

Generating Investigative Leads

5.6 The leads are gathered to further strengthen the above perception. First and the foremost challenge is the standards evolved by the management and to ensure a critical review of the policies and procedures that are put in place during the period wherein irregularities are suspected. The lead gathering could involve trend analysis, internal audit findings, process gaps, vulnerabilities testing and the missing link from such employees who have left the organisation or contracts discontinued under suspicious circumstances.

Data Analytics and Data Inter-relationships

5.7 Data analytics focuses on inference, the process of deriving a conclusion based solely on what is already known by the researcher. Banks and credit card companies, for instance, analyze withdrawal and spending patterns to prevent fraud or to identity theft.

Data analytics as a technique is extremely useful in generating leads and would depend on the area of review. Data inter- relationships involving two independent set of data and logical deduction of sequence of events, time chart analysis by plotting the date and timing of events relating to the leads or irregularities, occurring of events concurrently at two different places

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involving the same person, comparison of data relating to two independent departments for audit trails such as stores and quality control, standardisation of data and relating it to persons, assets or movement of asset/ people are methodologies, abnormal increase in expenditure relating to a particular department or a person are very useful in generating leads.

5.8 The comparison of the average tare weight of a particular vehicle category, the consistency in consumption standards over a defined period, the physical confirmation of stock or tracking of results of data analysis with a walk-through analysis of ground realities provide clues to isolate abnormalities. For example, the reconciliation of stock records with physical inventory, the gate inward of items from gate controls to consumption and stock on hand as against work executed.

Comparison of the quality control reports on rejections, qualitative classification of scrap by manufacturing units before transfer to scrap yard and scrap disposal by stores when properly reconciled would provide a clue on adequacy of scrap billing and collections.

5.9 Fudging of production records across batches in a production line to adjust shortages and surpass quality control tests, the illegal storage of items in stock on behalf of third parties, spurious spare parts from a data analysis of frequent breakdowns and replacements, the use of letter heads and bills of vendors to book duplicate bills, use of high standards of consumption for diverting stock (aluminum ingots or other metal items) to other production lines or personal business, the use of stolen goods and rebranding the same through repackaging, frequency of MIS reports, common source of authority and responsibility allowing manipulations (usurping of authority), false accounting entries based on modification to files (especially in excel spreadsheet), false indents and production plans to remove stock of items from plant, mixing of scrap and rejected items in lieu of good stock and adjusting shortages, false incentive schemes resulting in abnormal increase in sales, absence of periodical review of outstanding statements are source of potential leads to unearthing irregularities.

5.10 Cross verification of freight bills with procurement and stock records, third party confirmation for stock retained at places outside the entity are practices that provide leads to any fictitious booking of bills. The use of multiple copies of the freight consignment notes (book copy, consignor or consignee copies) at different locations may lead to splitting of single trips

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into multiple freight billings.

Data Mining

5.11 Data mining is the process of extracting hidden patterns from data. Data mining is an important tool to transform this data into knowledge. It is commonly used in a wide range of applications such as, marketing, fraud detection and scientific discovery. Data mining can be applied to data sets of any size, and while it can be used to uncover hidden patterns, it cannot uncover patterns which are not already present in the data set.

Use of specific audit tools ensures greater performance in less time. The sample size is no longer a constraint and substantive checks are now feasible on entire population. The developing of scripts (software programs) enable repeated use of a defined logical analysis and are useful in generating exception reports that enable identifying abnormalities over the entire population. The use of these tools has revolutionized the manner in which investigations are conducted by providing linkages to data; intelligence is gathered in terms of duplicate entries, data inaccuracies, the linkage among subsets of data for a meaningful analysis, etc.

5.12 The term data mining is often used to apply to the two separate processes of knowledge discovery and reaching definite conclusion. Knowledge discovery provides explicit information that has a readable form and can be understood by a user. Data miners sort through huge data sets using sophisticated software to identify undiscovered patterns and establish hidden relationships.

Information Security, Screenings and Detecting Leakages

5.13 Parallel telephone connections could be a reason for loss of business and information that would require some technical expertise to identify such leakages of information in private offices. The eavesdropping by unauthorised persons within the office premises, unauthorised retrieval/ loss of documents or removal of documents and records in relation to certain events are a good lead indicator for any discrepancies. Employees sitting late or an accountant or cashier volunteering to undertake multiple tasks on a regular basis or late sitting in office perennially are indicators of abnormal situations. Rotation of employees across locations, mandatory leaves, etc., are good practices that result in uncovering of leads on any suspected

fraudulent activities.

5.14 The abnormal entries in system, the unauthorised access, the signing of documents when the employee is not present in office, any favourable treatment to vendors, persistent employee referrals, personal information in HR records such as names of relatives of employees (father, mother, brother, dependent sister) and similar data in vendor or customer records, the use of residence telephone and dummy addresses, creation of work orders to facilitate fictitious billings or procurements, sabotage by competitors through housekeeping or other agencies unknown to the client, developing informers within the entity who are in the know of happenings, communication gaps between two locations of the company, use of facsimile machine for fictitious entities operated from employee homes, alterations in the input documents and data keyed in the system, etc., may pose threat to information security.

Extraction of deleted files or unauthorised copying of sensitive information from system in pen drives, frequent system breakdown, lack of adequate back up of information or loss of information trail are useful in generating leads.

Manipulations in Basic Documentation in Manual Systems

5.15 Use of carbon copies for marking additional figures or manipulating the expense amount is a methodology that should be related to the basis of billings and whether proper validation exist in the bill passing procedures. Alteration in dates and amount figures or reuse of prior period bills and supportings are common means of manipulation.

Use of two independent receipt books for customer and for company bookings are another source for perpetration of fraudulent activity. Some other sources are duplicate or photostat copies of bills and receipts used for accounting entries and in maintaining of cash book or use of memorandum books to deceive the customers and maintaining a separate book for accounting records. Improper use of all the copies of a documentation for the intended purposes, such as, goods consignment notes (freight, consignor, consignee and book copies), invoice copies (customer, office copy, accounting, book copy), not scrapping and destroying unused letter heads, invoice and receipt copies, unauthorised use of rubber stamps in bills and records for communication with customers, etc., may get used in fraudulent

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activity. Digitalisation and office automation has brought new surrogate methods, use of proxies, spyware and malware, programme bugs and new avenues for manipulations and corrupt practices and cybercrimes that are beyond the scope of this publication.

‘Entrapments’ by Fraudster

5.16 Luring of potential targets by fraudster using ‘simple vulnerability testing methods’ akin to a trial run before a full-fledged fraud is committed. A fraudster, generally, indulges in confidence building measures or strike rapport with the potential target. For e.g., he may build confidence with the distributor or manufacturer as a preferred customer through regular business transactions and ensure prompt payments to create an image of a customer with a reasonably good credit record. This encourages the client to enhance credit limit and the fraudster waits for an opportunity and defaults in payment.

5.17 The dry run by the potential fraudster is a common practice wherein the auditors’ practices regarding sample size, the documentation review style and time interval between two reviews are studied. The fraudster does a dry run on a sample basis to test vulnerability of getting caught before causing extensive damages. For the purpose, he gets into a position of confidence with the internal audit co-ordination matters. Another method adopted is to create sufficient documentary trail and retain the control within the department rather than allowing an independent verification by an accounts team. At first glance, the entire documentary trails as required by the auditors are maintained. In such situations, there is a need for cross check or independent confirmation as to whether the activity was undertaken.

5.18 The retention of records and documents and the manner of filing of documents for easy retrieval is a factor that would need close scrutiny. The fraudster tends to maintain the record that makes the audit process complex within a given time frame. The records and documents may get transferred to a distant location within a short period of time to prevent access to the internal auditors. Rewriting or creation of records and documents exclusively for internal audit purpose is a factor that needs caution while conducting investigation assignments.

5.19 The crashing of system or loss of data is a common reason that is given by the suspects in an investigative process. At times, situation may demand rebuilding of data using single entry method or based on data from external sources as a part of investigative process. The facility to add

suffixes or prefixes to payee's names in cheques, identical payment or receipt amount not backed by confirmation from vendors or customers are areas of suspected irregularities. The improper tax registration numbers on sale or purchase invoices or improper telephone numbers or item descriptions, photostat copies instead of originals are indicators of irregularities that would need appropriate scrutiny.

5.20 The master mind fraudster may use the services of gullible employees or undetectable third parties for indulging in irregularities. In the event of the fraudulent activities being uncovered, the master mind remains elusive due to lack of direct evidence. Under the circumstances, surveillance and background checks are resorted to uncover such remote controlled fraudulent activities. Generally, such irregularities are done in connivance with unsuspecting third parties outside the organisation. These, generally, surface through a whistleblower mechanism.

Logical Deductions

5.21 The procurement of material when sufficient stock is indicated in the books or not purchasing of material at competitive prices are indicative leads. In a chemical processing or edible oil processing unit quantity reconciliation in a reverse direction from output to input (flashing back akin to an ERP system) would provide sufficient direction on manipulation in stock or consumption patterns. The cross check with quality records would provide evidence of any manipulation in records vis-a-vis deviation in quality or adjustment of shortages. Any change in the frequency of MIS reports for each batch production could be a lead indicator of any manipulation in production records.

Lifestyle and Employee Behaviour Pattern

5.22 The background checks on employees, their movements, their interactions, gathering intelligence on their lifestyle and past track records are effective means to establish integrity of employees.

Time/ Motion Study and Documentary Trails

5.23 The in-out timings of vehicles/ employees during abnormal office timings, the start and end time of activities and comparison with standard timings are examples of gathering leads. The attendance and leave records with reference to employee user IDs are examples relating information

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against two sets of data.

5.24 Some examples of diversion of funds are:

- (a) Booking of revenue in an offshore company while booking the expenses (manpower cost) in a local company with marginal revenue projections. The contracts between the two companies (local and offshore) tend to be sham contracts that help in doctoring the revenue statements. The terms and conditions of contracts are, generally, termed confidential to the audit team. The internal audits of the revenue and cost statements are based on the information as shared by the management based on certifications. This is a common problem in companies handling projects abroad or foreign companies having project offices in the country. The cost of audit of these entities is considered prohibitive especially involving travel and stay abroad. As a result, these audits of offshore entities tend to be done locally based on photostat copies as forwarded by such entities. Confirmation of customer billings and cost becomes a constraint in these kind of internal audit assignments.
- (b) The productivity analysis of the manpower cost would provide a ready guide on diversion of revenue to front companies. The expense ratios are of extreme importance in such analysis prior to engaging in a detailed scrutiny. For example, a company employed about 400 labourers for gardening and maintaining of ETP plant. The labourers used to clock in their time cards, but were predominantly used in the farm house of the head of administration department. The labourers used to be again brought back to the company premises during their official time out hours. A surprise count of labourers in a covert manner with the attendance record over a period time revealed ghost workers. A background check revealed that these were deployed for personal purposes.
- (c) The purchase of heavy steel and other machineries through a front company (closely held) and inflating project cost leads to fund diversion to such entities. These are more relevant during end use monitoring or in due diligence audits on behalf of banks and financial institutions.
- (d) A foundry was sub-contracted for the job of preparing moulds for two wheeler hoods. The input material was aluminium ingots that was

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procured by a listed company and supplied to the front entity on a contractual basis. The front entity has estimated high standards of consumption that resulted in diversion of aluminium ingots for other applications such as, manufacture of fan blades, etc. The standard loss of aluminium ingots was never challenged. Similarly, this is a common problem in supply of MS sheets and other metal items to fabricators.

- (e) Competing bids is a common method for diverting the business to front companies. Here the front company along with the main entity becomes joint bidders to garner larger market share. This is a common factor for fraudulent activity wherein designated officials start clandestine operations of floating private ventures and diverting business while in employment with the main company.
- (f) Another difficult area of investigation is uncovering of front running practices wherein employees indulge in placing their personal interest first while engaging in large security trading deals on behalf of the company. Fund managers getting secret commissions is an area of serious concern that is difficult to uncover and may require the services of specialists especially involving background checks. Most company's except for obtaining declarations from employees do not monitor these dealings as these tend to be managed through brokers or persons who do not come under the purview of term "relatives". The settlement of the deals in these dealings may happen at an uncertain future date or cross deals among entities.
- (g) In a company, cash receipts issued to customers clearly stated the purpose for which the cash was collected and ensured greater transparency on charges that were levied and collected from customers. This provided a trail of account heads and the purpose for which the amount was collected from the customer. This provided greater accountability on usage of funds and detection of any diversion of funds for purposes other than for what these were meant. The CFO decided to overcome this problem of accountability by removing the detailed break-up of the charges on the face of the receipt to divert funds for purpose other than for what the customer has paid.

5.25 Certain resources such as IT support and technical support may not

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be required in every form of investigative assignment. These may, therefore, be outsourced on a need basis to maintain cost competitiveness in execution of the assignment. These agencies are more in the nature of specialised service providers in gathering of evidence. For these agencies an interview with the user can yield valuable information about the system configuration, applications, encryption keys and methodology.

Collecting Digital Evidence

5.26 Digital evidence can be collected from many sources. Obvious sources include computers, cell phones, digital cameras, hard drives, CD-ROM, USB memory devices, and so on. The principles applicable for detection of cyber crimes can be applied effectively and consistently to a relational data base. Additional copies of data base evidence are made in order to preserve the evidence for future presentation during a legal process.

5.27 Other specific practices that have been adopted in the handling of digital evidence include:

- (a) Handle original evidence as little as possible to avoid changing the data.
- (b) Establish and maintain the chain of custody.
- (c) Documenting everything that has been done.
- (d) Only use tools and methods that have been tested and evaluated to validate their accuracy and reliability.

Imaging Electronic Media Evidence

5.28 Chartered Accountants should use the support of Technical experts for capture of evidence or for working on a database in the investigation process. The process of creating an exact duplicate of the original evidentiary media is often called Imaging. Using a standalone hard drive duplicator or software imaging tools, the entire hard drive is completely duplicated. This is usually done at the sector level, making a bit stream copy of every part of the user accessible areas of the hard drive which can physically store data, rather than duplicating the file system. The original drive is then moved to secure storage to prevent tampering. During imaging, a write protection device or application is used to ensure that no information is introduced onto the evidentiary media during the investigative process.

Time Flow and Document Flow Reviews

5.29 Time flow and document flow analysis with reference to an activity where fraudulent act is suspected provides vital clue on the following:

- (a) The time available for manipulation in data entry;
- (b) The lead and lag between happening of event and recording in system;
- (c) Any mismatch in events in the entire sequence of an activity can be uncovered;
- (d) Any loss of data or human intervention can be uncovered; and
- (e) Any destruction of evidence can be uncovered.

CCTV Footage

5.30 CCTV cameras with various resolutions are fitted at key installations and locations. These have a defined storage period and a backup policy defines the storage of data up to a particular time period. This provides physical evidence of events happening at sensitive locations for further analysis.

Flow Charts

5.31 There are software tools that enable relational database analysis and provide leads on linkages between people who might be remotely connected in a fraudulent activity or who are associated with a fraudulent activity. As data is captured the critical data such as, address, telephone number, activity and other details are mapped and when the exercise is complete the flow chart displays the linkages.

Financial Ratios

5.32 Financial ratios provide a good insight in identifying areas of concern; these ratios can be considered as a starting point in the analytical process and even help in assessing the impact of fraudulent activity. Unlike the normal evaluation of business performance using these ratios, a shadow profiling of company's activities needs to be undertaken that will enable the investigating officer to isolate key concerns. For example, a favourable inventory ratio could be due to improper valuation of inventory, change in consumption standards during the year as compared to the previous year,

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write-off of inventory, fictitious purchases or inventory considered without booking of purchases, excess provisioning, etc.

5.33 The basic thumb rule for an investigative assignment is to obtain independent corroborative evidence on whatever documentary or circumstantial trail is placed before the investigating team. The simulation techniques of recreating the sequence of events in gathering leads and in defining milestones in the investigative approach would help drive the entire assignment.

Chapter 6

Diagnosing Fraud Behaviour

Chapter Summary

Since fraud is usually concealed, material misstatements due to frauds are difficult to detect. Nevertheless, the auditor may identify events or conditions that indicate incentives or pressures to perpetrate fraud, opportunities to carry out the fraud, or rationalizations to justify a fraudulent action.

Such events or conditions are referred to as “fraud risk factors”. Fraud risk factors do not necessarily indicate the existence of fraud; however, they often are present in circumstances where fraud exists. When obtaining information about the entity and its environment, the internal auditor should consider whether the information indicates that one or more fraud risk factors are present. The internal auditor should use his professional judgment in determining whether a risk factor is present and it should be considered in identifying and assessing the risks of material misstatement due to fraud.

Fraud Triangle

6.1 The factors that should be identified and removed to deter fraud (as described above) are best described in the “Fraud Triangle.” This idea was first coined by Donald R. Cressey. There are three Fraud Triangle conditions that are present when a fraud occurs. First, there is an incentive or pressure that provides a reason to commit fraud. Second, there is an opportunity for fraud to be perpetrated (e.g., absence of controls, ineffective controls, or the ability of management to override controls). Third, the individuals committing the fraud possess an attitude that enables them to rationalize the fraud.

6.2 The Fraud Triangle describes three factors that are present in every situation of fraud. According to it, the three main factors that induce a person to commit a fraudulent act would be as follows:

- (i) Motive (or pressure) – It is the need for committing fraud (need for money, etc.). This is a key ingredient to any illegal activity more relevant to criminal law. Usually, in case of frauds, the motive is quick and easy financial gain. The motive could emanate from economic, social or personal prejudices.

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- (ii) Rationalization – It is the mindset of the fraudster that justifies him to commit fraud. When a wrongful act is justified, the fraudster is emboldened to carry out such acts.
- (iii) Opportunity – It is the situation that enables fraud to occur (often when internal controls are weak or non-existent). A person with fraudulent tendencies looks for opportunities when there is a least likelihood of detection. For the purpose, such a person may indulge in trial runs and test the vulnerability on a sample basis. As the confidence level increases, there is a tendency to increase the frequency of such acts and cause further damages. The fraudster is, generally, aware of the consequences and takes a calculated risk.

6.3 While it is extremely difficult to prepare a comprehensive list of factors that lead to commission of fraud as these cannot be generalized to any given situation, the following are the reasons that may help identify the perpetrator of fraud or in evaluating whether an organization is susceptible to a fraudulent activity:

- (i) Crossing ethical barriers due to personal pressures, such as, performance targets and personal habits.
- (ii) Business strategies overriding control environment and effective governance with undue emphasis on targets and compensation.
- (iii) Disgruntled employee with revengeful attitude.
- (iv) A liking for breaking defined rules with employees displaying resentment to directions from superiors.
- (v) Greed and deceptive behaviour.
- (vi) Operating and financial decisions are dominated by a single person or few persons acting in concert.
- (vii) 'Subject' normally is evasive to audit queries and has frequent disputes with auditors coupled with a weak control environment. There are obstacles in ensuring proper audits and significant difficulty to audit certain transactions due to absence of adequate audit trails and documentation. There may be lack of awareness about internal controls. Sometimes, the audit recommendations are not considered pragmatic and are ignored.
- (viii) Undue empowerment of authorities at decentralized locations.

- | Before Fraudulent Act | After Fraudulent Act | | | | | | | | |
|--|--|-----|-------|-----|---|--------|----------|-------|----------|
| Amount in payment voucher approved by receiver before presenting to cashier had a blank before the amount in figures of ₹ 100. | Amount One thousand was inserted in payment voucher approved by receiver before presenting to cashier. (amount altered to ₹ 1,100) | | | | | | | | |
| <table> <tr> <td>Rupees</td><td>100</td></tr> <tr> <td>Total</td><td>100</td></tr> </table> | Rupees | 100 | Total | 100 | <table> <tr> <td>Rupees</td><td>1,100.00</td></tr> <tr> <td>Total</td><td>1,100.00</td></tr> </table> | Rupees | 1,100.00 | Total | 1,100.00 |
| Rupees | 100 | | | | | | | | |
| Total | 100 | | | | | | | | |
| Rupees | 1,100.00 | | | | | | | | |
| Total | 1,100.00 | | | | | | | | |
| (One hundred only) | (One thousand one hundred only) | | | | | | | | |

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- (v) Creating avenues to deceive through cleverly drafted policy guidelines.
- (vi) Loss booking through fake vendor bills.
- (vii) False sale orders, financing arrangements and customer realization.
- (viii) False entities and use of fax messages in these names for business.
- (ix) Fake academic/ qualification certificates.
- (x) Computer generated bills for consultancy or labour bills that cannot be corroborated.
- (xi) Splitting/ duplication of bills.
- (xii) Submission of inflated bills for documentation purposes such as, loan processing, medical reimbursements, etc.
- (xiii) Declaring insolvency and diverting assets to relatives and/ or known persons.
- (xiv) Creating avenues for mishaps for availing insurance claims.
- (xv) Planting persons for sabotage of competitor's product launch.
- (xvi) Stealing of confidential strategic information and selling them to competitors.
- (xvii) Borrowing from local money lenders are reflected in books as advance from customers towards sale orders.
- (xviii) Identity theft.

Case Studies

6.5 The following are some case studies on fraudulent activities:

- (i) The audit coordinator in a company was getting impatient on the slow progress on the audit front and was hinting at serious irregularities in several audit areas that needed immediate attention. While he was forthcoming with extensive details, a closer view of his responsibilities revealed conflicting roles and override of authority. He was indulging in wrongful activities and was trying to divert attention of the auditors.
- (ii) The stores personnel explained to the auditor that the local scrap dealer was a brother of a local politician and was a powerful man. He

suggested them to avoid venturing out for physical verification of stock or any confrontation with the scrap dealer. A closer review of the operations revealed that the storekeeper himself was being bribed and was indulging in issuing false gate passes for removal of material. The gate pass for MS and aluminium scrap as per the company policy manual was to be signed by Stores section and for garbage the same was to be signed by Administration department. Incidentally, the gate pass issued by stores section had indicated the item lifted as garbage and not scrap items. The security cell was not aware of the authorised signatory though a manual existed resulting in fraudulent activities.

- (iii) A senior official was getting irritable with the auditors even for trivial audit queries. This made the auditors suspicious. Further investigations revealed that he was engaged in siphoning of funds by manipulating creditors account, bank reconciliation statement and payment vouchers. The primary lacuna was non-verification of the source document by the cheque signing authority and instead the signing officer used to see the balance outstanding in the system. The suspect convinced the software professional to provide a facility of shifting the vendor codes in the system that enabled shifting of the transactions from one ledger account to another without a journal entry. This facilitated the issue of duplicate cheques to the same vendor accounts and misappropriation of funds through opening of dummy bank accounts and tampering of cheques by adding suffixes in the payee name. The internal auditor uncovered the fraudulent act while comparing the vendor related transactions with the material inward entries. The gate passes of earlier years were reused by modification to the input documents to cover up the duplicate entries. The internal auditor found manual corrections at the input stage of the material inward records. There was no segregation of duty in preparing the bank reconciliation statements. The suspect was involved in software development, in scrutiny of creditors ledger account, in generating of payment vouchers, in preparation of the vendor cheques, took over the charge of assisting in preparation of bank reconciliation statement, was responsible for hand-over of cheques to vendors and was in an unenviable position in matters involving strategic decisions.

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- (iv) An employee at a decentralised remote location had no avenue for promotion; yearly pay revisions were low despite his best performance on the work front. Alternate job was difficult to find in the place where he was posted. His income was insufficient to meet the household expenses that included payment of house rent, education of two school going children and food expenses. He was frustrated and had lost faith in getting any response from the management. He had the need and was looking for opportunities to bridge the imbalance between his income and expenses.

He booked the creditors' bills (expenses related to office administration expenses) as cash as well as credit purchases. The cash payments were pocketed by him, and the creditors were paid from the head office by cheque at monthly intervals. The internal audit coverage at such a remote location was not a regular feature. A scrutiny of the petty cash register with the ledger and control check points revealed duplicate entries, in cash and credit entries, being made by the employee.

- (v) A foreign company engaged in e-education business had its operations in India and funds were remitted based on projections given by the Chief Financial Officer. There was a budget exercise done at the beginning of the calendar year for the following financial year. To the extent the budget remained less utilised, a downward revision was ensured. The time taken to remit the funds was of one month from the foreign Corporate office based on an internal due diligence exercise. The Chief Financial Officer, in order to ease the funds requirement, started indulging in excess provisioning and creating secret reserves. The greed overtook his needs and he started indulging in booking fictitious bills. The collection of letter heads and blank bills from vendors became his habit. Further, booking commission payments and false consultation charges bills were other means he used to inflate the expenses. These enabled him to disclose increased utilisation of sanctioned budget amount. Initially, the Chief Financial Officer used these methods to manage funds shortage in the transit period. For the purpose, he opened bank accounts in the name of relatives who were not part of the definition of terms 'relative' in terms of the related party transaction disclosure requirements. This resulted in opening fictitious entities (proprietary

firms) for the purpose of transport hire companies, HR consulting firms, recruitment agencies, and advertisement agencies. Contracts were entered with these entities to bring sanctity to the dealings. This resulted in diversion of funds through booking of expenses against these entities. He outsourced the entire accounting function (data entry activity) to ensure that these activities are not detectable by in-house employees. He gradually replaced old time employees by new recruits known to him and supportive of his actions. During the investigative process, he defended and explained to the internal auditor that the company officials from abroad were victimizing him and that there won't be any discrepancy relating to documentation and supporting to the vouchers. This statement under the circumstances gave sufficient lead to the internal auditor and the case was solved in no time as the perpetrator of fraud was fabricating documents to claim fictitious expenses and falsification of financial statements. The required evidence in the form of unused letter heads, rubber stamps of all the entities were recovered from the office premises thereby providing conclusive evidence.

Chapter 7

External/ In-house Investigations

Chapter Summary

When does one realize that the internal audit gets into the nature of an investigative assignment? Simply stated it is a matter of common knowledge that when there is a doubt of dishonest intention then the nature of assignment gets modified. Although there is no ready to-fit formula for the conduct of an investigation, it is desirable that such assignments follow a set framework of execution. This Chapter elucidates the importance of mandate and confidentiality in an investigation irrespective of whether it is carried out in-house or through an outsourced agency.

Mandate for Investigation

7.1 While starting an internal audit, if we stumble across areas that are touching upon a suspected fraud, pause for a moment; think about the area that is creating an issue for the company, persons who are involved, materiality of the transaction and its impact on the overall operations. Sometimes, the management may be reluctant to spend time for unnecessary work. For instance, issues such as duplicate bill being submitted for Travel Allowance can be handled even by a departmental head without any special investigation. During the internal audit one should be alert to areas that need special attention. It is always preferable to prepare a summary report and submit it to the Head of internal audit department or bring it to the notice of the immediate superior in the reporting hierarchy. The message is not to commence investigation without a formal mandate.

7.2 It could be possible that the internal audit assignment is carried out by outsourced firm in an organization or by an in-house audit cell. The basic requirement when faced with such a situation where audit takes the form of an investigative assignment is to seek a referendum from the Chief Audit Executive. Further, the objective and methodology in an investigation depend on this mandate. From the client perspective, the investigation by an external investigative firm carries a greater acceptance considering the independent nature of the assignment.

External/ In-house Investigations

As a matter of principle, the ability of the firms in conducting investigation is of paramount importance in awarding an investigative assignment. Similarly, it is essential that the private investigators accept assignment for which they have the domain expertise. The greatest conflict arises when an investigation is carried out by an investigative arm or a subsidiary in an organization for its competitor.

7.3 During the course of an audit, one does come across situations of suspected fraud. In such a case, it is better not to come to a hasty conclusion alleging that a particular employee or person has committed a fraud on the company. As an internal auditor, one must place facts in an assertive manner to the extent that the reporting officer may take a serious note of the problem addressed and is convinced that there is a need for a thorough probe. The management's immediate reaction to a fraudulent activity is to seek explanations from the internal auditor as to whether any vulnerability was noticed in the past and brought to the notice of the management through their internal audit reports.

7.4 What constitutes a mandate for an investigative assignment ? A mandate provides a medium to clearly understand from the client or the head of the internal audit department, the objective for undertaking an investigative assignment. This is essential in the context of defining the areas of review and the restrictions and the jurisdiction beyond which a person is not supposed to extend his review. It enables ascertaining the available time limits to conduct the investigation. Where there are time constraints, the investigating officer may find himself at the wrong end, affecting the quality of work in execution of the assignment. Delays may result in action being taken on the wrong person, denying promotion or not declaring bonus to a deserving employee in the interim thereby affecting the reputation for the investigating personnel and the client at large.

The mandate in case of an external investigation covers the following:

- Terms of reference
- Engagement letter
- Investigation methodology
- Resource deployment (optional)
- Fee structure and expense reimbursements

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- Limitations and restrictions
- Security concerns and safeguards (optional)
- Expected deliverables (may not always be feasible to predict)
- Reporting requirements.

7.5 Contrary to the above there are circumstances during an internal audit when a 'perpetrator of fraud' (suspect) would be anxious to know the audit approach of the internal auditor including the audit plan, the scope of coverage and the time schedule during which the audit will be conducted. He will constantly attempt to read the auditors' thought process and is most likely to try to remove the critical files or documents that contain vital information. In case an internal auditor is apprehensive of vital documents being removed or there is sufficient ground to raise suspicions, it is advisable to secure the documents, the photocopy at least and where permissible the original documents too should be kept in a secured manner. The client needs to be formally notified as they may need these documents for further action.

7.6 A screening of the prospective client who approaches for investigative assignments is preferred by the private investigators. This is due to some considerations. Normally, assignments on behalf of individuals or partnership firms are not accepted as there are difficulties experienced in settling the assignment fee and subsequent recoveries. In exceptional circumstances, where the stakes are high and client relationships matter then such assignments are accepted in the larger business interests. The second important aspect is the background of the client who approaches the investigative agencies. Where the stature of a client involves a reputation risk for the investigative firm, there may be an aversion in conducting assignment for such clients.

7.7 In case of accounting and audit firms that specialize in investigative assignments, clarity of thought must emerge within the investigation firm in relation to conflict of interest that may arise in terms of other client engagements. For instance, in a client relationship the acceptance of the assignment or the outcome of the investigation may result in conflict of interest with reference to the other assignments handled by the same investigating entity.

Abundant caution is required in ascertaining whether the investigative process is being used as a ploy to settle scores in disputes wherein the

investigating officer is used as a pawn in the removal of evidence in order to weaken the defense in a legal proceeding. Further, caution is needed in ensuring that the engaging client is not drawing the investigative firm as a party to a potential litigation or making them a party to a legal suit filed by the engaging client.

Letter of Engagement

7.8 The most important aspect in initiating the investigative process is the preparation of the letter of engagement (LOE). For in-house investigative assignments, these could be alternatively supplemented by an inter-office memo (IOM) or a mandate given to a subordinate officer from his reporting superior. Whether it is a LOE or an IOM, there should be abundant clarity in the subject matter for investigation. This should be listed down at the time of engaging in a discussion with the management or the concerned superior. Any additional work that is required to be done during the course of the assignment should be backed by separate mandates. In a situation, where the investigative process involves engaging the services of other vendors then the same should be stated clearly to the client. For example, in an investigation involving scrap disposal, for establishing whether the rates negotiated are competitive or to understand impact of fluctuation in steel price, there may be need for engaging the services of a vendor to gather the requisite information.

7.9 When using the services of a vendor, it is essential to verify whether there exists any conflict of interest in engaging his services vis-à-vis other assignments handled by him for the client or a competitor/ third party. In some cases, there may exist any relationship wherein the vendor happens to be related to the client or such third party. Alternatively, whether the vendor happens to be related to the person against whose actions as a result of investigation process is being initiated upon. As in the case of LOE and IOM, there has to be a contractual arrangement in engaging the services of a vendor, including a non-disclosure agreement with such vendor as otherwise there could be legal hassles if confidentiality of information is not maintained. Especially, where the vendor is not professional in his approach and happens to be a small-time vendor who may not be aware of the implication of his actions. It is essential to make such vendor understand that he or his personnel cannot indulge in loose talk about the matter being investigated in public domain. In the above example of ascertaining the rates for disposal of

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scrap, the vendor while indulging in 'mystery shopping' should not divulge to any person whether internal to the client company or any outside person of the matter that is under investigation. The agreement with such vendor should include a liability clause for the purpose. In a nutshell, the mandate which the investigating officer has with the vendor should be properly documented.

7.10 There should be a clear understanding in any investigation process, as to who will be the key contact person. A single point of contact is most preferred and can either be the Chief Financial Officer or the Chief Executive Officer. The discussions on the matter being investigated should not be delegated to a junior person in the hierarchy. Many a time the client may not be able to appreciate this aspect and, therefore, it is imperative that the investigating officer should take the management into confidence in ensuring better control over the investigative process by holding discussions with senior personnel.

Non-disclosure Agreement (NDA)

7.11 There should be a Confidentiality Agreement or Non- disclosure Agreement (NDA) between the investigating officer and the client. There is a general presumption that such a NDA is required for investigation assignment to be carried out by external agencies. This is not true and such an arrangement is equally applicable to an investigation conducted by an in-house department, and it should be specific to the matter being investigated. Where this precaution is not taken, there is a tendency to discuss the matter at public places where a person inadvertently reveals classified information. The personnel in charge of investigation, in whatever capacity, should be made aware that they will be held responsible for any leakage of information relating to the matters under investigation. Even within the same department (whether within investigation agency or in the client company), the information on investigation is to be shared on a need to know basis. The members within the investigation department may not be privy to all the information or assignment handled.

Case Studies

7.12 The following are some case studies on aspects discussed above:

- (i) A leading private company had reported loss of nearly ₹ 400 plus crores due to unauthorised investments by the managing director of the

company. There is an element of delegation of power in matters relating to investments. Front running (akin to insider trading where employees riding their personal investments along with large scale investments on behalf of company) was a common phenomenon in regular business transactions that was difficult to monitor and was left to employees for self-declaration. Matters on business strategies were, generally, discussed at the board level and were not considered appropriate to be discussed with the internal audit functionaries due to strategic nature of the activity. Such a situation brings us to the question that who would be responsible for reporting on management fraud.

The internal auditor would need to define scope of the assignment once a mandate is given to him through a letter of engagement. The diversion of funds or assets is a common ground for most investigative assignments. The difficult proposition is to establish that these were unauthorised investments not referred to the board. Generally, a blanket right is given to the senior management within an overall limit. This could be stated as background to the assignments and rights under these powers that were abused. The internal auditor would seek special permission to probe into the aspects relating to diversion of funds to the personal account of the suspect or his relatives through these unauthorised investments. These may involve some part of the review being outsourced to outside firms and referral to legal experts. The investments could be fungible and exchanged for other benefits that are difficult to fathom. These could be cited as limitations. For how long these investments remain vested in various related group companies of the managing director is a matter that needs to be taken into consideration for highlighting any abnormalities in reporting to the Board.

The above situation clearly highlights that the mandate for investigation is of paramount importance in understanding the management expectations.

(ii) An investigative firm is appointed as vendor for certain support services. There was a dispute between the main investigative firm and the vendor in sharing of reviews in accordance with the agreed terms. At a later stage, the vendor felt that the amount he had agreed was not sufficient with respect to the work assigned to him. He had secured certain vital information during the investigative process. He threatened to sell the information as there was no direct agreement with the client. Where did the investigative firm fail in its engagement finalising process?

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There was no confidentiality (non-disclosure) agreement with the sub-contracting firm binding him to act in a defined manner in relation to client information. (The example is illustrative and is not purported to be a real-life example.)

Chapter 8

Pre-requisites of A Good Investigation

Chapter Summary

In any investigative assignment, the rights available under the law of the land must be respected and awareness of the local laws and regulation is essential. Whatever may be the compulsions, any violation of the rights of individuals or trespass would be counter-productive to the investigative process. While this may sound obvious, let us understand the implications of actions to the contrary.

Methodology Used for Investigation cannot be Fraudulent

8.1 One ponders 'whether the use of deceit in conduct of investigation is permissible'? It is a fundamental principle to any investigation that the methodology used for investigation to bring out the truth cannot be fraudulent. The Indian Penal Code refers to cheating as an act of using deceit on anybody to achieve valuable gain or causing loss to such other person. In the context of an investigation, where there is use of deceit in ascertaining the truth, such a conduct by the investigating officer may land him in trouble and he may be subjected to a criminal and/ or civil proceeding initiated against him. The use of deceit can result in committing the crime of 'cheating' in the eyes of law. For e.g., any misrepresentation by the investigation officer (Chartered Accountant) as representing a company say 'XYZ' and thereby gathering information or enabling action or refraining by the subject will make him liable for such acts. There is a risk of litigation which the investigating officer should bear in mind. Hence, one should refrain from use of illegal means in the conduct of investigative assignments and act within the laws of the land.

8.2 There are two facets to an investigation. First, these may relate to accounting records and documents, largely internal to the organisation with certain validation checks from external agencies. However, in investigative

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parlance where the accounting entries seem to be concocted or there is a doubt on the veracity of the transactions, external checks may be needed. The second facet of the investigation involves gathering of information on out of books entries, background checks or surveillance on the suspect or any person external to the organisation. The later aspect of the investigation could preferably be outsourced/ sub-contracted or done by experts or specialists (qualified professionals other than chartered accountants such as, legal experts or informers) who are in a position to provide advice or corroborative information that could clear the doubt or confirm the wrongful activities. Such specialists/ agencies have a network of contacts in the market and their predominant daily routine consists of engaging in field activity. They are in an advantageous position to collect information, and to assess the market scenario. These agencies are able to carry out the field work legitimately too. Instead of carrying out the entire investigation by Chartered Accountants, it is preferable to sub-contract or develop sources/ vendors. It is desirable that appropriate monitoring mechanism is in place for such external vendors/ sub-contracted activities by the Chartered Accountant firms.

8.3 Such an arrangement should be documented through an agreement describing the purpose of the engagement, the deliverables and the use of legitimate means to gather the requisite information or monitor the action. For e.g., let us examine a situation where the company has anonymous information that the bidding process for sale of assets is a facade as the entire operation is done through a team of bidders who are operating in a cartel, and there seems to be a collusion with certain officials in the company. Study on Investigative Audits in fixing the bid price and the entire decision on whom to sell to and the sale price is doctored. As a result, the entire open bid process is clouded as a sham transaction. For gathering information from the market, or bidding for contracts, there are genuine operators whose job is to solicit information within the legal realm. One of the approaches to this investigation could be to engage the services of specialist bidders and ensure engaging surveillance specialists who are better suited to conduct background checks and 'shadowing' targeted individuals, to establish truth about the allegations. Such an arrangement in the conduct of 'mystery' shopping or surveillance is referred to outsourced agencies, which are backed by formal agreements explicitly stating the use of legal means and exercising abundant safeguards in getting the required information. Once a list of vendors is given to these agencies, they normally do possess

Pre-requisites of A Good Investigation

the skill sets to ascertain whether any relationship exists among vendors, where they meet and whether any cartel exists, etc. This type of work is more suitable to a person who is adept at field work, who can do the surveillance, who has much more network in the market in which these vendors operate, who can within the legally permissible limit intrude into these vendor companies and understand their operations.

8.4 As an investigation process, this work of surveillance can be entrusted to them by ensuring that the terms of engagement with such parties are legal. For instance, it may be stated that a group of vendor companies have given their quote to buy certain material. It may be requested to find out the following:

- (a) Whether the constituents of the groups of vendor companies are related to each other.
- (b) What is the reputation of these companies in the market?
- (c) Are they really dealing in this material?
- (d) Are their partners, proprietors or directors inter-related?

It has to be explicitly stated that keeping in view these objectives, no methods that are contrary to law will be used and all norms will be adhered to. The above ensures protection to the investigating officer (Chartered Accountants) and the company that engages these services.

Avoid Impersonation during Investigation

8.5 Impersonation from a fraudster's perspective involves identity theft. This is usually a situation where the criminal is trying to assume the identity of another, in order to commit fraud, such as accessing confidential information, or to gain property not belonging to them. This is known as social engineering.

In this context, impersonation in place of another person/ fictitious person in an investigation is not acceptable. In this scenario, the subject believing the person who is indulging in impersonation may be revealing certain information vital to the investigative process that still will be considered as a deceit. In the eyes of law the investigating person has played a mischief and can be construed as an offence and the investigator can be taken to task in a court of law and sued for civil damages or proceed with under the criminal law. Thus, in the pursuit of ascertaining the truth in the matter under review, the investigating officer may land in trouble.

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8.6 Let us explore another scenario in the context of search and seizure in the investigative process. In a private investigation, where there is information that letter head, quotations, duplicate bills by the purchase officer or buyer are retained in his house, despite there being confirmed information, there is no right to enter the house. Such search operations can be done only in client's office or in such other office where the work is assigned. Even as an internal auditor one cannot search and seize material evidence, from the private desk of the 'subject' without seeking prior permission of the superior officer for possession of such material that can be produced as evidence.

8.7 The legal point of view is that there is no such authority of search and seizure to a private investigator (Chartered Accountant). Suppose bills, letter heads, etc. are in the private possession (outside the client's office premises) by the purchase officer; there can be no right of search or seizure or trespass in the investigative process to the private office or home of the suspect. To conclude, a private investigating officer (Chartered Accountant) does not have the right of search and seizure. One can however carry out search and seizure operations within the office premises of the organization.

Precautions in Investigative Assignments

8.8 The stakes at times in an investigative assignment are high and there are compulsions wherein a suspect tries to indulge in assessing the strength and weakness of the investigating officer (members of the investigating team). He is curious to know the strategies and tries to wipe out evidence or creates stumbling blocks or distractions in the investigative process. It is essential for the investigating officer (Chartered Accountant) to be unbiased, to build trust among the team of investigators and vendors. He should not compromise his position during investigation due to threat or other inducements and adhere to the code of conduct of the Institute of Chartered Accountants of India. The secrecy of information is a matter of paramount importance and should be above personal prejudices among the team members. Care should be taken to advise the inexperienced team members not to indulge in planting of evidence to improve the chances of success in an investigation. This may prove to be non-productive and harm the investigation process. The biggest task for a lead investigation firm is to prevent the chances of selling or sharing of information to undesirable sources. Thus, it is equally essential to build appropriate checks and controls in the investigation process. The management must take abundant caution in

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engaging the services of private investigators as the fee largely depends on the man hours spent and scope of the engagement that is not, generally, within the control of the management. There is, therefore, a need for constant updates on the progress made in investigation and ensure that there is no perception that there has been an undue advantage in the minds of parties to the engagement.

8.9 Perhaps the biggest security for an investigating officer is when he represents an organization (a Chartered Accountant firm) or works as a team, as distinguished from working in an individual capacity. This mitigates the threat on the investigating officer (an individual Chartered Accountant) on duty as the suspect is dealing with an organization (firm) and any physical assault or threat to the investigating officer will act against his interest. It is preferable that there is adequate security cover provided to the investigating team. Such a protection may not be always possible, and an investigating officer is expected to exercise diligence in taking decisions and is answerable for his actions.

Case Studies

8.10 The following are few case studies highlighting the abovementioned aspects:

- (i) The internal auditors of a reputed multi-national company brought to the notice of the head of the legal department that certain abnormal travel and administration expenses could not be corroborated with the corresponding legal activity. There were fictitious letter heads and rubber stamps of outside entities. The evidence was not in the private office of the persons claiming such expenditure.

The abnormal expenses could be identified through the inadequacies in the supporting documents for travel, local conveyance and recording of minutes. These were not conclusive and similar practices were followed by most other departments within the organisation. Any implication of a staff in legal department to the exclusion of other departments would have resulted in a biased investigation. Finally, the evidence was available through scrutiny of the listed cell phone bills, the outward records maintained in the dispatch section and the boarding and lodging bills of the concerned employee. These pointed out that the expenses were of personal nature and not related to business activity. The investigation in this manner was finally

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concluded without resorting to trespass into the suspect's private office to gather the evidence.

- (ii) An internal auditor during audit review and validation of the audit findings was on a field visit on an asset tracing job in a finance company. A review of the R.T.O records revealed that the vehicle had changed hands. The documents that were handed over to a broker for completion of R.T.O formality were misused, and vehicle had been sold to a third party under a bank finance arrangement. The finance company officials were not aware of this vehicle changing hands and they had repossessed the vehicle. Since the papers submitted to the R.T.O were cleared by the finance company employee though misused by the broker, the company had no right to repossess the vehicle as the banker had the rightful lien over the asset. The new borrower threatened to register a police complaint against the finance company officials and as a result the vehicle had to be released back.
- (iii) Some former employees of a company colluded with outside elements and started a competing business with the company. The company was dealing in a product that was not available in the local market and imported the same from its manufacturing units abroad. These groups of people (former employees) used an insider to divert this product to a place outside the manufacturing unit. The internal auditor summarized the following:
 - (a) In the production planning process, the indents placed were in excess of requirements. There was no confirmation on record of the material shipped vis-à-vis Pre-requisites of A Good Investigation indents received from some of the locations.
 - (b) The daily MIS was converted into a monthly MIS for monitoring loss in transit and manufacturing loss.
 - (c) Certain new local transporters were appointed, and contracts entered. The freight bills for these transporters were cleared within 15 days as compared to 30 days of credit allowed to other transporters. Authorization rights/ approvals for freight bills were localized in the recent period of audit that was hitherto approved from Head office.

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- (d) The material was shipped to a local unit outside the factory premises and material transshipped to outside elements. The transport operator was a conduit in this process and was paid in cash immediately on transshipment of goods to outside elements. The internal auditor could not trespass into the transit unit as the same belong to outside parties not belonging to the company.
- (e) A review of the local transport freight bills and cross verification with the security guards and outside informer helped the auditor to establish that the vehicle belonged to the spouse of the indenter employee. The same was corroborated through the R.T.O office records (external validation).
- (f) Based on the reconciliation of the Form F under the Sales Tax Act for inter-state stock transfers, it was concluded that the indents were fabricated, and the material was diverted to outside premises and transactions amounted to theft of the goods.

Chapter 9

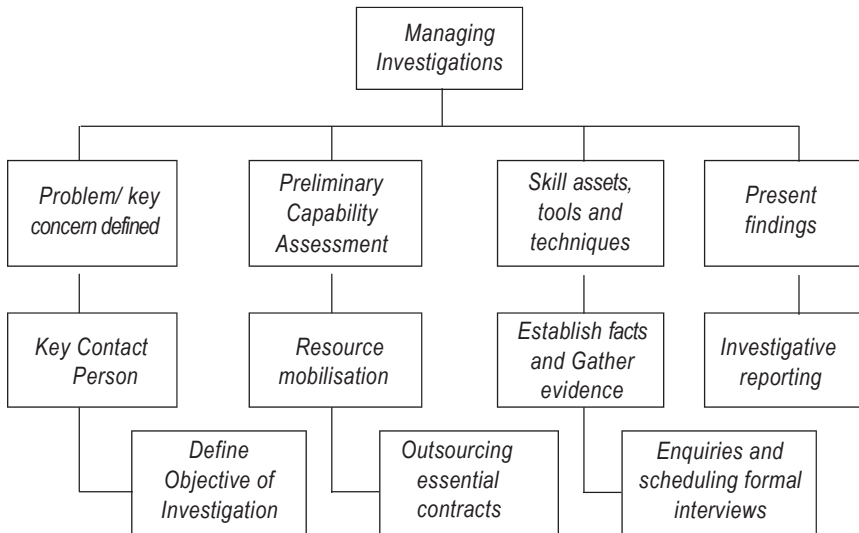
Managing Investigative Assignments

Chapter Summary

This chapter provides an overview of investigative process starting from problem definition, capability assessment, skill sets required, mobilisation of resources, time and cost estimates to final presentation of the results. The importance of planning, client confidentiality and precautions on use of tools and techniques to a limited extent has been elaborated. While an attempt is made to make the readers aware of the pre-requisites of handling an investigative assignment, however, these would primarily depend upon client expectations and status of trails available in carrying out an investigation.

9.1 The investigators are required to conduct assignments in varied business enterprises with varied situations. Fundamentally it is their approach in managing the assignment and skill sets that are important. An investigator may not be fully aware of the domain knowledge of the business enterprise where he is commencing an assignment. However, he must have the ability to quickly grasp information on business process knowledge, people engaged, critical documentation requirement, activity flow and timing of these activities, and the chain of authority and responsibility within the organization or environment in which the investigation is being conducted. He thereafter looks for clues based on deviations in these processes. He is expected to apply the skill sets as may be required in each situation.

Managing Investigative Assignments



Problem Identification - Key Concerns

9.2 The objective of carrying out the investigation will depend upon the key concerns expressed by the client. There could be allegations against employees that need to be corroborated like, kickbacks and allurements to employees, appointment of business heads, extension of services of employees as a matter of gratitude, propriety audit for key managers leaving the entity, red flags identified by internal auditors, information gathered from whistleblowers on unusual or unacceptable practices, contractual arrangements to the detriment of the company, misuse of authority, conflict of interest, breach of contract, attempt to sabotage a product launched by third parties or competitors, the leakage of research and development information, clandestine transfer of secret product formula, damage claim filed on the company and validation thereof, disputes among key constituents of a business entity, formation of dummy companies operating against the interest of the company, misinformation or falsification or distortion in financial results by management, theft on the company, spurious and counterfeit products affecting the company's market share, etc.

Preliminary Capability Assessment

9.3 Vetting of the key concerns is the first step in confidence building exercise with the engagement client. It is imperative for the client and investigative firm to understand the key concerns and assess capabilities in

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managing the assignment within the legal realms. Similarly, there are assignments that involve conducting of interviews with the suspect or the use of gadgets in a lie detector test which are exclusive rights given only to police authorities under a defined process. It is of common knowledge that these gadgets are not allowed to be used to unearth information by the common man.

Key Contacts and Roles

9.4 A record of key contacts should be maintained and filed properly. Preferably a standard format should be put to use for ease of retrieval. There should be a common understanding with the engagement client or the key person with whom the progress of the investigation and other requirement will be discussed. Generally, there is a single point contact person for meeting the investigation needs and he acts as the coordinator.

Creating Project Codes

9.5 Each assignment is given a unique project code that is used for all the internal and external communications. The project code enables to keep track of the time and money spent on the assignment. Any cost overrun is notified to the customer for necessary approvals. This helps in understanding whether the cost and fee projections are in order. The assignment of project codes helps in maintaining confidentiality about the client and the assignment handled vis-à-vis the outside world.

Investigation Methodology

9.6 Depending upon the nature of the assignment, the approach could either be a covert or overt. A leading foreign company having operations in India approached an investigation firm to find whether there is any diversion of business. The foreign company had an Indian arm, a company registered in India and was informed that for conducting business in India, there is a need for operating through such a front-end company. The first task by the investigation firm was to create a relationship of trust with the lead investigator. The condition put forward by the client was that the investigation should be done in a manner that the business interests of the foreign company in India are safeguarded. However, a covert assignment ultimately comes into the open at some stage of the investigation. In the present case, the investigation had to be conducted across the globe involving extensive coordination among two investigative firms one based in India and the other firm based at Canada. The investigation revealed diversion of business by

the management personnel in India to a private closely held company. Using the resources of the parent company the persons in India were operating a business within a business and had resorted to activities for personal gain. The investigation efforts included safety of the senior management personnel during their stay in India and managing the entire exercise.

The investigators prefer to have an overt approach when the fraudulent activity has already been uncovered and is known to the suspect, and there is a likely belief that the evidence could be tampered with or destroyed.

Identifying Resources

9.7 Depending upon the nature of activities based on the preliminary assessment and the geographical spread, the client is given an indication of the resources that will be deployed including stay arrangements, the IT support, and the key safety measures wherever necessary. Further, confidentiality is of the people engaged especially for background checks and field activities are required to be maintained. The engagement of law firms for legal support or lead firm where there are various territories is a matter to be decided in advance to ensure proper co-ordination. The timing of engagement of various team members is decided as a strategic matter. At this stage, the decision on cost of the investigation is of paramount importance and client acceptance is very important to prevent any disputes at a later stage.

9.8 Irrespective of the nature of investigative assignment, a conservative approach with utmost care is required to be taken in terms of engagement of resources till the conclusion of the investigative process. This may require many hours of brainstorming, drawing up strategies and simulated exercises to prevent any act that may affect the quality of investigation.

Defining the Objective of the Investigation

9.9 Understanding the objective of the investigation is of utmost importance. Any ambiguity in this area leads to futile efforts and such miscommunication would lead to disputes in settlement of dues for the investigating firm. Hence, the objective of the investigation and background to the investigation should be formally communicated to the investigating team.

Drawing the Scope of Coverage

9.10 In case of any untoward incident, it is important to shut the doors and draw boundaries. This is a preventive measure from loss of any vital clue and removal of evidence. This ensures a focused approach towards investigation. In a controlled environment, there are systematic checks and balances that are ensured by a professionally managed company. Any attempt by the suspect to cover up the audit trail will require camouflaging all these checks and balances. A good investigator will take stock of all these controls to be in place in the investigative process. It is important that all the outlets or escape routes in terms of removal of evidence are blocked to prevent any set back in the investigative process. At this stage, it is essential to define the timelines for the assignment and for various constituents of the investigation team.

Safeguards in Use of Tools and Techniques in Investigation

9.11 There are sophisticated tools such as, voice recorders, cameras, bugs, video shoots, CAAT, spying software, frequency analyzers for detecting whether there is any eavesdropping.

Flowcharting and data relational analysis, physical inspection, interviews are some of the techniques that are commonly used in an investigation. The investigating officer must first ascertain whether the local laws and regulations permit the use of the tools, gadgets and methods that will be deployed in the conduct of the investigation.

Use of Voice Recorders, Cameras and Video Shooting

9.12 It is preferable that any audio or video recording of events be informed to the subject to ensure that these do not infringe privacy laws before engaging in such activities where these are private conversations. Recording of telephone conversation should be with permission from subject and must be informed to him. The responsibility on the investigator for in camera investigation is extremely difficult and requires extra caution in terms of addressing the subject. Any careless recording could lead to negation of evidence and care should be taken not to infringe on the privacy of the individuals. As regards video/ voice recording is concerned, it cannot be construed as substantial evidence and the same can be refuted in the court.

At best it can only be corroborative evidence.

Profiling of Key Suspects and Informants

9.13 Profiling can be done either on suspects or informants to establish a fact and it helps in progressive steps in an investigation. For example, the frequent loss of cartridges/ stationery in a common pool of printer, an information that administration department accepts bribe in allotting canteen contracts, etc., are situations that normally suit an investigation by a police authority. However, during internal audit when the company officials would prefer to internally investigate the matter then profiling of suspects comes handy. Profiling helps in narrowing down on the suspects out of a group of people involved in an activity.

In simple terms evidence can be categorized into:

- a. Testimony
- b. Documentary evidence including digital evidence
- c. Physical evidence
- d. Circumstantial evidence including eyewitness and personal observation

Gathering and Interpretation of Evidence

9.14 In an allegation by a third party that the purchase officer in a company was accepting bribes, a real time pre-audit of the activity was conducted wherein the vendors were engaged to record the proceedings and the profiling was done to establish whether the suspect was engaging in such an activity. During the discussion the purchase officer vehemently stated that there are many others who wanted to engage in a business arrangement and, therefore, something had to be done to promote the business relationship. The place and time of payment of the bribe was finalized and this fact was recorded in the presence of witnesses. On the appointed day when money exchanged hands, the immediate superior who was asked to be present within the premises was informed of the development and when confronted, the suspect had no option but to admit his wrongful act. The role of an independent witness is very important in the entire process. Such an admission before an independent witness is like an extrajudicial confession.

9.15 When an accused is produced before a magistrate during an enquiry

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or a trial, the investigating officer should produce the case file after having completed the daily diary including the time of investigation. These diaries are of very valuable aid to an enquiry or a trial. The entries in this diary are to be filled in a chronological order in an objective manner. These details are not required to be shared with the accused for the simple reason that the details of the informants which are generally kept confidential will be revealed and could endanger such an informant. The daily diary improves the credibility of the investigation process. It is advisable that even in a private investigation the investigating officer should maintain a case file and a daily record of events in a chronological order. This will ensure in continuity of investigation in the event of handover of charge to a new investigating officer if such a situation arises.

In such a situation, it is advisable to document the sequence of the events as distinguished from a case diary, i.e., recording the events during investigation. An independent witness to the events with the working notes duly signed would hold good in any investigation.

9.16 Whether during the course of internal audit turning into an investigation or when there is a suspicion on vital evidence being retained in the drawer at the office work station, it is important to gather the evidence in a proper manner, even when these are retained within the office premises of the engagement client. The superiors need to be informed of the intended action. The details of the actions need to be documented including the findings in the sequence of events noting and signed by an independent witness. The extent to which a person can retain his personal belongings in the office premises depends on the rules of the organization. That is the reason some companies impose restrictions by obtaining declaration from employees on limited retention or non-retention of personal belongings including money in the office premises.

Whether it is a case of retention of foreign currency or personal cash in the personal locker in a gymnasium or in an office premise, the above process of documenting the evidence is admissible in a court of law. Whether this will stand test of scrutiny is a separate issue. Further, investigation related to activities helps in establishing the source of money to strengthen the test of scrutiny.

Schedule of Evidence and Working Papers

9.17 A schedule of evidence gathered and working papers should be maintained. The working papers should be prepared under the presumption that these may be required to be presented as evidence in litigation suits or during the formal interview phase at a later stage in the investigation. The exhibits and key evidence should be kept in a secured manner to prevent from any tampering or destruction.

Documenting the Sequence of Events and Related Key Concerns

9.18 This is an important aspect in any investigation. A well-documented investigative process ensures that irrespective of the presence of the investigator at a later date, it is easily understandable and retrievable by successors. Especially when litigation proceedings prolong for long duration, the standards for documentation can be customized to investigating officers' needs and as such there is no standard format that is comprehensively used. This includes documenting of assumptions at each stage of the investigation.

Interview Process

9.19 The objective of an interview is to establish the truth and, hence, it forms an important aspect of any investigation. There are ground rules for conduct of an interview within legal realms.

Presentation of Results including Reporting

9.20 The presentation of results should be defined at the time of finalizing the engagement terms. The results could be verbal, presentation through visual aids, or formal reports. In private investigations, where the management is not interested in prosecution of the suspect and is only interested in confirmation of a doubt for internal reasons, and then the same is ensured without a formal report being submitted, i.e., through verbal briefing. Where these are issued for limited internal use, the same should be mentioned in the reports. The language of the investigative report should be simple and easily understandable, especially, when submitted to a legal authority or for filing a police complaint. There should be no subjectivity or bias in the report as it is a report from an independent agency. The investigative reporting and presentation of findings is dealt with in Chapter 13 of this publication.

Case Studies

9.21 The following case studies illustrate situations discussed above:

- (i) Three persons, viz., a business magnate, a prominent socialite and a media person came together at a common event on a trip abroad. Their acquaintances turned into friendship. They decided to give a shape to their relationship by starting a business venture. The socialite assured all help in getting permissions but insisted a sizeable upfront contribution to his social outfit. The business magnate offered financial assistance but had very little time to attend to day-to-day business operations. The business relationship commenced with a share in profit between the business magnate and the media person under a mutually acceptable formula in sharing of profits arising out of the venture. Years passed by, the media person landed in trouble and there arose a reputation risk to the business magnate. The socialite had already distanced himself at the outset. The business magnate was now looking for an avenue to sever his relationship. He summoned his trusted partners and sought clarification as to how the business performed. To his surprise, explanations to several queries remained unanswered by the operating management. The Chartered Accountant was approached for ascertaining the areas of revenue leakages and the extent of damages suffered by the client engagement. A review of the financial statements revealed diversion of assets and funds to another entity. The minutes of the meeting could not provide corroborate information on key decisions taken by the operating management. The Chartered Accountant had a role to conclude the investigation through proper conflict resolution measures and had to quantify the amount to be settled between the parties to the dispute.
- (ii) A foreign company had set up its operations across the globe and was monitoring the business operation through designated offices. The company officials were informed that to operate in the line of the business there was a need for an Indian company. The audit head from the designated office had doubts about this requirement and, therefore, approached the Chartered Accountant with caution and requested that the assignment need to be carried out in a covert manner. In the course of the investigation if it is confirmed that there is indeed a need for an Indian company to run the business then there is a need to maintain utmost secrecy in the matter as otherwise

this will result in loss of business opportunity the impact of which could be significant. The Chartered Accountant had to plan his strategies in minute details and studied the fund flow pattern and usage thereof. Under the pretext of change of software applications for accounting package across the globe and for standardisation, the data in the hard disk was copied by the investigation team and was provided to the senior engagement partner of the Chartered Accountant firm for further scrutiny. The operating management had diverted business to their own entity in every 2 out of 3 bids for various projects. The investigation revealed a closely held company was operated in the form of a company within a company resulting in diversion of business to such other company. The entire operating management had to be overhauled.

- (iii) The internal auditor during regular vouching at a manufacturing plant saw several instances of stapler pins being used for the supporting vouchers. These were all photostat copies and originals were retained at the corporate office. The auditor was inquisitive regarding consistent use of stapler pins in the weigh slips considering that the tare weight of the vehicles in the weigh slips was not in line with the carrying capacity of the truck. The management mandated investigation into the matter and it was found that the computerized weigh scale operator was fiddling with the dot matrix printer to ensure that perforations are aligned in a manner that the gross and tare weight slip can be mismatched. This resulted in 3 to 4 tons of steel scrap being clandestinely shipped out of the plant (being the difference in the tare of a bigger vehicle being swapped against the gross weight of a smaller capacity vehicle).
- (iv) During an internal audit it was noticed that the scrap lifting time was generally during the change in shift. At a manufacturing plant, there was this urgency to catch the shift bus failing which other means of transport was an expensive proposition for the company employees. With the permission of the senior officials an investigation was done to conduct a surprise check during one of the shift change timings. The perpetrator of fraud observed this urgency factor and considered this as the most vulnerable time to upload and transport aluminium ingots along with the MS scrap from the plant. Around 275 kilograms of aluminium ingots were downloaded from the loaded truck. The scrap dealer accepted his mistake.

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- (v) The average time in lifting of garbage was, generally, half an hour and the comparison of the gate entry timings revealed an average upload time of one and a half hour that was the normal duration for loading of scrap. The gate pass was prepared and signed by storekeeper for garbage. These gate passes were supposed to be prepared and approved by the administration department. It may be noted that the guidelines for material movement were perfectly in order, there was a scrap disposal committee in place and a scrap disposal manual was available for referral. The security guards were under a contractual arrangement and were not aware of the signatories to the gate passes. On suggestion from the Chartered Accountant who conducted the investigation, as a preventive measure, the management created separate earmarked area for segregation of scrap material, constructed separate bins, installed a CCTV camera for monitoring the weighment and dispatch activity. The authority and responsibility for lifting of scrap was redefined. There was a periodic reconciliation of scrap material and proper segregation of scrap material into capital project scrap and regular production scrap was done.
- (vi) The management of a leading pharmaceutical company had a peculiar dilemma, the internal audit reports and anonymous letters referred to extensive corrupt practices in almost each department, especially, at senior managerial levels. The company operations were comparable to the best in the world and, therefore, such allegations were hard to believe. After initial reluctance as to whether the management should order in a full-fledged investigation, the matter was referred to the Chartered Accountants. It was agreed that there would be a preliminary assessment which would primarily involve understanding the internal audit perspective on the alleged irregularities. The allegations included extensive bribery in allotting of contracts and superfluous work allotment in civil work, labour contracts, purchases, projects, etc. The objective of the assignment was to gather evidence to substantiate these alleged irregularities. If the alleged irregularities were proved to be correct, then this was to be followed by formal interviews for necessary management action. The Chartered Accountant firm conducting the investigation ensured that all the vital documentation and records were taken possession of. A profiling of all the contract renewals and cancellations was

done. Informants were identified for gathering vital information for reason for cancellation and simultaneous scrutiny of the work orders and bills ensured. The result revealed anomalies in scope of work defined in work orders, conflict of interest in allotment of contracts, and the reconciliation of thinner and paint stock inside the factory revealed disproportionate work execution for the payments made to contractors. There were bills cleared for road repair works that could not be corroborated with the work done and justified. The work measurement sheet was inaccurate. Splitting of work orders to overrule authority levels were noticed. There were group of labourers meant for gardening and ETP plants diverted for personal work in farms of the administrative head. This was corroborated through a physical count of labourers as compared to the punch (pay) cards in the custody of the administration department. The comparative rate of hire of bus for transportation of employees from their homes to offices were compared with similar facility in the vicinity and vast differences in payment were noticed. Drawings for civil work were not in line with the final execution of the work. Rework charges were not adequately explained.

- (vii) The painting contract work allotments revealed several work orders released in the name of select contractors. The grapevine revealed that whenever a senior official from the head office visited the plant even for a brief period the entire cabins were painted to ensure that neatness and cleanliness was maintained. The investigator had doubts as to whether the painting contract was really executed. The work order of value above ₹ 50,000 was to be referred to a superior officer. All the work orders were within this limit. The management is desirous of appointing you as the investigating officer on this assignment. What would be your approach on this assignment? To provide you a hint, the work order had specifications mentioned in the form of work schedule with number of coats and area to be painted. The bills submitted were in line with the area mentioned on the work order and the work was certified by the authorised signatory to the work order.

A review of the gate records and the stores record was done to identify the extent of paint stock and primer that was brought inside the plant. The paint company provided a mathematical formula on

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area wise paint consumption. This was applied to the overall estimated and actual area billed by the contractor. The contractor had all the contacts under the earth to wipe the paint on the wall to clean it, and the quantity of thinner had far exceeded the requirement.

- (viii) In manufacturing industries, there are general standards relating to basic cost, pricing and consumption standards for materials, especially, for recording in an ERP system. In a cement manufacturing company, the supply of coal was generally from the collieries. The internal auditor had raised several queries during the routine scrutiny relating to high level of stock as per excise records in some months and at the same time questioned the need for buying the coal stock from the open market. Further, transportation by road resulted in double the cost of procuring directly from collieries by rail. He noticed that quality of coal had high moisture content and was high on ash content. The management ordered an investigation in the matter and it was noticed that the physical stock of coal was negligible as compared to a significant book stock. When the production records were scrutinized for the previous years, it was noticed that the head of production had resorted to altering the standard coal usage percentage from 22 to 24 in the production process. This resulted in covering up the pilferage and diversion of coal stock.
- (ix) A review of the transportation cost in an engineering industry was showing an abnormal increasing trend. The company had many outlets from which the freight operator plied (milk van distribution system). It was noticed that the authorisation of the bills and documentation requirements resulted in multiple goods consignment note being prepared. In a day of 8 hours a vehicle could ply at the most two full (to and from) trips including loading and unloading time to a destination. A consolidation of the freight payments for the same vehicle across locations revealed that the freight operator had resorted to splitting of a single trip into multiple trips and submitted separate claims through sets of bills at each of the locations of the company for the same trip. The freight operator was a regular contractor for the company for more than a decade and finally had to be blacklisted.

Managing Investigative Assignments

- (x) A regional manager in a chemical plant oversaw collating indents and production planning. In addition, he was given the charge of handling freight payments. The regional manager by a defined date used to collate the indents from various states across the country. He introduced certain additional indents on his own and in the process imported material and repacked it and sent to his personal warehouse where it was rebranded and sold in the market on cash basis. The material was shown as indented from a place in north India where it was never needed. The material was transported through a mini truck belonging to his wife. He had finalised a rate contract in his wife's name and ensured that the freight payments were made within 15 days of dispatch. He had cheated the company to the extent of about ₹ 20 million in 2 years. The company wants your opinion in pursuing legal action on the employee. What is the control weakness that would enable the company in succeeding in this endeavour?

At the year end, for each of the indents received from across the states there was need for Form F that had to be collected for the purpose of Sales tax. The regional manager in order to cover up his follies had forged Form F entries that never emanated from the concerned offices in north India.

The introduction of GST has brought in a remarkable change in the sphere of indirect taxes, with seamless digitalization and cascading effect that has mitigated this fraud risk of misrepresentations and deficiencies that prevailed in the system.

- (xi) Corruption charges were levied against a plant supervisor and management decided to undertake an in-depth investigation into the matter. The Chartered Accountant divided his team into two groups, each team working independently. One of the teams entered the plant and commenced data analysis while the other team was in charge of undertaking field work. The condition was that none of the team members would interact with each other unless some vital evidence was gathered. The in-house team meanwhile isolated the list of contractors whose contracts were discontinued over the past two years. A disgruntled contractor became an informant and the external team gathered vital information relating to mode of operation. The vital question was how to prove bribery allegations as these are very difficult to prove in a real time situation. The contractor was asked

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whether any cheque payment was ever made by him to the company official. There was one incident where about three years back a cheque was issued by the contractor. However, he was illiterate and could not have written the cheque. This made the job simpler. The contractors' bankers were approached and with the help of the contractor the old cheque could be retrieved. The bearer cheque was prepared by the plant supervisor in his handwriting and his father-in-law had gone to the bank for cash withdrawal. To ensure that there are no chances, the HR records were perused to unearth the marriage card of the employee and it was established that it was indeed the father-in-law who had visited the bank. During the formal interview that followed, the plant supervisor readily accepted the misdeed.

- (xii) A client approached an investigative firm to ascertain misuse of credit card that was sent by courier by Non-Resident Indians (NRIs). The courier company had 100 employees who used to carry out sorting and it was difficult to identify at any given point of time which group of employees used to flick the credit card and misuse them. The following steps were taken by the courier company as a control measure:

- Installing of in-house CCTV cameras to track pilferage.
- Warning customer not to send credit cards and debit cards through courier.
- Insurance policy as a matter of control was ensured by the credit card companies for any misuse arising out of theft of credit cards.

Despite the above measures, the pilferage and misuse of credit cards could not be controlled. The investigative firm refused to take up the assignment as they did not possess the requisite skill sets to carry out the assignment. The other reason was that the goods bought by the fraudster from the misuse of credit card had exchanged many hands and it was difficult to carry out the investigation without trespassing into the final buyers' home. The client had only the option of referring the matter to police authorities.

Chapter 10

The Interview Process

Chapter Summary

Interview forms the major source of evidence and adds colour to opinions. The purpose of an interview is to obtain the truth, to detect deception and to ensure that information gathered is a fact and not an opinion. It is essential to obtain complete facts. The purpose of the interview includes obtaining of confession or signed statements. It is an art to establish facts through questioning and interactions without threat, inducements or coercion. This Chapter is intended to provide an insight into the preparatory steps, types of interviews and certain attributes of the interviewer and the interviewee.

10.1 Interview is the process of obtaining information from witnesses, victims and suspects. This is more of a question and answer session with an informant, witness or suspect designed to get the required information. The information obtained here may be true or false. Generally, an informant is friendly in nature and gives information. The interviewer should ensure a friendly approach.

The witness is a person who could be friendly, neutral or hostile in nature. The approach to elicit information is through examining the witness. The suspect is a person when there is reasonable suspicion or could be identified as the actual perpetrator. Generally, the suspect tends to be hostile in nature and should be subjected to a thorough questioning.

The fundamental requirement in an interview comprises of extensive planning, conducting the interview according to self-governed rules and maintaining accurate notes (recording).

Types of Interviews

10.2 The following are various types of interviews:

- (i) **On the scene interview:** This is an interview by internal auditors and is not, generally, planned. This is, essentially, to capture an event on a real time basis.

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- (ii) **Formal interview:** These are well planned and involve an objective approach. The following four important aspects are to be borne in mind by the interviewer in a formal interview:
- (a) One must not reveal any essential information.
 - (b) All the statements made by the interviewee should be corroborated. This is achieved by series of questions that are meant to further elucidate or provide information that can be cross checked beyond doubt on the statements made by the interviewee.
 - (c) Exploit an advantage secured during questioning. The interview is normally conducted with a limited objective of establishing truth in a matter under suspicion and any response from the interviewee that facilitates this objective should be fully exploited by the interviewer.
 - (d) The objective is to maintain a proper record of all information gathered during interview. This is very essential as the interaction between the interviewer and interviewee could be the basis for any future course of action or deriving a conclusion or could be used in a legal suit. Such a record prevents any misinterpretation or misunderstanding in ascertaining the facts or denial at a subsequent date.
- (iii) **Group interview:** It is rarely used and involves situations where the target audience could be a group of persons. This is primarily used in labour union discussions or when there is suspicion among a group of people. Various techniques are used to isolate the suspects including planting of interviewees in the group. These interviewees raise contentious issues in the group that are challenged by other group members thereby exposing them. The investigator by his mere observation can identify the suspects.

Primary Rules for an Interview

10.3 Privacy is to be maintained during an interview and one must ensure that there are no interruptions by calls through telephones, mobiles, fax machines or other distractions. The interview should be conducted in the client office environment and not at the suspect's place. It should be conducted in a tranquil environment. It is imperative that at any given time

during the interview a single person performs the role of the lead interviewer with a specific role assigned to the rest of the members. Group interviewers (all the participants talking by turns) should be avoided.

10.4 A good interview comprises of establishing a rapport with the interviewee. There should be no dearth of queries posed to the suspects. The queries should be structured to uncover relevant facts. Questions should be framed such that all pertinent issues are addressed sufficiently to reach a conclusion. This requires the interviewer to have abundant perseverance. The funnel effect ensures that the questioning process filters irrelevant information and is objective in its scope.

Plan the Interview

10.5 The most important aspect in an interview is planning. The primary question is to decide the way the interview might support the investigative process. The objectives of the interview, therefore, must be defined in line with the desired outcome to facilitate progressive enquiries. There should be constant focus on issues that will elicit new information and information that needs to be further corroborated. There is a need to visualise the target and to ensure that the interview proceeds in the planned direction to get to the relevant points and ensure that the evidence/ facts collected are unassailable. The place of the interview, the number of persons to be present during the interview, knowledge about the regulatory provisions that need to be adhered to, the intended course of actions depending upon the probable outcome of such interviews are matters to be decided in advance.

Preparatory Steps before an Interview

10.6 Setting the environment where the interview will be held is the first step. This is followed by collecting all equipment, such as, writing materials, gadgets, etc. The evidence gathered and the timing is essence in challenging the interviewee, therefore, the support staff at the interview should be well informed of the requirements.

10.7 A robust mechanism of retrieval of essential documents must be ensured for an organised conduct of the interview. The availability of the interviewee should be confirmed as otherwise this may result in waste of time and resources. As a part of the advance planning it is essential to ascertain whether the interviewee is likely to be present at the place of the interview. There should be no prior intimation about the purpose of the interview as this will kill the surprise element.

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10.8 The timing of the interview should be scheduled appropriately, and the sequence of questions and clusters of topics should be worked out. The questionnaire and documentation process should be a record of the statements in a chronological order. It is important that there is adequate background check of the target. This includes ascertaining whether witness is a related party of the suspect.

The practice session prior to the interview is termed as a 'Mock Trial' and it aims to simulate the interview conditions. It is an essential part of any interview process wherein one of the investigating team members plays the role of 'devil's advocate'.

10.9 There should preferably be a written interview plan to understand roles of the participants as to who the lead interviewer would be, who would take notes, etc. While all the above-mentioned procedures are ensured, it is unfortunate that the documentation of the preparatory steps is not usually done adequately in most investigative assignments as this is considered as a cumbersome process.

Interview Techniques

10.10 The interview techniques could be either direct interview or a signed statement. Team interrogation, group interview, feigned information, duress, bright lights, denial of requirements, use of force are things that need to be avoided in an interview. Within the legal framework, the interview tactics could vary according to the targets depending whether the subject is a casual offender or professional criminal with premeditated intentions.

Questioning the Interviewee

10.11 The starting point in an interview is to build rapport with the interviewee. Care should be taken to avoid leading questions. Let the target do the talking without any interruption or coercion. Time the questions effectively. There should not be any hesitation in asking silly questions occasionally. As an interviewer, ensure that there are multiple options during the questioning process and seek documentary evidence in support of the subject's version, wherever possible. Lay the foundation for the interview process and pin the interviewee's story. Confront him with contrary evidence when he goes awry in his replies, cut off false denials promptly, break up the interviewee's version and draw out and pin down the interviewee's admission.

Documenting the Interview

10.12 Notes should be taken for the entire interview with the help of a note taker. It should be ensured that adequate guidelines are laid down for taking notes during the interview. These must be more detailed for crucial and formal interviews. These notes may be placed as evidence in civil and criminal proceedings.

Recording the Interview

10.13 Extra caution is needed while conducting an in-camera interview or using a voice recorder. The interviewer must diligently frame the questions in advance. The interviewee must be informed about the use of voice recorder just before the interview in order not to violate privacy laws. Confessional statements should reflect clarity and interpreters should be used wherever necessary.

Why Interviews Fail?

10.14 The following are some of the reasons for failures in interviews:

- (a) Lack of proper planning, preparation and information.
- (b) Ignorance or shallow knowledge of facts and events
- (c) Lack of technical knowledge.
- (d) Interviewee could be stubborn, and the interviewer is unable to channelize or direct the discussions as per plans and/ or may deviate from the main purpose of interview.
- (e) Disregard for the legal/ statutory requirements while conducting the interview.

Sequence of Events in an Interview

10.15 As discussed above, the sequence of events in an interview and certain prerequisites are listed as follows:

- (i) **Getting Engaged**
 - First impression;
 - Managing first contact;
 - Creating the right atmosphere;

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- Building rapport;
- Addressing needs and concerns; and
- Showing empathy and interest.

(ii) Seek Explanations for Interview

- Reason for interview to establish truth;
- Introduction;
- Ground rules – breaks and refreshments;
- Background and time factor;
- Introduction of exhibits/ documents;
- Explain formalities;
- Explain use of audio/ video recording of interview; and
- Outline of interview.

(iii) Keep an Account

- Setting the scene;
- Obtain an uninterrupted account of happenings;
- Identification of the events, recalling, probing and summarizing; and
- Remain flexible and responsive to information uncovered.

(iv) Evaluation and Learning

- Review the interview critically vis-à-vis investigation;
- Improvements needed and learning for others (for rest of the interviewees);
- Manage Interruptions smoothly without disrupting continuity;
- Malfunctioning equipment's should be tried and tested prior to the interview; and
- Be aware of the 'subject' behaviour, especially, the use of aggressive language.

General Profile of a Successful Interviewer

10.16 The following are general profile of a successful interviewer:

(i) Posture

- Upright;
- Frontally aligned;
- Open, no crossed arms or legs;
- Avoid slouching; and
- Always maintain eye contact when asking questions. Look away when suspect gives denials.

(ii) Facial Expressions

- Avoid expressions of disbelief, shock, anger, humour, disgust and skepticism;
- Show interest; and
- Express or display understanding and acceptance for suspect's actions.

(iii) Tone of Voice

- Confident and believable;
- Smooth speech;
- Controlled;
- Modulate at appropriate times; and
- Don't use a skeptical or disbelieving tone.

(iv) Hand Gestures

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- Palms should be up and arms open;
- Avoid negative or strong gestures;
- Avoid personal contact is not desirable and could be seen as offensive;
- Meet and greet;

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- Start with non-threatening conversation; and
- Allow interviewee to like you.

(v) **Building Rapport**

- Observe interviewee's verbal and non-verbal behaviour;
- Consider use of formal titles e.g., Dr., Mrs., Mr., Sir., etc.;
- Never let interviewee take control of the interview; and
- Use observations during pre-interview stage as a basis of comparison during 'behavioural analysis' stage.

Characteristics of Body Language of Interviewee

10.17 The following are some characteristics of body language of an interviewee:

(i) **Defensiveness**

- Rigid body;
- Arms and legs crossed tightly;
- Minimal eye contact;
- Head down with chin depressed toward chest;
- Fists clenched; and
- Crossed arms.

(ii) **Evaluating**

- Slightly tilted head;
- Sitting on edge of chair with upper torso forward;
- Hand to cheek gesture; and
- Stroking chin or the beard.

(iii) **Nervousness**

- Clearing throat;
- Hand-to-mouth movements;
- Covering mouth when speaking;

- Tugging at ear;
- Twitching lips or face;
- Playing with objects or fidgeting;
- Shifting weight while sitting or standing;
- Tapping fingers;
- Waving foot and pacing back and forth restlessly; and
- Whistling.

(iv) Suspicion/ Secrecy

- Failing to make eye contact;
- Glancing sideways at you;
- Rubbing or touching nose; and
- Squinting.

(v) Needing Reassurance

- Pinching the fleshy part of hands;
- Gently rubbing or caressing some personal object ring, jewelry, watch; etc.
- Biting fingernails or examining cuticles.

(vi) Frustration

- Tightly clenched hands or shaking fists;
- Hand wringing and rubbing back of neck;
- Controlled short breathing;
- Blind staring;
- Running hands through hair; and
- Stamping foot.

(vii) Points to Ponder during Interviews

- People often lie;
- Body language tends to be more honest;

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- People don't realise that the body language is being assessed;
- Transitions count more than positions;
- Look for conflict between spoken words and body language;
- Look for clusters of behaviour inconsistent with the spoken word; and
- Be mindful of mirroring behaviour.

Interview Techniques Essential

10.18 The following are some essential elements of interview techniques:

- Active listening and responsive style;
- Proper environment necessary;
- One person to interact at a time;
- Be unbiased regardless of the outcome;
- Record facts and not opinions;
- Read non-verbal communication;
- Detection of deception; and
- Focus on conversational techniques.

Queries during Interview

10.19 The following queries should be considered during an interview:

- What, where, who, when, why and how?
- What was in suspects mind and why did he do it?
- The act – what was done?
- The modus operandi – How?

10.20 The following tips are useful during questioning:

- Use open questions — How did you do that? What happened next? Where were you then?
- Use closed questions only to confirm facts and save time - Did you steal the money?
- No leading questions - Having found the safe open did you close the door to make it secure?

- No multiple questions - Where did you spend the money and what did you buy for whom and why?

Don't in an Interview

10.21 The following should be avoided during an interview process:

- Oppressive or threatening behavior;
- Offensive language or behavior;
- Offering inducements;
- Physical force;
- Fabrication or trickery;
- Do not interrupt; and
- Maintain structure, sequence and control.

Closure of Interview

10.22 The following aspects are important during closure of interview:

- Summarize main points;
- Ask subject – add, clarify, change the points;
- Has the subject any questions or comments on the conduct of interview;
- Formally 'sign off'; and
- Actions.

Question Typology

10.23 The question typology is, generally, as follows:

- (i) Introductory- provide the introduction, establish rapport, observe reactions and establish the purpose of interview.
- (ii) Informational – non-confrontational, non-threatening, information gathering and unbiased factual information.
- (iii) Closing – A positive note, reconfirming the facts, further facts or opinions and stressing the confidentiality.
- (iv) Admission – of incriminating documents, of incriminating conducts or confirms voluntary participation and disclosure.

Questioning Methodology

10.24 While questioning, it is better to be general and reach backward, i.e., from known information to unknown areas. Following are some important aspects in this regard:

- Start with open questions that make the interviewee talk.
- It should be followed by closed questions to conclude an interview.
- During interview, avoid double negative questions.
- Avoid complex questions that the interviewee has difficulty in responding.
- Avoid sensitive questions that may irk the interviewee.

Finally, avoid emotive words as interviewee may take control of the interview.

Chapter 11

Investigation Report*

Chapter Summary

The purpose and importance of investigative reports stems from understanding terms of the engagement as stipulated by the management. Although an investigation is, normally, conducted under the presumption that the final outcome and methodology should withstand the test of scrutiny in a court of law. Private investigations, generally, end up with briefing the management. This Chapter is an attempt to make the readers aware of certain thumb rules that are important in drafting investigative reports.

11.1 The medium of presentation of the findings vary according to the subject matter under investigation. There are occasions when the management is interested only in material evidence and does not insist on a formal report. There are occasions where video or power point presentations are made. It is necessary to understand the prerequisites of a good investigative report.

11.2 Each investigative firm has its report format and has its own style of representing facts and evidence to the engagement client. Generally, the formats designed for investigative reporting are consistent with reference to the objective of the investigation. The subject matter of the report could be results of surveillance, violation of patent or trademarks, reporting on background/ reference checks, providing a specialist opinion, conclusive investigative assignments, etc.

11.3 The management sees the investigator as an advisor and is, therefore, consulted for the future course of action once the process of gathering evidence is completed and the report is submitted. He is expected sometimes to comment on the adequacy of the evidence in seeking a legal remedy. Hence, depending upon the importance of the matter under investigation, the discretion as to whether to include such recommendations, opinions or conclusions in the investigative report, is with the investigation

* Report format may vary in private investigations.

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firm. The investigative reports are restricted to gathering and presenting evidence to the management.

Objectives of an Investigative Report

11.4 The primary objective of an investigative report is to logically present facts and evidence gathered that will enable the management to reach an informed opinion on the subject matter that is under investigation.

Salient Features of an Investigative Report

This is an indicative format and can be suitably modified depending upon the nature of assignment.

(i) A Cover Sheet

For external investigative firms — With client information, investigation assignment reference, date and header signifying confidentiality of information and Investigation 'title'.

For in-house investigations – 'Subject information' – (name, designation, function, department, location), investigation reference number, year/date, alleged violation, name of investigating officer and department references.

Each page has a similar indication of confidentiality of information.

(ii) Table of Contents

This is optional and, generally, not used in private investigations.)

(iii) Report Titles

Background – Point of reference in conduct of the investigation.

Introduction – Terms of reference and key contact(s) with representative(s) of engagement client.

Scope of coverage – including place where investigation is being conducted.

(iv) Other Important Information

Limitations, constraints, indemnities including exclusions in scope of coverage (if any).

Statement of facts.

Modus operandi and sequence of events. Comments on available evidence.

Investigation Report

Supplementary information on results of surveillance, background checks, interviews, results of engaging the services of expert witness, etc. (wherever relevant).

Explanations and defense offered by the subject (wherever relevant).

Conclusions and recommendations (may be qualified depending on the sufficiency of evidence).

List of Appendices (Annexure).

List of Witnesses and Exhibits (Annexure).

11.5 The investigative report should enable a reasonable person to reach the same conclusions and understand the recommendations based on the facts presented. There should be abundant caution in ensuring that the report is not circulated to any person other than those entitled to the classified information.

While drafting the investigation report care should be taken not to deviate from the main objective of the investigative assignment. The following are not desirable in investigative report writing:

- (a) The report covers multiple facets of the problem without reaching a conclusion. The use of words, such as, 'appear', 'seems to be', 'perhaps' indicate that the report is inconclusive.
- (b) A careful reading of the findings may result in reaching more than one conclusion.
- (c) Personal bias or subjectivity in reporting facts without a comprehensive review could hamper the outcome.
- (d) There should not be any offensive or abusive language in the report, especially, against the subject or any other person referred to in the report.
- (e) There should not be any remarks that are sarcastic in nature.
- (f) The report should not reflect a personality clash between the investigating officer and the 'suspect', or written to appease the engagement client.

Planning the Report Contents

11.6 The investigating officer while drafting the report should obtain opinion from his team members and legal counsel or the reviewing authority on the sufficiency of the evidence gathered, the method of proof to be used, and the proposed recommendations.

Planning a final report is a process that begins at the time an investigation is initiated and is assigned to a designated official in the investigative team. Report writing can be simplified if the evidence is organized in a neat, concise, logical, and easily retrievable manner. The 'specimens', 'photographs', results of analysis, computer generated records (CDs, DVDs etc.,) or exhibits need to be kept in a neat and structured manner in a working paper folder.

11.7 In case of a private investigation, the original documents are, generally, handed over to a superior authority within the organization, whilst a photocopy is retained by the investigative firm. In most investigative assignments, post completion the backup exhibits or evidence collected is handed over to the client and not retained by the investigative firm. Such a handover is formally documented during the process of collecting documents and investigation as well as when these are returned to the engagement client.

11.8 The investigative working formats must include a 'Summary of Statements given by Witnesses and Records document'. This document should be comprehensive and should list all witnesses contacted and nature of evidence obtained from those witnesses, irrespective of whether these are cited or not in the investigative report. At the same time, this summary information should be brief and to the point. Care should be taken to see that there is no duplication in the documentation.

11.9 In case the report content is witness oriented then numbered files can be established for each witness. The witness's testimony and any supporting document that is obtained from the witness should be appended with each such witness file. A separate witness folder should be created for each person contacted during the investigation and should include such person's identity like, name, address, telephone number(s), voter ID or any other identity. Where the evidence is too large to fit neatly into the witness folder, the same should be kept in a readily accessible manner with appropriate location or packed in corrugated box duly referenced to the witness folder.

Generally, a bar coded packing system for the purpose is ensured. The evidence file retention retrieval process is managed by specialized agencies and can, therefore, be outsourced. The work papers that contain vital evidence are kept sealed (such as, plastic strips that need to be broken to open the seal) and at a secured place by the investigating officer.

Report Writing

11.10 Chartered Accountant firms specialising in investigation normally maintain a document manager that is web based and retain hard copies at the respective locations where the investigation is in progress. Some of these firms have offices across vast geographies or distant locations across the globe and, therefore, need interactive facility between the investigating officer (investigative staff) and the reviewer (senior engagement partner), who may be centrally located at the Corporate Head office. To ensure standardization in reporting, audit report templates and links are maintained as database in a central server. This allows the investigative team to effectively prepare an integrated, complete and accurate report. The 'pre-designed template' only enables standardization in format and not in content as these largely depend on the drafting skills of the designated investigation team member.

Reporting Facts

11.11 Facts stated must be unbiased and not subjective. The interpretation of facts should preferably be left to the readers as these tend to be consistent in reaching to a common conclusion. This is because any distortion or misrepresentation of facts will diminish the quality of report and credibility of the person preparing the investigative report.

To ensure that the report deals with facts and does not digress into expression of matters that appear to be opinions and vitiate the objective of the investigative reporting and to ensure that the reading of the report reflects an impersonal attitude, use of personal pronouns should be avoided. An exception to this rule is when there is a need to quote information gathered from witnesses or other persons during the investigative process. It is in this context that a testimony obtained from witness should be presented fairly. In order to ensure that the report is unbiased, independent and objective the signatory to the investigative report should not refer to themselves as the undersigned, the writer, or your representative (meaning client – agent relationship).

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11.12 There is a need for abundant caution in use of quotes in the report. The person drafting the report must extract and represent information from documents with reference to proper context. Any attempt to conceal or omit facts that tend to favour the subject could influence the outcome of the investigation and therefore should be avoided.

Accuracy in Reports

11.13 Investigative reports form the basis for the management to initiate disciplinary and legal actions and, therefore, accuracy of facts is non-negotiable. Inaccuracies can negate the value of the report and diminish the reputation of the investigative firm and the credibility of the investigation officer including the person drafting the report.

There is a need to draw a distinction between fact and opinion. Avoid using statements such as “the subject could give no plausible explanation”. It is a conclusion and others may find that the explanation is plausible. The report should state what the subject has said and let the evidence show whether the statement is worthy of belief. Do not allow conclusions to surpass the evidence. A conservative statement that is consistent with the facts is stronger than an exaggeration. Exaggerations tend to raise doubt relating to all the evidence presented in the report.

Essential of a Good Report

Fair reporting

Accurate - adequately validating the figures (if any values are quoted) in the report

Complete – including a defined scope of coverage Brief, concise and relevant

Logical presentation

Structured format with appropriate main and sub-headings

Grammatically correct

Cross references to annexure and exhibits

Unambiguous, easily understandable and without technical jargons

No offensive remarks on the subject should be impersonal.

11.14 Restricted circulation (marked strictly confidential), judgment in the choice of words, punctuation that clarifies the meaning, and a correct

application of the rules of grammar are essential for accurate reports, appendices, schedules and exhibits. Errors in these essentials may have a negative effect in the minds of the readers. Carelessness in details, errors in computations and incorrect dates materially affect the value of a report.

Mathematical computations in the report, appendices, schedules, and exhibits should all be verified for accuracy. Special investigation teams have computer applications that verify correctness of the data and formulae. For review purposes, supply a tape containing computations or electronic file so that these may be verified.

11.15 Preferably avoid using technical jargons, including those used in accounting and legal parlance. However, in some instances, vernacular terms (or terminologies that are locally prevalent) may be necessary for clarity in reporting the results of investigations, particularly those involving subjects in wrongful activities. Meaning of particular terms should be explained when they are first used in the report. For example, it may be advantageous in a report concerning a pyramid scheme to describe the nature of the operation, including the technical jargons used therein, before presenting evidence of the violation. If numerous technical terms are necessary, it is advisable to give glossary.

11.16 In drafting the report, present the material with the objective that it could be clearly understood by a reader who has no knowledge of the facts surrounding the investigation. The report drafting person must exercise good judgment in selecting the facts that are material to the matter and ensure that nothing essential for a complete understanding of the investigation is omitted. This is especially true for any information that is favourable to the subject. All statements of material facts relating to the violation should be supported in the investigative report by evidence that will establish the truth and accuracy of the statement. The source of the evidence should be documented. Each statement of material fact in the investigative report, with the exception of statements made in the section on conclusions and recommendations sections, must be supported by evidence citations. These citations must be specific, including page and paragraph numbers. Statements made in the conclusions and recommendations sections must be supported by evidence cited elsewhere in the report. No unsupported statements may appear anywhere in the report.

11.17 All defenses of the subject and their representatives must be refuted, and any mitigating circumstances, exculpatory evidence, or other impediments to a prosecution recommendation must be fully addressed.

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Speculation concerning potential defenses or explanations that have not been raised by the subject and/or their representative should not be included in the report.

If it was not impossible to interview a key witness or to take any other pertinent investigative step, this should be explained in the “Other Pertinent Data” section of the report. For example, in an investigation on misappropriation of consideration on sale of product in which the customer was not approachable for being interviewed, the reason thereof should be noted. Addressing such issues will underscore the thoroughness of the investigation and prevent unnecessary requests for supplementary information.

Finally, in order to ensure completeness, the report should be read and revised as often as necessary before it is submitted for review.

Brief and Concise

11.18 Conciseness necessitates removal of all superfluous material. The rule of conciseness applies to the entire report and repetition in the content of the report should be avoided. Schedules, summary, exhibits, tables, footnotes, and appendices may be, especially, useful in reducing the length of the narrative and presenting the financial evidence with integrated details.

Logical Presentation

11.19 A well-written report may lose its effectiveness for lack of a logical presentation. A mass of data indiscriminately presented in the report would be confusing and may impair the reader's ability to comprehend the facts relating to the investigation. A well-written report requires adherence to the primary purpose of the report. Irrelevant material should be excluded. Clarity and presentation of communication is important. Each sentence, paragraph, and section of the report should help serve the primary purpose of the report. A well-written report requires careful planning, critical review, and frequent revision by the report writer.

11.20 Each paragraph should be classified according to the subject matter (theme) and any new topic or idea should be the subject of a new paragraph. Any special emphasis can be brought out through a separate sentence or a passage. Such emphasis can be brought out through numbering, indenting and by use of summary schedules.

11.21 The investigation report is addressed to the designated official of the client engagement. Where interim reports are issued to the client, the same should be stated in the header or footer of the entire report. Similarly, the term confidential should be stated in the header of each page. There is a reference to the person who is required to be contacted as a representative of the investigating firm. The date of the investigation report will be the date when the report is forwarded to the engagement client.

Peer Review

11.22 The investigative report should preferably be referred to a superior officer within the investigation firm to ensure that evidence gathered, and conclusions reached are reasonable. Where there is a limitation in arriving at a decision in a matter under investigation, it is important that the report is adequately qualified. Most investigative firms engage the services of a legal expert or ensure that the investigative report is vetted for meeting the legal requirement and to safeguard the interests of the engagement client as well as the investigation firm.

11.23 Once the investigation report is presented, there should be a process of formal closure of the assignment through a closing meeting. The documentation requirements relating to working paper management and custody thereof should be formally communicated to the client and retention norms should be specified for safekeeping of the records and documents. It is to be ensured that the draft report is stamped and cancelled to prevent misuse of the same. Duplication in pages should be avoided.

There should be clarity in disclaimers in the report and adequate safeguards for the investigative firm in matters of litigation. There should be restricted circulation of the report unless otherwise authorized by the client. At the same time, it should be ensured that the investigation report is not used for purposes other than those specified for, in the terms of engagement between the client and the investigative firm.

A peer review of the performance of the investigative staff may be conducted at periodic intervals. This should include reporting norms and retention of working file documentation.

The Final Report

11.24 The final report is a confidential document and its primary purpose is

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to apprise the superior officers and legal counsel of the organisation of the result of the enquiries with a view to assess the merits and demerits of a matter under investigation and facilitate reaching a conclusion. It is imperative that the final report presents a clear, complete and well-connected picture of the matter under investigation and explain and analyse the available evidence. This report is generally for in-house use of the business entity and shall not be discussed/ quoted outside the entity. Some important aspects are as follows:

- (i) The typing should be in double space. The ink impression should be dark enough for easy reading. Paragraphs should be numbered properly.
- (ii) Enquiries/ investigations should be thorough and complete and the information disclosed in the final report should be adequate on all points so that it is not necessary for senior officers to raise any avoidable queries.
- (iii) The allegations, facts of the case, evidence available and the opinions and comments should not be mixed up in the final report. They should be dealt with separately and succinctly.
- (iv) Repetition should be avoided. All allegations should be listed in proper order in a clear and definite form and discussed separately in detail.
- (v) The analysis of the facts of the matter under investigation should be kept separate from the opinion. When there are multiple allegations and more than one suspect, care should be taken that the conclusion is drawn for each of the allegations and each of the suspects.
- (vi) If any of the witnesses could not be questioned or documents could not be obtained, the same should be mentioned clearly with reasons in the final report.
- (vii) There should be no delay in the submission of the final report or in furnishing the supplementary information to the senior management to whom the report is addressed. The investigating officer and the legal officer should be given time targets to furnish the report and information sought with their comments.
- (viii) The opinion received from experts or the relevant portion thereof should be incorporated in the final report.

Investigation Report

- (ix) The legal officers should not merely summarise the evidence collected during the investigation or enquiry. They should give a careful analytical note which should inter alia, bring out the points to be established and the evidence that substantiates these points. They should highlight the important propositions requiring decision of the senior management. Any further investigation to be done should be set out in the final report.

Chapter 12

Legal Action

Chapter Summary

Contrary to management expectations, investigating firms are reluctant to engage in matters relating to court appearances (other than as expert witness) and filing of police complaints, etc. The investigating firm plays an advisory role in these matters. In this Chapter, certain basic legal aspects that may be relevant to the management have been examined.

Use of Investigation Reports to Pursue Legal Action

12.1 The management may want to proceed legally in filing a complaint with the police authorities once an investigation report is submitted. There is no defined format or the medium (e-mail, telephone call, registered telegrams, etc.) to lodge a police complaint. Police complaint can be lodged by any person, anywhere at any time. In such complaint correct facts only should be stated. The key coordinator of the engagement client should engage effectively in defining the process and circumstances of the case to the police authorities. Obtaining a formal acknowledgement of the complaint filed is advisable and is given by the police authorities especially to corporate representatives. The technical details should be explained in a lucid manner and in matters involving financial crimes the use of internal documentation such as, goods receipt notes, delivery 'challan', gate pass, internal control system and abuse of authority and other matters need to be elucidated clearly to such authority where circumstances warrant. The management should be able to display independent and unbiased approach in stating the facts to the police authorities. The following criteria should be applied to all such investigation reports used for filing a police complaint or registering a legal case:

- (i) Maximum use of appendices (Annexure and Exhibit) helps in eliminating the need for detailed explanations of each of the supporting, exhibits and minor details of the investigation. When appendices are used, each should have complete references to all relevant testimony and documentary evidence.

- (ii) Abbreviations should be avoided.
- (iii) If the facts and circumstances surrounding two or more subject investigations are the same or are interlinked, the results of the related investigations should be presented in a single report.
- (iv) It is recommended that a table of contents reflecting report sections and page numbers be submitted as part of the investigation report where the report content in size is significant. However, prior to submitting the investigation report, the page fields should be updated. Generally, in investigation reports the legal format in numbering of pages is adopted.
- (v) The table of contents is designed to provide a quick reference to important sections of the report. The complexity of the investigation and the circumstances of the investigation will determine the extent of details to be included in the report. Additional section headings may be included in the investigative report, if warranted. The list of witnesses and exhibits and the title and number of pages of each appendix should be included in the table of contents.

First Information Report (for Criminal Cases)

12.2 Any person can give information to the police relating to the commission of a cognizable offence and the Criminal Procedure Code provides manner in which it is to be recorded. A copy of the information has to be given to the informant. An FIR sets the criminal law in motion.

An FIR is not substantive evidence but it can be used to corroborate an informant or to contradict him, if he is called as a witness to a trial. Telephonic complaints can be taken for investigation as suo moto case by the police. Not all complaints can be converted into an FIR unless the police is satisfied prima facie.

12.3 If complaints are not registered then one can approach the local magistrate's court under section 156 and the court if satisfied, register the crime, alternatively it will direct the police under section 202 to investigate and report. It is to be noted that the submission of report is only to explain the facts of the case to the police authorities while lodging a complaint or filing the FIR (in case of criminal cases). The police authorities would be conducting an independent assessment and investigation of the matter brought to their notice.

Pros and Cons of using Affidavits

12.4 When the 'subject' seeks legal remedy there are occasions that there is an allegation that the investigation was not conducted in a fair manner. The investigating officer must take abundant caution when statements are obtained from the 'subject' as proof of irregularity being committed and may have to approach the local magistrate in registering the statements in the presence of an independent witness to ensure that the statements are not retracted subsequently. For example, let us take the example of financial irregularities through offering of excessive discounts by dealers beyond the stipulated limits prescribed by the manufacturer. The situation may involve obtaining of declaratory statements by the staff of the dealer who while replying to the questions raised by team of senior officials of the company may have revealed of the dealer being involved in excessive discounts as against the company policy affecting the company operations. The investigating officer (the chartered accountant or his support team) can be confronted by the owner of the dealership and the statements can be challenged in a court of law stating that the employee of the dealer was coerced into making such a statement and that the company officials have not allowed such dealer employee to reach out to the owner. Such a counter allegation may result in retraction of all the statements and claims on the dealer. Under these circumstances, when an investigation assignment involves visiting offices of third parties, the concerned 'subject' who makes the statements should be taken to a local magistrate and an affidavit should be prepared and signed before a local magistrate and duly registered. Being an independent agent, this adds value to the investigative process and makes it difficult for the defense to purge these statements. Even a simple affidavit duly recorded and notarized before Public Notary helps a lot. Any evidence of the facts may be attached to the affidavit. In the above case, if the employee can procure any form, etc., filled by the buyer who got the excessive discount it should be attached. The place or territory where the crime has been committed, should be place the where the complaint has to be lodged.

Chapter 13

Investigative Audit and Allied Services

Chapter Summary

Investigative audit field is a unique combination of accounting, investigation and legal knowledge and, therefore, is not restricted to conduct of investigation alone. There are other specialised areas that provide an entire gamut of services that add value to the clients. These are extensions of the skill sets that are required for carrying out the investigative assignments. The salient features and pre-requisites for each of these products are discussed in this Chapter.

Due Diligence

13.1 The investigative practice is bestowed with one portion of the entire due diligence activities due to its inherent networking of people and ease in gathering and validating data or information. Whenever new alliances are formed or there is a business expansion plan or a merger and acquisition, need for due diligence arises. When a company is desirous of venturing into unknown businesses or geographical territories, due diligence activity is immensely useful in situation where there are unfamiliar customers, varying cultures and languages, legalities that make the understanding and controlling of the entity in such a market difficult. There is tendency to conduct this exercise in-house by most corporates and consultants are hired only on a need basis where certain critical information is required.

Prior to engaging in any business relationship, it is advisable to possess knowledge of the respective company and individuals based on facts and not just perceptions.

13.2 Due diligence activity ensures whether the business of the target company conforms with that projected to the client. It ensures a reputation check on the target and includes activities such as, valuation of the business. It may involve profiling of individuals/ corporate entities for historic background information; position in market, reputation check, distribution network, litigation, etc. The fees basically depends on specific requirement of

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the client. The fee depends on the information sought by the client. These can be categorised as follows:

- (i) Basic information that is available in the public domain comprising of data base check, data mining, websites search, research reports telephone search, media search (newspapers reports, etc.), credit rating companies research reports, data base updates through 'crisil', ICRA, Care Rating etc.
- (ii) Financial records review, visit to ROC, search reports, etc.
- (iii) Visit to the target business, asset verification, surveillance, etc.
- (iv) Police check in order to confirm whether the target is involved in any activities that could pose reputation risk, crime record checks, number of court cases pending against the target, etc.
- (v) Sensitive information relating to the target that is normally not available in public domain such as, civil litigation history, any crime history, corporate affiliations and details thereof in terms of kind of business interest, nature of shareholding, history and reputation of those businesses, etc.

Integrity Check Services

13.3 When an investor is looking forward to enter into a new business relationship then background checks are the most sought after services. Such background checks may involve:

- (a) Review of potential suppliers;
- (b) Entering into a licensing agreement;
- (c) Reviewing prospective joint venture partners;
- (d) Diversifying into new markets;
- (e) Review of existing customers;
- (f) Reviewing potential merger or acquisition targets; and
- (g) Reviewing individuals or small and medium sized firms those are engaged as brokers or consultancy agents for investing company. The background check helps in ascertaining their capability and mode of dealings are within the ethical norms for the investing company.

13.4 The time and money spent on these assignments are generally rewarding for the client and might safeguard them from a significant business risk. In many such assignments giving clean chit to the 'targeted party' is a difficult proposition to substantiate than a negative 'findings' report.

Background Checks and Surveillance

13.5 These are more suited to non-accounting professionals and involve extensive field work and data mining. Excellent networking is a prerequisite to handle these kinds of assignments. A typical assignment would involve ascertaining the reputation of the business partners before entering into a business relationship.

Pre-employment Screening

13.6 Experience has taught many businesses that if they had objectively and comprehensively screened candidates prior to employment, many malpractices such as, conflict of interest, industrial espionage, theft of proprietary information, contravention of business compliance issues and business fraud could have been avoided.

13.7 Employment screening is an essential process to safeguard any business from hiring persons who are either unqualified or of questionable integrity. Screening applicants through prior and post hiring enquiries is loss prevention in the real sense. This screening can be extended further to business partners, vendors and dealer networks. This is, generally, a volume activity and work profile involve screening of individuals from senior management to the operating level. The senior the hierarchy, the higher the information requirements, the time span for completion and resultant service fee levels. For mass employment screening, the fees are generally negotiable and tend to be competitive. This includes resume check, telephone check, database searches, pretext enquiries, review of university records, enquiries with the local police station and other information available in the public domain. The objective is to filter any false claims about qualification, work experience and personal background or identify weakness on account of withheld information that is relevant to employment such as, previous criminal convictions or misconduct.

Tackling Ethical Dilemma

13.8 Every organisation has an in-built value system with its own mission

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statement, code of conduct and core values that need to be imbibed in the work environment. There are several business situations that create a situation of ethical dilemma in the minds of employees that require a greater understanding of these value statements. Whether it is conflict of interests or protection to the whistleblowers, role of ombudsmen, effective upward communication and workshops bring greater clarity in the minds of the operating people. Abundant experience and knowledge of work culture is essential in addressing these issues and is a highly specialised activity. To append a value to these activities is a difficult task.

Investigation into Financial Crimes

13.9 Investigative assignments although of primary importance do not ensure a perennial stream of work. Hence, it is important to ensure a minimum allocated percentage of time in a year towards building these kinds of assignments. This is the only way sustainability can be brought to the investigative practice. This can be achieved through product differentiation between consulting, internal audit and investigative assignments. The resource constraints can hamper the accepting of investigative assignments and, hence, regular updating of skill sets is a critical factor in managing these kinds of assignments.

Identify End Use of Funds

13.10 These assignments are similar to bank audits except that the client could be Non-Government organisations, World Bank projects and many social projects wherein the donor is interested in deriving a comfort about the end use of funds. Any diversion of funds not in accordance with the objective of the organisation would hamper the reputation of the organisation and future flow of funds.

Asset Tracing

13.11 Asset tracing investigations suit debt recovery process for banks and financial institutions. Asset tracing is desirable but not of the recovery proceeds as these are high risk propositions and are difficult assignments. Accordingly, there is a need for abundant caution in understanding the mandate from the management and deliverables. Asset tracing are done for merger and acquisition activities as part of due diligence activities of the organisation. In a disproportionate asset case, the asset tracing team plays a major role in evaluating the asset amassed by the employee vis-à-vis his disposable income.

Legal Support

13.12 This practice should be seen from an accounting perspective and involves pre-trial discovery, various forms of alternative dispute resolution in business, providing assistance to lawyers with accounting, business solution, and valuation aspects in legal initiatives. This will include damage analysis or defending a claim for damages. Generally, this should be the preferred practice of Chartered Accountants. This will be inherent strength for the members who already are well versed with court matters.

Expert Witness

13.13 An expert witness or professional witness is a specialist who by virtue of his education, training, skill or experience possesses knowledge beyond that of an average person and sufficient to the extent that his opinion about an evidence or fact with the scope of reference is called an expert opinion.

A qualified expert may testify by giving an opinion or otherwise and such a testimony should be based on adequate facts or data and should be a product of reliable principles and methods. The expert witness must have applied the principles and methods reliably to facts of the case in forming an opinion. A Chartered Accountant with his domain professional knowledge can play the role of expert witness effectively.

Damage Assessment/ Business Valuation

13.14 It will require reports from the Chartered Accountants on account of business interruption, loss of stock/ assets, ocean loss claims, fire claim, damages arising out of professional negligence, product liability (warranties) and loss of profits due to disputes, breach of contract, business valuation for new acquisitions, etc.

Intellectual Property Rights Protection

13.15 Some of the investigative firms are backed by retired police officials or army officials and experienced lawyers who have a wide network of contacts. They provide adequate training for isolating incidents of counterfeit products being sold in the market. The source of such product is traced most of the time, and with the help of local police network the operation is successfully completed including seizure of unauthorised machinery, closure of manufacturing facility and suggesting remedial measures to the affected client. This practice includes corporate brand vulnerability assessment.

Anti-Fraud Reviews (AFR)

13.16 These reviews are a tool for fraud deterrence and are used for identifying the root cause for the occurrence of a fraudulent activity. This requires improvement in the existing procedures to eliminate the 'fraud enablers'. Short-term steps are more procedural and long-term changes include ethics workshops and focusing on cultural changes within the organisation. AFR is a process of assessing the vulnerabilities in the present work environment of a business entity. The process requires visualising fraud scenarios under a set of pre-defined conditions. Identifying the critical areas for review is an important step in this type of assignment. This is followed by creating hypothesis of events called 'triggers for fraud'. The fraud trigger is tested with reference to people, processes, timing, reporting and documentation of activities. The past occurrence of fraud, the frequency of such occurrence over a defined period, the impact on the entity in terms of materiality and on its reputation are influencing factors in the risk profiling process. The exercise concludes with prioritising these risks and suggesting remedial measures. Essentially, this exercise is revisited after a defined time interval.

The diagnostic review for assessing vulnerabilities to fraud is a step towards deterrence of fraud. From a management perspective elimination of fraudulent activities though desirable is improbable. Hence, any remedial measure arising out of diagnostic reviews should be subjected to a cost benefit analysis and should not result in degrading the functioning of business entity.

Cyber Crime

13.17 The services under this category among firms vary depending upon their in-house capabilities. The services include data recovery that enable the retrieval of e-mail messages and deleted documents. The services include creation and maintenance of evidence to ensure proper collection and presentation of data in court, data imaging and information security compliance audits.

Case Studies

13.18 The following case studies illustrate the situations mentioned above:

- (i) The CFO/ CEO of a company had excelled in ensuring a consistent business performance coupled with a hyper growth in business volumes. This has brought in greater expectations from the board members in terms of using their expertise in other new business ventures and similar expectations from the audit committee members in strengthening the internal controls with more delegation of power. This has necessitated reorganisation of the reporting structure including identifying a new breed of leaders who can carry on the good work. The HR Head was summoned and was briefed about some eligible candidates within the organisation and to look for new talent outside the organisation. The HR person started profiling the candidates and had reservations on the integrity of the persons to whom the business mantle can be handed over, based on grapevine information. However, to prove this point he was in need of the right feedback and supporting evidence to corroborate facts. An investigation firm was called in to ensure a background check seeking specific information about the candidate without revealing the real objective that he was a potential candidate for a senior position. Do you consider this appropriate in not revealing the true objective?
- (ii) The competitors in a business managed to launch their competing product despite company's best efforts to maintain confidentiality of information. This brought in an element of distrust within task force on information leakages to the competitor. The management realised the need for conducting an information security review to identify the control gaps that lead to this mishap time and again. The internal auditor was summoned to undertake a covert assignment (Special audit assignment) to identify the manner in which information reached the competitors.

A part of the assignment required the internal auditor to look into avenues for leakage of information and a specialist was needed on matters relating to use of technology and review of telecommunication lines. Accordingly, a decision was taken to outsource the technical aspects of the review. Using

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the services of technicians for presence of any bugs and an effective surveillance mechanism they were able to successfully identify the problem. The technical surveillance revealed that none of the internal task force members were responsible for information leakage.

Chapter 14

Market Scenario for Investigation

Chapter Summary

The Chapter provides an insight into the market scenario for investigation that has a room for all types of operators whether it is a freelancer or a group of persons handling various facets of investigation under a contractual relationship. In fact, there is a dearth of operators as the type of work requires exceptional skill sets, risk element and has immense stress in getting the resources for the existing operators. The Chapter deals with client concerns and precautions to be taken in assigning of jobs.

14.1 In an open economy with a focus on globalization, foreign companies are setting their sights on India and vice versa resulting in forging of alliances giving thrust to due diligence activities. However, any fallout in such relationships at a later stage may give rise to a situation requiring mediation and conflict resolution.

These companies in India that have tie ups with foreign entities do have the risk of facing allegations of manipulation of accounts outside India. These developments could result in unanticipated reputation risk and unforeseen strain in business relationships. The assertion by the management that the Indian operations are insulated from such developments should be seen in the proper perspective. To take a decision as to whether to continue or sever the business relationship, management needs to revisit the due diligence exercise done prior to forming an alliance. This exercise can be more ably done by a Chartered Accountant.

From an investigative services perspective, this is an area to watch out for in the next few decades and has immense potential for the investigative practice.

14.2 This brings several questions to the forefront like, who is the client, how to vet referral of assignment, how to assess fraud risk, what is the expectation of the client and finally how to make a beginning in an investigation assignment, etc. Generally, investigation is used as a tool for confidence building by borrowers vis-a-vis the lenders or could be on behalf of the lenders to ensure checks and balance on safety of their investment or

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loan disbursed. Here the target client could be a money lender or the borrower client. Similarly, where the assignment is about integrity check or surveillance, the HR department personnel could be the target client.

Types of Operators

14.3 The market scenario for investigative assignments is very encouraging with enough space for all kinds of operators in these types of engagements to the extent permissible under the law. Primarily, this market is unorganized and private investigators can be classified into the following categories:

- (a) Freelancers (retired police officers, ex-army personnel, etc.);
- (b) Private detective agencies;
- (c) Risk management firms (those with a global network being an advantage);
- (d) Audit firms (proprietary, medium sized partnerships, and large firms);
- (e) In-house departments (on behalf of the management).

14.4 Apart from the above, investigations may be mandated under Statute. For e.g., investigations instituted under direction from regulating authorities (Banks, Financial institutions, Registrar of companies, Reserve Bank of India, Insurance Regulatory and Development Authority, Securities and Exchange Board of India, etc.) or by Law enforcement agencies (on behalf of the State or Court of Law).

Resources in an Investigative Firm

14.5 Generally, the assistance of retired Intelligence Bureau officers, CBI officers, or Ex-officers of high profile regulatory authorities and former Government officials with investigative background and integrity and proven track record are considered as essential support for brand building and the training needs within the investigation firms. These officials are considered essential for field work and form an integral resource in establishing a network of informers and are a source of information vital to the objective of conducting investigation within the legal framework. Since clientele information cannot be shared by investigative firms, the experience of the team members and the presence of a multi-faceted team (CAs, MBAs, Law Graduates, Psychologists, Historians, Sociologists, IT professionals,

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Statisticians, etc.) become a confidence building measure to ensure core competency. An investigation being a specialized activity involving multi-faceted skill sets, there is a tendency to form limited liability companies that suit brand building too.

14.6 A distinct feature in this field is the high attrition rate among the investigative personnel. Considering the quality of personnel, and risk and skill sets involved, the compensation is generally benchmarked with the best in the industry with reference to other professional services. Cost considerations are a critical factor in the engagement process, for the management as well as the investigating firm. The engagement fee mainly depends on the time spent and objective of the assignment and may vary from firm to firm, based on their skill sets.

14.7 A Chartered Accountant in accordance with his professional knowledge base is able to be an efficient coordinator among these agencies ably supported by analytical skills, working knowledge in process evaluation and requisite documentation, especially for investigations involving financial crimes. He is, therefore, at an advantage to play the role of a strategist in carrying out the investigation. However, for field work, the services of non-Chartered Accountants may be availed.

14.8 For the above agencies, there is a need to ensure that resources in terms of manpower or investigative tools are gainfully deployed. Hence, multiple services apart from core investigation are created. This comprises of conducting surveys, research reports, media exposure, periodical representations to management, due diligence, conducting background checks (surveillance), reference checks for appointment of personnel to important posts in an organization, reference checks for HR department (large volume contracts), integrity checks for employees, assignments related to patents and trademarks violations, business ethics workshops, validation of processes for game shows in media, etc. are some examples. An internal auditor who has a better understanding of financial as well as operational audits is more suitable to be engaged in investigative assignments, whenever the situation warrants. It is desirable for investigating firms to engage in a dialogue with the internal auditors at the planning stage itself to evolve their strategies.

Chapter 15

Way Forward

Chapter Summary

This Chapter is intended to encourage the members to hone their skills to look for opportunities and develop resources to ensure greater diligence in executing their professional responsibilities. This practice rather than being seen as fault finding exercise should be construed as confidence building measure that requires the attention of members, management and audit committee representatives.

Representations to the Members

15.1 Investigative practice is a specialised field and is a confluence of the fields of Accounting, Law, Information technology, Sociology, Psychology, Journalistic aptitude, Business communication and Business administration. Investigation is a team effort and, therefore, a post qualification course covering any of these fields could immensely help members in honing their skills. This would mean more members take up investigative practice in an endeavour to minimise corruption in the society. There is need for a functional interface between the world of accountants and the legal profession.

15.2 The investigation work in private companies is largely unorganised and unregulated and often involves experimenting on the job at the risk of the engagement client. This creates the need for extensive training workshops in developing the skill sets of members. With the rise in financial crimes, it is imperative that a Chartered Accountant is alert to the new accounting world order in developing processes that enable isolation of fraudulent activities.

Representation to Management

15.3 The management could allocate a budget for addressing risk of fraud as a part of the overall risk management plan. This could include structured anti-fraud programs at pre-defined intervals, keeping in view the existing control environment. Where fraudulent activities are found to be rampant in certain sectors, the formation of an investigative cell by whatever name

called to ensure an array of activities including a surveillance mechanism to identify red alerts within the organisation could be an added advantage supplementing the internal audit function.

An in-house coordinator (could be the compliance officer or the chief audit executive) to advice on matters relating to investigative support within the organisation could be designated.

Representations to the Audit Committees

15.4 There is an increasing role of Audit Committees (especially, the independent directors) whose expertise could be of immense use in functioning of the enterprise. While the mandate for investigation is a management decision, the audit committee has the right to seek clarification from the management on the action taken on red flags as highlighted by the internal auditors. This strengthens the role of internal audit functionaries in terms of evaluating the control environment of the entity at the same time bringing service differentiation between audit and investigative assignments.

Chapter 16

Strengthening Control Environment

Chapter Summary

This Chapter provides an insight into various facets of fraud risk, audit risk, control risk, reporting risk and regulatory risk within the legal framework of Company Law, SEBI and RBI guidelines. An attempt has been made to avoid technicalities to make the contents understandable to the readers from the point of view of financial reporting, ethical norms for conduct of business and an enabler in strengthening the governance, risk and compliance norms within a corporate entity and its relation in transacting with the outside world.

Heightened Vigilantism and Legacy Issues

16.1 Any financial irregularity or a wrongdoing has an element of chain reactions in revelation of series of criminal or civil misfeasance impacting the financial reporting norms spreading fast in the corporate world. These include entities operating in the financial services sectors, namely, infrastructure leasing, housing finance companies, consumer goods financing, credit card service providers, private Banks and the list is ever expanding to anything that can put “good money miscalculated business decisions”.

16.2 The mounting NPAs in nationalized banks is getting into catastrophic situation. The cybercrime is creating havoc in ruling the world of deceptions in causing irreparable damage to the financial eco-system. Stealing and trading in information and trespassing into privacy matters, fake news are other factors impacting businesses. In these conditions, financial reporting requires abundant care in placing facts, disclosures and preparing notes to accounts. It seems the aftermath of these conditions is worrisome and corporate world must prepared for a long-drawn litigation battle in these recessionary conditions.

16.3 A recessionary economy drains any amount of finance infused in the business eco-system and minimizes the avenues to leverage the downturn with a parallel business activity in the wake of uncertainties. “Economic value

creation” being an essential criterion for propelling growth, may require measures to “arrest” the incremental loss that may arise out of under recovery in cost of production. The inventory carrying cost and finished goods net realizable value would need to be reassessed in the wake of “slackness” in demand. Estimating the “fair realizable value” is bound to be a challenge in appending a value to “impairment of assets and investments”. These are circumstances wherein the priorities in terms of collective consumer demand shifts to essentials of life for survival, putting into back-burner the desirables and the use of luxury items. The austerity measures in controlling cost are a short-term measure that can strap the sagging fortunes of a corporate entity. The adverse conditions overrule the risk assumptions of a business entity and puts to test the mettle of business leaders in carving out a bailout package to tide over the adverse conditions. Forensic auditors, internal auditors and statutory auditors would need to demonstrate conservatism in varied aspects of financial reporting.

There is a need to focus on the fiduciary responsibilities of finance professionals and on the role of internal auditors as conscience keeper of the organization in matters of adequacy of controls, documentary trails and distinguishing the assurance roles from investigation audits.

Tone at the Top-Ethics & Governance

16.4 The “Tone-at-the-Top” assumes paramount importance in advising corporate functionaries to comply with business ethics & integrity norms that is depicted through:

- (a) **Governance Code** in any organization sets out standards of good practice in relation to issues, such as, Board composition and development, remuneration, accountability and audit, and relations with shareholders
- (b) **Code of ethics** is a guide of principles designed to help professionals conduct business honestly and integrity
- (c) **Code of conduct** for a group or organization is an agreement on rules of behaviour for the members of that group or organization
- (d) **Due professional care** is exercised when audits are carried out in accordance with standards set for the profession

16.5 From the above perspective, the following key definitions carry

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importance for the Chartered Accountants.

- (a) **Officer - Definition** : An Officer includes any director, manager or key managerial personnel or any other person in accordance with whose directions or instructions the Board of Directors or any one or more of the directors is/are accustomed to act.
- (b) **Officer in Default – Definition Under Companies Act, 2013**: An ‘Officer-in-Default’ for the purpose of any provision in this Act (which enacts that an officer of the company who is in default shall be liable to any penalty or punishment by way of imprisonment, fine or otherwise), means any of the following officers of a company, namely:—
- (i) whole-time director;
 - (ii) key managerial personnel;
 - (iii) where there are no key managerial personnel, such director or directors as specified by the Board in this behalf and who has or have given his or their consent in writing to the Board to such specification, or all the directors, if no director is so specified;
 - (iv) any person who, under the immediate authority of the Board or any key managerial personnel, is charged with any responsibility including maintenance, filing or distribution of accounts or records, authorises, actively participates in, knowingly permits, or knowingly fails to take active steps to prevent, any default.”
- (Refer to Companies Act, 2013, Commentaries, Guidance notes, rulings therein, notifications, SEBI guidelines and the Companies (Amendment) Act, 2020)
- (c) **Fraud defined under Companies Act, 2013**: “Fraud in relation to affairs of a company or any body corporate, includes any act, omission, concealment of any fact or abuse of position committed by any person or any other person with the connivance in any manner, with intent to deceive, to gain undue advantage from, or to injure the interests of, the company or its shareholders or its creditors or any other person, whether or not there is any wrongful gain or wrongful loss. ‘Wrongful gain’ means the gain by unlawful means of property to

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which the person gaining is not legally entitled and ‘wrongful loss’ means the loss by unlawful means of property to which the person losing is legally entitled.” It is perhaps the first time that the Companies Act defines fraud that expressly imposes civil liability and implied criminal liability (covered under other legal regulations) on the fraudster for non-compliance.

“Fraud” also means and includes any of the following acts committed by a party to a contract, or with his connivance, or by his agents, with intent to deceive another party thereto his agent, or to induce him to enter into the contract;

- (i) the suggestion as a fact, of that which is not true, by one who does not believe it to be true;
- (ii) the active concealment of a fact by one having knowledge or belief of the fact;
- (iii) a promise made without any intention of performing it
- (iv) any other act fitted to deceive;
- (v) any such act or omission as the law specially declares to be fraudulent.

16.6 Audit risk in customary parlance is defined as ‘the risk that the auditor expresses an inappropriate audit opinion when the financial statements are materially misstated. Audit risk is a function of the risks of material misstatement and detection risk’ (Refer Chapter 3). For detection of fraud risk, Chartered Accountants are required to use their professional skepticism while doing audit. It may not be possible to detect acts that have intent to injure the interests of the company or cause wrongful gain or wrongful loss, unless the financial transactions of such acts are reported in the books of account/financial statements of the company, backed by appropriate disclosures.

16.7 Control risks perhaps refers to rudimentary control checks and mechanisms that result in assurance on robust controls in financial reporting when the situation is otherwise. This assurance often masks the existence of breach of control due to absence of validation controls or matters not visible to the human eye in understanding the deficiencies in organizational governance, compliance, and control mechanisms beyond perception of the auditor or corporate functionary. An auditor may not be able to detect if an employee is receiving “facilitation payment” for favouring a specific vendor

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which could be a fraudulent act, not be recorded in the books of account of the company or a connected party in the chain of monetary transaction for a illegal activity. (Refer Prevention of Corruption (Amendment) Act, 2018 read with the Prevention of Money Laundering Act, 2002)

16.8 This brings to a moot point on persons covered for Reporting on Fraud under Section 143(12) of the Companies Act, 2013:

- Statutory Auditors of the company
- Cost Accountant in practice, conducting cost audit under Section 148 of the Act;
- Company Secretary in practice, conducting secretarial audit under Section 204 of the Act
- Branch Auditor appointed under Section 139 to the extent it relates to the concerned branch
- Internal Auditor

In line with the above, it is imperative that appropriate internal documentary manual is prepared in every organization for defining the Accountability: Authority & Responsibility in the preparation and presentation of the financial statements.

16.9 In any business entity the fissures of financial irregularities are visible when, the avenues to gross up revenue and allocate resources, capital and recover cost seem to be far minimum for individual businesses. The scrutiny of Consolidated Financial Statements and Standalone Financial Statements require utmost professional diligence in ensuring “end-to-end” tracing and tracking of line items in the financial statement. The signatory to the financial statements is primarily held responsible for robust financial controls. A single misstatement can impact the consolidated financial statement of entire business house from a stakeholder’s perspective. With “audit risk” at an all-time high this is the time when Chief Financial Officers would need to take extra care to ensure that the figures are validated not only for the present financial years but preferably of past years too. An error or omission can thus be corrected and restated as per the mandated provisions of Ind AS. The Indian Accounting Standards (Ind AS) require the Companies to reinstate the financial statements (namely the additional 3rd Balance Sheet) in the eventuality of any misstatements in prior years or inadvertent errors in financial reporting. This provides an opportunity to restate the financial

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statements for any material gap in financial reporting, exercised with caution reflecting on the ramifications in other regulatory aspects of statutory compliances, remittances of dues, statutory filings and judicial pronouncements.

16.10 The reported scandals in the financial sector, especially in infrastructure, banking and housing finance companies have brought a chain-link to financial irregularities and it is important to understand the impact of external environment on the veracity of the financial statements. An investigation assignment of tracing monetary trail or related party transactions normally helps in identifying any direct or indirect trail of links to any money laundering activity or diversion of funds by vested interests, of fictitious dealings and even offloading of Non-Performing Assets (NPA) customers by banks through the broker/ dealer/ consulting network acting as a conduit to channelise the bad portfolio as fresh loans in NBFCs records.

16.11 The post recovery measures after any recessionary condition result in manifold increase in loan disbursements and revival packages to boost the economy. There are systemic brakes in monitoring the sanction and deployment of subsidies and this requires a digital integration of the various data points. There is a “Chinese wall” separating the “manufacturing activities” and the “financing activities” that deters a reconciliation of Manufacturing and Retail data. The introduction of GST from on 1st July 2017, has perhaps mitigated this data deficiency and could eventually be an aid to bridge the broken chain-link of multiple financing on the same asset and bring credence to the financial data in the system through an integrated and codified transactional digital trails.

16.12 In accordance with the prudential norms of RBI and Banking Regulations Act, 1949 or under the Companies Act, 2013 and related SEBI guidelines, Bad Debts, Write Offs, Provision for Doubtful debts in any NBFCs or corporate entity could provide a vital clue to veracity of the financial statements. The classification of the heads of account in terms of revenue items and balance sheet items, perhaps needs a scrutiny of the “secret reserves” through “excess customer collections” or “unadjusted receivables” or “unreconciled customer receivables” are areas that require adequate validations through customer confirmations and background checks to affirm the existence of such customers.

16.13 NBFCs are prone to the risk of multiplier effect of funding an asset repeatedly that could result in collapse of the financial system. Such

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transactions are passed through the weakest link in the chain of the banking system in the remotest location of the country where the “intermediaries” have nexus with banking officials and in some countries, these are prone to bypassing the banking procedures and controls, especially in tax havens. In contrast, any surplus money parked in NBFCs customer loan accounts is perhaps a mechanism to hoard black money or else why would a borrower pay in advance money that does not bear any interest.

“A common example of a fraudulent activity is availing of multiple loan transactions with several financial institutions by gross misrepresentations against the same asset. The value of the asset financed, or income of the applicant is misstated to increase the eligibility norms or make up for no down payment resulting in generation of cash proceeds for the perpetrator of fraud, profiting him at the cost of the company (entity).” (Refer Chapter 2)

16.14 Any investigation trail in scrutinizing the Non-Performing Assets of the nationalized banks would eventually lead to investigating the trail of money in tracing and tracking of the assets financed. This exercise could eventually, lead to scrutinizing the disbursal of loans by the NBFCs involving multiple locations of the branches or impersonations or relooking into bailout package offered to the bankers by the Corporate Financiers including the veracity of the securitization of the asset portfolios. This indirect linkage could expose finance companies to fictitious loans or misrepresentation of customer KYCs to avail multiple financing that is comparable to any sub-prime crisis.

16.15 The digital world has brought a new dimension to the “fraudulent acts”, in terms of using surrogate methods and proxies in executing the “wrongdoing” strategies. A web-search of the leading Banks and NBFCs whether in the housing finance, gold loan or even vehicle financing segment, would indicate financial consultants floating start-ups under fictitious names and tend to use the “Corporate Logo” and corporate resembling names and float proprietary or partnership concerns as agencies and make believe websites, as though operating at the behest of the “Banker” or “NBFCs”. Wherever there is an alleged collusion between the banker and such intermediaries, these normally result in diverting company funds to other activities for an interim period and regulate the flow of funds back into the companies accounting system. This nexus results in “fly-by-night operators” using the names of company officials in their “website” and operate like franchisees, chit funds, micro-financing, MSME and without taking due

permissions from the regulator. RBI has periodically issued list of blacklisted NBFCs and Cooperative Banks, the customers do fall into a trap in a digital economy and succumb to the allurements of fancy commissions and convenience services offered by these “operators” and agents. The gullible customer pays their dues or fixed deposit remittances, apply for income tax refunds or NSC refunds and even online investments that are routed through these fictitious entities. The corporate may not have any inkling about these out of books’ operations, and in the event of complaints received from the investors, the company impacted as a matter of defense, largely issue disclaimers in local newspapers “disassociating” with these operators. Reporting these matters to the cyber-crime cell is resorted to by companies to take note of the impact on customers and public at large.

16.16 To the extent there are genuine loan disbursements, any recovery of bad debts written off would add to the profits of the company and be subjected to attracting tax in the year of recovery. Another significant factor that can be a valid cross check is the extent of insurance claims filed, settled and these have distinct impact on the financial disclosures for the banking and NBFCs.

16.17 Normally in reporting to governing boards, an issue is reported through a whistleblower mechanism, or by an informer or employee or through the internal audit process or any matter involving management override of controls. These are collated in the order of criticality and an internal committee that sifts through these issues and arranges them in order of priority. These are subjected to a preliminary examination to verify the authenticity of the issues. Whilst in internal audits the focus is on symptoms and control gaps, in investigative assignments the focus is on curing the “disease”, assessing the damages and assigning accountability on persons responsible for “origination of the disease” and tracing, recognizing, presenting, and safeguarding the evidential trail with designated authorities. Appropriate action taken report and closures form a part of the mandate for any internal audit or investigative assignments.

Ignorance of Law- Not an Excuse

16.18 “Ignorance of law can never be an excuse and therefore a greater awareness for all employees covered under the definition of Officers under section 2(60) of the Companies Act 2013 is imperative in their role as Key Managerial Personnel, Internal Auditor, Cost Auditors, Secretarial Auditors,

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Statutory Auditors. These questions would require a practical understanding of the various terminologies read with penal offences and consequences." Ignorantia juris non excusat or ignorantia legis neminem excusat (Latin for "ignorance of the law excuses not" and "ignorance of law excuses no one") is a legal principle holding that a person who is unaware of a law may not escape liability for violating that law merely because he was unaware of its consequences.

16.19 Annexure I (at the end of this chapter) gives a sample of 350 key questions to enable any Chartered Accountant working on an Investigative Assignment to understand the governance mechanism of a Corporate Entity and a must read from web search of dictionaries or legal glossary of terms on interpretation of statutes, standards, policies, procedures and guidance notes. These questions would help in the investigation process, in report drafting and preparing the charge-sheet or even preliminary assessment or help in defining the scope and mandate for investigation by governing boards. These questions enable the company officials or client, the internal auditors and investigation officials especially Chartered Accountants to seek answers with reference to various laws and regulations and code of ethics documents within an organization and/or issued by the Institute of Chartered Accountants of India in its various publications. The indicative questionnaire to some extent has legal definitions in various statutes and dictionaries, and customary practices in corporates that would help in report drafting or communication procedures in an investigative assignment.

16.20 The above could be supplemented with regular awareness programmes or familiarization programmes on organizational policies, procedures, regulatory norms tuned to business dynamics for employees, business partners, brokers, agents, governing boards, directors and key managerial personal or anyone in the organization who is bestowed with fiduciary responsibilities.

Points to Ponder - News Analysis

16.21 The Economic Times dated November 23, 2019 reported that Ministry of Corporate Affairs (MCA) wants fraud-hit Industrial Solutions Company to restate accounts of the past five fiscal years reflecting the actual financial position of the company, including receivables from companies linked to erstwhile promoter. The new management of the company, soon after the fraud came to light, had on August 30 expressed its desire to restate

financial accounts for the last five years and it will now expedite the process. MCA has filed a petition before the Mumbai-bench of the National Company Law Tribunal (NCLT) seeking permission to re-open the books of account and recast the financial statements of the company and its subsidiary companies for the past five financial years beginning 2014-15.”

16.22 The recent case of a nationalized bank providing LC facilities to a diamond merchant brings to light the need to check the veracity of the top line revenues of corporate entities. Where there is a rolling packing credit, the Nationalized Banks provide a LC drawing limit within which series of export transactions are recorded in the financial statements subject to the billing date, forex impact on currency movement and settlement through honouring the LC by the destination banker of the client.

In Chapter 5, Investigative Tools and Techniques, there is a semblance to what is stated in the above news item relating to international operations, funding, adherence to banking covenants and financial reporting. “The pre-shipment and post-shipment packing credit is an interesting activity for validating the overseas billing and collection process. The accountant may find himself in a situation where the billings done are resulting in stockpile up at the offshore location that may have remained concealed. If the same is done through a distributor or front company, the risk of non-moving stock is a serious cause for concern. Alternatively, the undisclosed sale of stock while sending a pile of stock is a method to fraudulently divert funds. The concessional rate offered for these transactions may not be available for indefinite period and force the accountants to manipulate the debt covenants. Similarly, the same situation may occur when there is no control over movement of stock or debtors by the manufacturer vis-à-vis dealers/distributors or intermediaries. Availing of multiple loans or credit against the debtors or stock is an area of fraud risk concern.”

16.23 In the economic times dated May 16, 2018, there was a reference to “CBI filing charge-sheet against a bank scam. In its charge-sheet filed in the CBI special court, against billionaire jeweller and 17 other entities, including companies owned by him and other individuals, in connection with the over USD 2 billion Bank scam, the agency has slapped charges of criminal conspiracy and cheating under the provisions of the Prevention of Corruption Act. The FIR was lodged based on a complaint from the Bank. According to it, the alleged loss to the bank was over Rs 4,886 crore, arising out of 143 Letters of Undertaking (LoUs) and 224 Foreign Letters of Credit issued to the companies of the diamond merchant. The total loss, allegedly perpetrated by

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the jeweller and his nephew, absconding, was over USD 2 billion. It is alleged that the accused bank officials, in a conspiracy with private persons, had sent the unauthorised LoUs and Foreign Letters of Credit to overseas branches of Indian banks for release of funds to the accused companies' suppliers or to clear the liabilities of the accused companies. The accused Bank officials allegedly did not enter the instructions for these LoUs in their internal software to avoid scrutiny. They were sent through an international messaging system for banking called SWIFT, used to pass instructions among banks globally to transfer funds. In case of default, the bank issuing the LoU has to pay the liability to the credit-giving bank."

16.24 The Economic Times dated September 18, 2019 headlines read "11 years later, the world is still living in the Lehman shadow". (Global central bank balance sheets hover around \$25 trillion, nearly four times the level in 2008.) The shadow of Lehman Brothers continues to loom large on central banks 11 years after the storied Wall Street investment bank foundered, touching off a broader market collapse that sent the world economy into its worst crisis since the Great Depression. Liquidity was the primary tool that central banks had then used to haul their economies out of the subprime sinkhole. That script doesn't seem to have changed much a decade later." And it is imperative to ensure a detailed scrutiny of the KYC documents and cross check of the collaterals offered as security back-up for such sub-prime loans in the portfolio of Bankers and NBFCs that has financed the loan that has gone bad or is declared as a non-starter account, right at the outset when the loan was disbursed.

Annexure I

Illustrative List of Questions that form the edifice of the Governance Risk Compliance mechanisms:

1. What is a disclosure norm?
2. What constitutes misrepresentation?
3. What is fraudulent misrepresentation?
4. What is rescinding a contract?
5. What is enforcing performance of contract?
6. What is fraudulent activity?
7. What is wrongdoing?
8. What is wrongful Gain?
9. What is wrongful loss?
10. What constitutes professional negligence?
11. What is an “act of doing” or “action” (to do) in legal parlance?
12. What is inaction (‘fails to do or not doing’) or passiveness (not to do)?
13. What is internal control?
14. What constitutes breach of internal controls?
15. What is intrusion?
16. What is intrusion detection system?
17. What is unauthorized?
18. What is unauthorized access?
19. What is unauthorized transaction?
20. What constitutes excess authority or exceed one’s authority?
21. What is management override of control?
22. What is ratification?
23. What are the consequences of ratification?
24. What is the remedial action?

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25. What is fraud risk?
26. What is control risk?
27. What is regulatory risk?
28. What is business risk?
29. What is finance risk?
30. What is compliance risk?
31. What is governance risk?
32. What is risk remedy?
33. What is redressal of risk?
34. What is risk appetite?
35. What is residue risk?
36. What is misconduct?
37. What is rule for suspension on misconduct?
38. What is impeachment?
39. What is meant by Termination of Service?
40. What is mistake as distinguished from fraud?
41. What is true and fair view?
42. What is Indemnity Insurance Cover?
43. What is fidelity Insurance Cover?
44. What is disclaimer?
45. What is indemnity?
46. What is limitation clause?
47. What is force majeure?
48. What are liquidated damages?
49. What is liquidation?
50. What is bankruptcy?
51. What is insolvency?

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52. What is line of defense?
53. What is the principle of natural justice?
54. What is conflict of interest?
55. What is beneficial interest?
56. What is express and implied authority?
57. What is related party transaction?
58. What is a penalty under any given statute?
59. What is punishment under any given statute?
60. What is penal offense under any given statute?
61. What is “Fine” under any given statute?
62. What is imprisonment under any given statute?
63. What is a price rigging?
64. What is personal enrichment?
65. What is meant by gratis?
66. What is money trail?
67. What is money laundering?
68. What is anti-money laundering?
69. What is corruption?
70. What are anti-corruption measures?
71. What is insider trading?
72. What is price sensitive information?
73. What is delegation of authority?
74. What is joint and several liabilities?
75. What is personal liability?
76. What is reporting?
77. What is escalation?
78. What is informing?

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79. What is notifying or notification?
80. What is declaring?
81. What is confessing?
82. What is rebutting?
83. What is responding?
84. What is fiduciary responsibility?
85. What is fidelity claim?
86. What are procedural conditions for claiming fidelity claims?
87. What is an alert or a red alert?
88. What is a flash report or confidential report?
89. What is disciplinary proceeding?
90. What is disciplinary action?
91. What is warning?
92. What is a reminder?
93. What is reprimand?
94. What is sermon?
95. What is summon?
96. What is a legal notice?
97. What is a warrant?
98. What are the implications of issuing or receiving a warrant?
99. What is an offense under the Indian Penal Code?
100. What are the immediate procedures when an offense is noticed?
101. What is a civil right?
102. What is meant by right of employees?
103. What is a Constitutional right of Citizens in corporate world?
104. What is freedom of expression?
105. What are the court guidelines and limits on freedom of expression?

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106. What is information?
107. What is data?
108. What is data privacy?
109. What is personal information?
110. What is company information?
111. What is cybercrime?
112. What are digital forensics?
113. What are computer forensics/ computing fraud?
114. What is representation?
115. What is meant by representation to board?
116. What is representation to statutory authority?
117. What is representation to shareholders?
118. What is representation to public?
119. What is statutory filing?
120. What is completeness and accuracy of statutory filings?
121. What is confidentiality?
122. What are the ground rules for sharing or communication of information?
123. What is damage control?
124. What is reputation risk?
125. What are immediate steps or ground rules for safeguarding reputation risk?
126. What is defamation?
127. What is filing a defamation suit?
128. What is authority or designated authority?
129. What is abuse of authority?
130. What are the ground rules for removal of authority?

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131. What is responsibility?
132. What are ground rules of removal of responsibility?
133. What is disaster recovery plan (DRP)?
134. What is a back-up plan for emergencies for disaster recovery management?
135. What is fundamental duty of Indian citizen?
136. What are the rights of Indian Citizen?
137. What is abuse?
138. What is psychological abuse?
139. What is physical abuse?
140. What is verbal abuse?
141. What is abuse of authority?
142. What is abuse of official position?
143. What is office of profit?
144. What is undue advantage?
145. What is breakdown of an Individual or insolvent Individual?
146. What is nervous breakdown?
147. What is hypnosis and state of hypnosis?
148. What is meaning of blanked out?
149. What is psychopath?
150. What is mental disorder?
151. What is psychic?
152. What is lunatic mind in any statute?
153. What is meaning of incapacity in any given statute?
154. What is amnesia?
155. What is selective amnesia?
156. What is meaning of person of unsound mind?

Strengthening Control Environment

157. What is stress?
158. What is hypertension?
159. What is undue pressure?
160. What is demanding as a corrupt practice?
161. What is extracting?
162. What is use of “force”?
163. What is undue influence?
164. What is alluring or temptation?
165. What is entrapment or sting operation?
166. What is compulsion or forced compulsion?
167. What is stretch target from organization perspective?
168. What is an unrealistic target from an organisation perspective?
169. What is meaning of overdrive?
170. What is meaning of financial projections?
171. What is the meaning of forecast or financial forecast?
172. What is the meaning of business outlook?
173. What is the meaning of prospective effect?
174. What is the meaning of retrospective effect?
175. What is the meaning of regression analysis?
176. What is the meaning of budgeted or estimated or planned?
177. What is the meaning of extrapolation?
178. What is the meaning of analogy?
179. What is average, mean, median, standard deviation, variance in analytics?
180. What is the meaning of predictive analytics?
181. What is oppression?
182. What is mismanagement?

Study on Investigative Audits

- 183. What is irregularity?
- 184. What is financial irregularity?
- 185. What is deviation from policy?
- 186. What aberration is from laid down process?
- 187. What is adherence to laid down processes?
- 188. What is non-adherence to laid down processes?
- 189. What is by-passing of processes/ authority/override of authority?
- 190. What is compliance?
- 191. What is non-compliance to laws and regulations?
- 192. What is monitoring of compliance?
- 193. What is meant by validation checks of compliance procedures?
- 194. What is governance?
- 195. What are governance norms?
- 196. What is financial scam/fraud?
- 197. What is propriety?
- 198. What is impropriety?
- 199. What is integrity?
- 200. What is criminal misfeasance?
- 201. What is credibility?
- 202. What is credible information?
- 203. What is meaning of reliable?
- 204. What is meaning of relevant?
- 205. What is ethic?
- 206. What is duress or under duress?
- 207. What is coercion?
- 208. What is imposition?
- 209. What is overpowering?

Strengthening Control Environment

- 210. What is harassment?
- 211. What is cruelty?
- 212. What is mental Harassment?
- 213. What is physical harassment?
- 214. What is deprivation of right?
- 215. What is solitary confinement in office/ at workplace?
- 216. What is Imprisonment or fortified or locked up at workplace?
- 217. What is confession?
- 218. What is submission?
- 219. What is consensus?
- 220. What is compromise?
- 221. What is acceptance?
- 222. What is an “appeal”?
- 223. What is “pleading”?
- 224. What is petition?
- 225. What is writ petition?
- 226. What is mercy petition?
- 227. What is meaning of alleged subject (person)?
- 228. What is meaning of allegedly (referring to person)?
- 229. What is the meaning of accused?
- 230. What is the meaning of witness?
- 231. What is the meaning of informer?
- 232. What is the meaning of informed decision making?
- 233. What is the meaning of grapevine communication?
- 234. What is the meaning proxy operator from a corruption practice?
- 235. What is the meaning of surrogate? Surrogacy from a corrupt practice?

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- 236. What is the meaning of master mind from a wrongdoing perspective?
- 237. What is the meaning of fraudster?
- 238. What is the meaning of fraudulent activity?
- 239. Who has the power and authority under statute to conduct investigations?
- 240. What is a subject matter?
- 241. What is an issue?
- 242. What is “event”?
- 243. What is “occurrence” of an event?
- 244. What is an “instance” or “case” or “matter”?
- 245. What is a “transaction” dealing?
- 246. What is meaning of dealings?
- 247. What is meaning of underhand dealings?
- 248. What is grievance?
- 249. What is grievance addressing procedure?
- 250. What is grievance redressal?
- 251. What is disposal of a matter or case or issue?
- 252. What is closure of a matter or case?
- 253. What is concluding of a matter or case or an issue?
- 254. What is adjudication of an Issue?
- 255. What is Trust between superior and subordinate in an organization?
- 256. What is criminal breach of trust?
- 257. What is abetment?
- 258. What is complicity?
- 259. What is collusion?
- 260. What is allegiance?
- 261. What is nexus?

Strengthening Control Environment

- 262. What is power of influence?
- 263. What is bribe?
- 264. What is bribery?
- 265. What is an act of bribery?
- 266. What is error?
- 267. What is commission of error?
- 268. What is meaning of erroneous?
- 269. What is allegation?
- 270. What is accusation?
- 271. What is compliant?
- 272. What is whistleblowing as distinguished from informing?
- 273. What are rights for a whistle-blower?
- 274. What is fact?
- 275. What is meaning of material facts?
- 276. What is mistake of law in relation to mistake of fact?
- 277. What is evidence?
- 278. What is evidential information?
- 279. What is documentary evidence?
- 280. What is material evidence?
- 281. What is verbal and hearsay evidence?
- 282. What is primary evidence?
- 283. What is secondary evidence?
- 284. What is the meaning of admissibility of evidence?
- 285. What is the meaning of inadmissibility of evidence?
- 286. What is opinion?
- 287. What is inference?
- 288. What is a conclusion or drawing conclusion?

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- 289. What is a trial or a court trial?
- 290. What is a hearing or a court hearing or disciplinary hearing?
- 291. What is a judicial proceeding?
- 292. What is a disciplinary proceeding?
- 293. What is ethical dilemma?
- 294. What is failure to do ones' duty?
- 295. What is inaction as distinguished from procrastination?
- 296. What is deferral of action?
- 297. What is adjournment?
- 298. What is postponement of hearing or court hearing?
- 299. What is impact assessment?
- 300. What is damage assessment?
- 301. What is meaning of consequences?
- 302. What is the meaning of consequential?
- 303. What is examination?
- 304. What is evaluation?
- 305. What is an assessment?
- 306. What is a "test" from an investigation perspective?
- 307. What is meaning of "testimony"?
- 308. What is the meaning of "testimonials"?
- 309. What is the meaning of "collaterals" or "collateral security" or "bond"?
- 310. What is a bail?
- 311. What is anticipatory bail?
- 312. What is contempt of court?
- 313. What is sub-judice?
- 314. What is a scrutiny?
- 315. What is a signatory?

Strengthening Control Environment

- 316. What is authorized signatory?
- 317. What is meaning of approving authority? (in organization)
- 318. What is due diligence?
- 319. What is professional diligence?
- 320. What is reasonable diligence?
- 321. What is financial diligence?
- 322. What is technical due diligence?
- 323. What is legal due diligence? 2
- 324. What is delay as distinguished from time-lag?
- 325. What is procrastination as distinguished from deferral?
- 326. What is denial of rights?
- 327. What is a governing body?
- 328. What is the meaning of powers and rights of governing body?
- 329. What is financial literacy of board members?
- 330. What is meaning of expert and expertise?
- 331. What is the meaning of specialist as distinguished from an expert?
- 332. What is legal and what is illegal?
- 333. What is legal authority or statutory authority?
- 334. What is quasi-judicial authority?
- 335. What is on taking on oath?
- 336. What is oath taking from prosecution proceedings?
- 337. What is First Information Report (FIR) filing with a police authority?
- 338. What is the impact of FIR and what is period of validity of FIR?
- 339. What is quashing of a FIR?
- 340. What is consequence of police compliant?
- 341. What is a legal notice?
- 342. What is a charge sheet filing?

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- 343. What is prosecution?
- 344. What is judicial proceeding?
- 345. What is contempt of court?
- 346. What is court of appropriate jurisdiction?
- 347. What is trial?
- 348. What is expert witness?
- 349. What is affidavit?
- 350. What is filing of an affidavit with notary?

Chapter 17

Setting up an Investigative Audit Cell

Chapter Summary

Faced with advances in technology and growing responsibilities, many Chartered Accountants are bracing themselves for more changes ahead and understand that they must adapt to be effective. The transformation required from the conventional role of an internal auditor to that of a business transformation leader can be modelled as an evolution process, emulating the global trends in offering valued services with an added responsibility of execution excellence conforming to best global practices and Industry Standards. This transformation is a necessity in planning for business continuity and sustainability. That is why when transformations are planned, it's important that Chartered Accountants step up to play a broader role one that includes modelling of desired mind-sets and behaviour in transforming the business itself.

This Chapter deals with nuances of setting up consulting wing in the investigation sphere within a Corporate Entity and role of Chartered Accountants working in Industry to strengthening this internal practice. Where necessary the engaging of experts would further the purpose of engaging practicing Chartered Accountants and management consultants.

Note: Readers are recommended to study the Chapters 1 to 15 for basics, before reading Chapter 17 to 21.

Business Continuity Management and Business Sustainability

17.1 Business Continuity Management (BCM) assumes increasing importance as a specialized niche area of focus and requires the help of Chartered Accountants and finance experts to be adept in managing business disruptions, threats and crisis management. It matches business continuity capabilities and risks. The goal of BCM is to enable any organization to restore critical operational activities, manage

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communications, and minimize financial and other effects of a disaster, business disruption, or other major events.

17.2 This Chapter specifically discusses the definitions of Business Continuity Management (BCM) and Crisis Management (CM), the activities that may be performed by dedicated consultancy wings and investigation services can play beyond the confines of internal audit function before, during, and after a crisis and includes evaluation of key BCM elements. The next Chapters deal with the nuances of operating an Investigative Audit Cell akin to a consulting wing in Corporate Entities and engaging the services of Chartered Accountant firms for investigative audit assignments.

17.3 These methods could vary across corporate entities, Chartered Accountants firms and would vary from an individual proprietary firm handling an investigative Audit assignment to a large contingent of investigation officials. The next chapters deal broadly with the following :

- (a) Fundamentals of Investigative Audit Practice Guide
- (b) Practice Conduct
- (c) Engagement Conduct
- (d) Reporting

17.4 Chapter 21 deals with essentials of entering into an engagement contract as followed globally by leading consulting firms. These are the minimum expected requirements and addendum has been provided in Chapter 19.

17.5 Chapter 22 consists of a specimen Investigative Audit Consulting Engagement Progress Record. This document is designed to be universally applicable but needs to be customized to local laws and regulations and work eco-system.

17.6 Due to wide range in the scope of Investigative Audit Consulting engagements and their reporting, a specimen report has not been included.

17.7 This Guide is not intended to equip personnel to carry out Investigative Auditing. It is anticipated that appropriate training will reinforce the guidance in this document and that it will be supplemented as appropriate with practice material. In this way, the benefits of this Guide could be maximized.

17.8 While the policies are intended to summarize the actions that are

Setting up Investigative Audit Cell

required for Investigative Audit, the material in the remainder of the Guide provides guidance. It is intended to assist, where appropriate, in the interpretations and application of the policies. It is a matter of judgement for the engagement “assignment head” to determine in the circumstances of an assigned Investigative Audit Consulting engagement the way in which each policy is implemented.

17.9 Chapter 18 deals with Introduction to the Investigative Audit Practice Guide as follows:

- Fundamentals
- Policies norms and guidance notes
- Scope of practice

17.10 Chapter 19 deals with following preliminary steps for investigative audits:

- Fundamentals
- Integrity and objectivity
- Engagement acceptance and continuance
- New clients/ assignments

17.11 Chapter 20 deals with Engagement Conduct for investigative audits as follows:

- Fundamentals
- Planning process
- Engagement personnel
- Operational procedures
- Documentation

17.12 Chapter 21 deals with following Reporting Procedures for investigative audits :

- Fundamentals
- Reporting standard norms
- Report content flow

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- Review process – checks and balances
- Expert Evidence and certifications

Chapter 18

Introduction to Investigative Audit Practices Guide

Chapter Summary

This Chapter deals with policy norms and guidance on establishing an investigative audit cell within a corporate entity, a practicing chartered accountancy firm and/ or a consulting firms, and the structural format in reporting, setting up the investigation audit wing and scope of investigative audit practices. Broadly, the coverage of chapter is as under:

- (a) Policy norms and guidance
- (b) Scope of practice

Policies Norms and Guidance

18.1 A global Investigative Committee could be set up under the chairmanship of the Audit Committee of respective business entity to coordinate and support the investigative Consulting practices. One of the principal objectives of the Investigative Consulting Committee is to provide guidance to sub-divisions in each country of operation of the Investigative entity in the provision of Investigative Consulting services that are consistently of the highest quality.

18.2 The purpose of this guide is to help in maintaining the highest quality of in-house client service and minimize the risks in performing Investigative Audit & Consulting engagements. The Guide sets forth investigative policies and provides guidance to be followed in the performance of Investigative Audit & Consulting engagements. This Guide supplements the material found in the Investigative Audit cell's existing Governance Policies, SOPs, Procedures manuals, Code of conduct rules and adherence to internal process documentations or the relevant manual, practice guides used by the sector/ businesses/ entities.

18.3 The policies are stated at the beginning of each relevant chapter of the Guide.

18.4 The policies set out in this Guide should be preferably be made

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mandatory, unless precluded by the law or professional standards, to all Investigative Audit & Consulting engagements planned and could preferably apply to all business areas wherein there is a country specific Investigative Audit & Consulting sub-division. Though this Guide is quite exhaustive Chartered Accountant firms may supplement it with additional policies and guidelines to provide for the following by way of even numbered paragraphs:

- (a) provide guidance on policies adopted, locally, in addition to businesses world-wide policies.
- (b) provide guidance on other requirements, be they professional, legal or regulatory in nature.
- (c) set out guidelines adopted, locally, that are more specific than the world-wide requirements.

18.5 Even-numbered paragraphs may not delete or reduce policies, except with the prior approval by the **Investigative Audit Committee**.

Scope of Investigative Audit Practices

18.6 Investigative Audit Consulting engagements are defined as engagements where one or more defined Investigative Audit & Consulting services are provided within the entity functions or by an independent consulting agency or a Chartered Accountant Firm. An Investigative Audit & Consulting engagement can draw resources from any of the businesses in which Business Group or Industry house has niche industry presence across the globe. In addition, functional expertise may be called upon as appropriate. A high degree of consultation between the legal practitioner and internal professionals is encouraged, if desirable.

18.7 In general, globally leading Investigative Audit & Consulting service providers have specialized focus on the following:

- (a) Advice to Legal Counsel – Assisting the internal legal cell (in-house or of each entity) in gathering and evaluating evidence, determining the relative strengths and weaknesses of a case, and preparing for a trial.
- (b) Expert Opinion – Serving as an expert witness with respect to matters about which the testifier possesses specific, relevant competence.
- (c) Investigations- Conducting special investigations at the request of a client entity or governing boards, its counsel or a regulatory agency, typically (but not exclusively) where fraud has been alleged or is

Introduction to the Investigative Audit Practices Guide

suspected.

- (d) Arbitration and Mediation – Serving as an arbitrator, mediator, expert adjudicator, or as a court-appointed referee in resolving a dispute between parties.
- (e) Insurance Claims- Assisting insurers, adjusters or claimants to quantify insurance claims, such as loss of profits or earnings.
- (f) Asset Tracing- Assisting legal cell, law enforcement agencies, counsel or corporations to identify movements of funds or other assets, typically (but not exclusively) where a defalcation is suspected.
- (g) Document Management services – Assisting counsel in the management of documents to be used in a trial or alternative dispute resolution proceeding, including coding, sorting and retrieval capabilities.
- (h) Court-Ordered Procedures – Carrying out special procedures pursuant to a court or arbitration order, or as a result of an agreement among parties (which may in the Indian Context include government authorities, CBDT, SFIO, SEBI, RBI, IRDA, NHB, TRAI, CID, ED, EOW, ACB or any quasi-judicial authority, public body or NCLT or other committees and boards as appointed by the Tribunals, court, lower and High Court and the Supreme Court of respective country).

18.8 Certain services are specifically excluded from the scope of Investigative Audit & Consulting services:

- Corporate Recovery Services (Corporate Recovery Services are not excluded when they involve any of the services covered in para 18.7) – the firm's corporate recovery cell including operations and legal cell is responsible for providing services to troubled companies and their lenders, and acting as a trustee in bankruptcy proceedings.
- Tax Services – Services relating to presentation before tax authorities relating to tax issues, including assistance to counsel when a dispute between a taxpayer and a taxing authority is expected to arise, are covered by guidance in the Taxation cell of the entity in their Tax manual. That guidance is directed primarily toward instances when the Business Group or Industry houses taxation, finance or secretarial functions are providing consulting or compliance services

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to the respective business/ client Entity.

18.9 An Investigative Audit & Consulting Mentor (or a designated Qualified Accountant or a law graduate) is a natural person who specializes in the providing Investigative Audit & consulting services as defined above. Such a person normally devotes at least fifty percent of his/her time for Investigative Audit & Consulting services.

18.10 It is anticipated that personnel in other areas of functional discipline of Business Group or Industry house will, occasionally, serve as expert witnesses regarding the application of accounting or auditing principles in specified circumstances. In these instances, although consultation with Investigative Audit & Consulting Mentor is recommended, it is not required.

Chapter 19

Engagement Practices and Conduct

Chapter Summary

This chapter deals with the operational modalities within an inhouse investigation cell (by whatever name called) in a corporate entity, including practicing chartered accountancy firms and consulting business entities, that are required to comply with policy norms and engagement practices before accepting or commencing an investigative audit. Comply with all applicable policies as may, from time to time, be adopted by the proposed **“Investigative Audit & Consultancy Board”**. Comply with policies relating to integrity and objectivity and engagement acceptance and continuance. Client entity in this chapter to include department, functions or specific activities in a corporate entity.

Prior to the acceptance of any Investigative Audit & Consulting engagement a thorough review is performed to determine whether a conflict of interest exists. An Independent Director of governing board as Investigative Audit & Consulting Mentor is preferably involved in each Investigative Audit & Consulting engagement. A concurring Board Member of the Audit Committee as Concurring Mentor could be appointed for each Investigative Audit & Consulting engagement. A written engagement contract, signed by the entity client or counsel, is preferably, obtained to document the role and the responsibilities to be undertaken and the terms and conditions under which they are undertaken.

Fundamentals

19.1 This Chapter covers the following:

- (a) Integrity and objectivity
- (b) Engagement acceptance and continuance
- (c) Engagement contracts

Integrity and Objectivity

19.2 Investigative Audit Cell has established policies regarding integrity and objectivity enshrined in its Core Ethos and work philosophy. Each Key Managerial Personnel and personnel is bound by these codes of conduct and compliance procedures. Similarly, each Investigative Audit & Consulting Mentor, Investigative Audit & Consulting Personnel and professional staff member engaged in an Investigative Audit & Consulting engagement is required to be aware of, and comply with, these policies and procedures.

19.3 Modern litigation is often conducted by a team. Investigative Audit & Consulting practitioners play a constructive role on the team while maintaining the necessary objectivity. In order to maintain objectivity, Investigative Audit & Consulting practitioners involved in Investigative Audit & Consulting engagements ought to comply with following:

- (a) It is preferable to follow the engagement acceptance and continuance policies outlined in this guide
- (b) Maintain control over the selection of techniques and methodologies; the timing and extent of their application.
- (c) Have access to all relevant records that are available or identify scope limitations where access is denied.
- (d) Maintain control over the content and tone of their report.

Engagement Acceptance and Continuance

19.4 The Manual or the relevant manual/ policy documents/ practice guides/SOP/used by the member entities outline general quality performance considerations for evaluating prospective entity clients. The Risk Management Guidelines and the F&A/ Internal Audit service manual or the relevant manual/ SOP/Practice guide used by the member entities across any business address adequately evaluating prospective and continuing entity clients from the angle of Related Party Entity, Arm's Length Pricing, Transfer Pricing, Governing Board members, CFOs and cross functional relationships are evaluated to weed out any form of conflict or threat arising out of code of conduct rules under the professional guidelines or organizational guidelines or regulatory guidelines or any litigation matter or cross liability issues in terms of business relationships with such entities. Although much of the guidelines in the aforementioned sources specifically addresses Investigative Audit Cell of the entity client's acceptance and

continuance, the guidelines can be and has been extended to non-audit and accounting situations as rendered by Internal audit, IT, Secretarial, Finance, Taxation, Indirect Taxation, Consolidation of Accounts and any other services involving cloud computing or any other form of consulting or as member of governing boards of outsourced situations.

New Clients/ Assignments (Investigative Audit Cell of Entity)

Conflict of Interest

19.5 Additional guidance for Investigative Audit & Consulting engagements is covered in this heading.

19.6 If engagement mentor becomes aware of a potential conflict or business-related issue that was not known when the engagement was accepted, the engagement mentor would consider whether the matter should be disclosed to counsel or cleared within Investigative Audit Cell. The engagement mentor follows the appropriate steps of clearance in accordance with the policies of the engaging business entity (and that of the Governing Board of the investigative audit cell).

Investigative Audit Cell's Competence

19.7 Prior to the acceptance of any Investigative Audit & Consulting engagement it is necessary to obtain from the client entity or counsel enough information about the issues involved to assess whether Investigative Audit Cell has the relevant expertise and a suitable engagement mentor is available. It needs to be borne in mind that the credentials of an expert witness may be examined or challenged prior to their producing evidence in court.

19.8 An Investigative Audit & Consulting Mentor is appointed for each Investigative Audit & Consulting engagement, usually as engagement mentor, or as concurring mentor.

Other Matters

19.9 Where work is referred from another Investigative Audit & Consulting Sub-Division (Country Specific for MNCs) or an independent Chartered Accountancy Firm or parent company or a subsidiary, it is responsibility of the referring Country's or such other division's or firm's or entity's

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Investigative Consulting Sub-Division's Mentor or the business entity KMPs/ Independent Director of that country to carry out appropriate entity client acceptance procedures. It is incumbent upon the Mentor to whom the work is referred to confirm that appropriate client acceptance procedures have been carried out by the referring mentor/ entity officials.

19.10 The adequacy of the fees (cost debits within entity functions) and the client's ability to pay the fees or absorb the cost debits/ allocations are considered by the engagement mentor before accepting the engagement. The fee and contracts and engagement acceptance procedures bring credibility to the Investigative Audit Consulting wing or practice akin to that performed by a professional independent consulting agency under the auspices of governing boards and audit committees within the legal realm.

19.11 The client evaluation process is appropriately completed in accordance with the policies of the code of ethics of the Institute of Chartered Accountants of India and other regulatory requirements.

Entity Client Continuance

19.12 During an engagement, the engagement mentor may have cause to re-evaluate the relationship with the client. Situations which may lead to a re-evaluation include:

- (a) The initial results of a preliminary assessment in an investigation indicate the involvement of a previously unidentified third party who had put Businesses or entity into conflict.
- (b) Continued association with the conduct of the entity client assignment would damage the reputation of Investigative Audit Cell or Business entity.
- (c) The engagement mentor believes that the client is withholding important information or providing incomplete or misleading information.

19.13 Where a re-evaluation of a client relationship takes place, the policies of the member entities of the group and code of ethics of the Institute of Chartered Accountants are followed.

Engagement Letters and Contracts

19.14 The Investigative Audit Cell's -Risk Management Guidance or the

relevant manual/ practice guide used by the member firm contains general guidance regarding the definition of engagement terms in an engagement contract. This section provides additional guidance for Investigative Audit Consulting engagement contracts.

19.15 An engagement contract defines the terms of the Investigative Audit Consulting engagement as agreed with the client entity or counsel. Use of an engagement contract is in the interests of Investigative Audit Cell and the client entity as it helps to avoid misunderstandings as to the functional roles and responsibilities.

19.16 Appendix A to this technical guide sets out investigative audit cell's minimum requirements for an engagement contract. An engagement contract in respect of an investigative audit consulting engagement will usually refer to (at the discretion of the engagement mentor) the following:

- (a) The identity of the entity client engaging investigative audit cell (for example, is it the company directly or the company's counsel?);
- (b) The individual with whom investigative audit cell s would liaise;
- (c) The subject matter of the engagement and the client's purpose for the engagement
- (d) The scope of the engagement and any limitations on scope.
- (e) The level of confidentiality required as between the various parties to the engagement.
- (f) The timetable and allocation of responsibilities between investigative audit cell, the entity client and any other involved parties.
- (g) The fee structure or fee estimate and who is responsible for payment of fees.
- (h) The nature, extent, purpose, and distribution of reports;
- (i) Entity Client's acknowledgement of the terms of the engagement and where necessary the terms relatable to the mandate given by the Audit committee of the entity client.

19.17 It is recommended that disclaimers and restrictions, if any, to be included in the final report be described in the engagement contract.

19.18 Where permitted by the member country (Business Group or Industry house) professional standards and laws, the engagement mentor usually obtains an indemnity from the client, or relevant third party, to cover the

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following:

- (a) Any costs incurred by Investigative audit cell as a result of the Client Entity or its employees being summoned to testify regarding related matters under review by law enforcement agencies or others;
- (b) Any costs incurred by Investigative audit cell, at the request of the client, to seek protection against disclosure of summoned materials in the possession, custody or control of Investigative audit cell.
- (c) Claims, demands, suits or other proceedings against Investigative audit cell or practicing Chartered Accountants for damages, losses, costs, liabilities or expenses, including reasonable fees and expenses of counsel that may be incurred by Investigative Audit & Consulting Cell in defending any such claims, that may arise out of the engagement. This indemnity would not apply if the investigative audit & consulting cell is found to have been grossly negligent, dishonest or to have committed a fraudulent act in the course of the engagement and if such damages, losses, costs, liabilities or expenses would not have been arisen but for such gross negligence, dishonestly or fraud.

19.19 The engagement contract usually contains an appropriate limitation of liability on the part of Investigative audit cell for losses resulting from negligence.

19.20 If it becomes apparent that the scope of the work has changed such that the original engagement contract is no longer adequate, the terms of the revised engagement are required to be confirmed in writing, the client is notified immediately, and agreement is in writing on the revised terms.

Chapter 20

Engagement Conduct

Chapter Summary

This chapter deals with engagement conduct and mention that investigative audits should be carried out in accordance with the Standards which are, equivalent to those stipulated by the laws governing the jurisdiction of the action and in the context of Indian conditions, with a reference to guidance notes, technical guides and other auditing and accounting publications including Standards on Forensic Accounting and Investigation services, prescribed by the Institute of Chartered Accountants of India . Investigative audit engagements should be properly planned and approved by the engagement mentor. Engagement personnel ought to possess appropriate skills and competence to properly carry out the work for which they are responsible. Engagement personnel should be supervised by the person at a higher level of responsibility to ensure that they carry out their specific responsibilities thoroughly and effectively. Sufficient and appropriate documentation ought to be maintained for evidentiary purposes and to support findings on investigative audit engagements.

Access over documents and files should be restricted and strict control ought to be maintained over them.

Fundamentals

20.1 This section provides guidance on following aspects:

- Planning process
- Engagement personnel
- Operational procedures
- documentation

Planning Process

20.2 Proper engagement planning, by understanding the salient issues of the engagement, provides the opportunity to identify, at an early stage, problems which may arise during the engagement.

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20.3 Planning an engagement requires the following matters to be considered:

- (a) Obtaining adequate knowledge of the client's business; work ecosystem, people, process and technological infrastructure, the maturity level of internal controls and size of market share and power centres.
- (b) Obtaining an understanding of the nature of the legal action and its background:
 - i) Understanding the client's purpose, expectations, needs with respect to the engagement.
 - ii) Considering what expertise is required for the engagement.
 - iii) Reporting options such as opinion report, other report, oral report, or affidavit.

20.4 When planning an investigative audit engagement, the following additional matters should be considered:

- Securing relevant information, including computer records;
- Assisting the client to manage the turmoil typically associated with an investigation
- Determining whether decisions made by the client not to investigate certain issues will limit investigator's ability to reach proper conclusions.

20.5 An Investigative Audit Engagement Progress Record is used on all investigative audit engagements as a global best practices in the Industry. Appendix I & II (in Chapter 22) provides a suggestive list that can be tailored to specific requirements. The sections are completed as the engagement progresses.

20.6 The form of any additional planning documentation will depend on the nature of the engagement, the personal preference of the individual performing the planning exercise, and the judgement of the engagement mentor. The engagement mentor should document his or her approval of the planning process on the Investigative Audit Engagement Progress Record.

20.7 As the objectives of investigative audit engagements often evolve over time as additional information becomes available, the engagement approach may require revision. The form of documentation of amendments to the engagement approach will depend on the personal preference of the

engagement mentor. Approval of substantive changes in approach is documented by the engagement mentor. When it is anticipated that the engagement will extend over several years, consider documenting the reasons for changes in engagement approach.

Engagement Personnel - Expertise & Specialisation

20.8 The engagement is performed, and the report prepared by professionals having appropriate technical training and proficiency in investigative audit work, with due care and an objective state of mind.

Training

20.9 All mentors and staff are responsible for adhering to the education and training requirements as set out by their professional bodies and the Investigative Audit Cell Manual or the relevant manual/ SOP/ Practice guide used by the Country level Sub- Division.

External Consultants & Specialists

20.10 When the work of an external expert or specialist is used to support the Investigative audit findings, reasonable assurance is obtained concerning the expert's/ specialists reputation for competence.

20.11 When the external expert or specialist submits his findings, and reliance is placed on these findings by client management or any other authorized authority. For investigative audit, to rely on those findings, following steps need to be taken:

- (a) There is a need to evaluate whether the expert's findings are reasonable based on the investigative Audit Cell's knowledge of the client's business and knowledge of the methods, assumptions and source data used by the expert/ specialist.
- (b) There is a need to assess whether all relevant documentation was provided to the expert/ specialist and whether the expert's findings are based on complete information.

Legal Counsel

20.12 Legal issues affecting Investigative Audit Cell are dealt with in

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Business Group or Industry house's best interests through full and timely consultation with (in-house) legal counsel when circumstances arise on an engagement which could lead to legal action being commenced against investigative audit cell.

Operational Procedures

20.13 The Investigative audit assignment may involve assisting lawyers in identifying documents which are relevant to the dispute. If engaged to do so, the Investigative audit practitioner/staff or personnel would need to review any documentation provided by the other parties to identify documents and classes of documents which have not been provided but which may be relevant.

20.14 The client is kept informed of the status of the engagement.

Supervision of the Engagements

20.15 Engagement staff/ personnel on investigative audit assignments would need to be properly supervised by appropriately qualified personnel. Appropriate supervision involves the following:

- (a) Directing engagement personnel to determine that they understand the scope of the engagement as a whole and the procedures to be performed by them.
- (b) Monitoring the work performed throughout the engagement and determining whether appropriate procedures have been properly performed.

Review of Investigative Audit Work

20.16 Work is reviewed by an appropriate level of personnel to determine that the results of the procedures provide proper support for conclusions reached and that no essential procedures have been omitted or important conclusions overlooked. This process is followed for correspondence, schedules, reports and other communications to clients.

“Salient Features” of the Investigative Audit Engagement Progress Record

20.17 The review process is documented, where applicable, on the

Investigative Audit Engagement Progress Record.

20.18 The Investigative Audit Engagement Progress Record contains sections designed to record important points in key areas of the engagement, particularly those relating to the objectives of the work undertaken (referred to as “salient features”) for review by and discussion with the engagement mentor. Where applicable, these notes are prepared as necessary and the engagement mentor signs the Investigative Audit Engagement Progress Record to indicate that the salient features have been adequately considered in the preparation of the report.

20.19 When completing the Investigative Audit Engagement Progress Record the engagement team should bear in mind that opposing counsel may gain access to this document.

Review by the Engagement Mentor

20.20 The engagement mentor determines that the policies relating to supervision and review have been followed to confirm that the work performed provides sufficient and appropriate evidence to support the conclusions reached.

Documentation

20.21 The nature of Investigative Audit work is such that an engagement may extend over several years. As staff continuity is not always possible, it is important that working paper files are prepared and are complete. Documents that may be useful include:

- (a) A chronology of events relevant to the dispute
- (b) A list of the individuals involved in the engagement, their contact details and their respective roles.
- (c) A list of the other parties to the legal action and the key members of each litigation team.

20.22 Schedules and working papers should be prepared comprehensive and complete as possible to enable the reader to understand the contents with ease and understanding. Schedules must be clearly labelled to indicate from where figures came and their meaning as well.

20.23 Assumptions made during the engagement and the reasons for

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making these assumptions should be documented.

20.24 The guidance provided in the remaining sections of this chapter is not intended to override the policies of regulatory guidelines with respect to documentation.

Access of Opposing Counsel to Investigative Audit Cell Working Papers

20.25 It is prudent for engagement mentors to assume that Investigative Audit cell working papers and computer records may be accessible to the opposing counsel during the litigation process.

20.26 Where interim or draft final reports are issued to the client, copies are retained or discarded in accordance with the policies of the member Investigative Audit sub-divisions at country level (in case of MNCs). Where such reports are retained, the engagement file will ordinarily contain copies of each report and document the reasons for any changes between interim or draft reports and the final report issued. It is expected working copies of reports, which are not distributed outside the engagement team, will not be retained in the engagement file.

Meetings with the Client

20.27 Verbal comments and opinions on matters of substance are confirmed in writing as soon as is practicable.

20.28 The engagement mentor considers the need to confirm the content of meeting notes with the client when matters of major importance or significance are discussed at meetings.

Interviews or Questioning Sessions

20.29 Hand-written notes taken at, or after, interviews are retained in the engagement file. Contemporaneous notes will usually record the date and time of the meeting, the date and time of preparation of the notes, and the details of the discussion.

20.30 Interview or questionnaire documentation includes the original questions prepared for an interview and any documents referred to during the interview.

Telephonic Conversations

20.31 Notes of external telephone conversations relating to an engagement

are retained, particularly when important matters are discussed during a telephone conversation between the client and personnel.

Internal Discussions and Communications

20.32 Important matters regarding an engagement, which are raised during internal discussions and communications, are recorded in a memorandum and retained in the engagement file.

Judicial Proceedings

20.33 Where a representative of Investigative Audit cell gives expert evidence in connection with the engagement, a copy of the court judgement is included in the engagement file.

Documentary Control

20.34 Investigative Audit engagements must be entered into with a clear realization that the work carried out may be produced in court as evidence. Original documents in auditor's possession remain confidential, except as required by law or court order, and are safeguarded from loss, alteration or destruction. For investigative engagements consideration is given to recording the source of each document when it is obtained. Copies of original documentation remain confidential, except as required by law or Court order, and are kept safe and secure.

20.35 Documentation produced by the engagement team during the engagement is kept secure. Files maintained on computers are protected from unauthorized access to safeguard integrity and confidentiality of the information contained therein.

20.36 Documents deemed no longer necessary for the engagement should be discarded as to maintain their confidentiality.

Retention of Documents

20.37 Documents are retained by Investigative cell in accordance with legal requirements for business record retention and the policies of the member country level Investigative sub-divisions. Where an engagement involves a regulatory authority, any specific documentation requirements of the regulatory body are considered.

20.38 It is recommended that a policy for retention of Investigative documents is formulated, documented and followed by each practice in compliance with the above requirements. It is anticipated that this policy would consider retention periods for:

- (a) Matters which are not completely resolved; and

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- (b) Matters which have been settled and there is no expectation of further litigation.

Chapter 21

Reporting Norms

Chapter Summary

In a corporate entity, the governing boards and the audit committee stipulates the norms of reporting in consultation with the management who are responsible for fraud risk management in a corporate entity (Refer Chapter 3).

It is an establish practice in industry, across global consulting firm, that information transmitted in any form clearly communicates the degree of responsibility that is assumed (unless there is no possibility for misunderstanding as to the nature of the information and the degree of responsibility assumed).

The reporting norms include appropriate restrictions on publication, circulation or distribution to parties other than those to whom they are addressed.

Apart from internal communication within the corporate entity of the inhouse investigation audit cell, (including of practicing chartered accountants, management consulting firms), external communications are reviewed by individuals with an appropriate level of experience and authority.

It is of paramount importance that “Expert testimony” on behalf of Investigative audit cell is provided by the persons who possess the necessary expertise and competence to do so.

Fundamentals

21.1 This section provides guidance on:

- (a) General reporting guidelines
- (b) Report content related matters
- (c) Review process
- (d) Expert evidence

General Reporting Standards

21.2 All information and documentation generated by the Investigative services may ultimately be presented in a court of law. All communications, whether by report, letter, email, mobile applications, websites or in any other communication medium, are drafted as if they were external communications of findings to avoid the danger that information may be misinterpreted.

21.3 The basis of any information transmitted to a client or other party in any form is clearly explained and the degree of responsibility by the firm clearly communicated. Any responsibility assumed by Investigative cell is repeated in all correspondence to the client, or alternatively, reference is made to the engagement contract or other document in which Investigative cell's responsibility is set out.

Signing Authority

21.4 Where an individual other than the engagement mentor gives expert testimony on behalf of the Business Group or Industry house, the engagement mentor will consider the appropriateness of the expert witness.

Presentations and Oral Reports

21.5 After oral presentations or discussions, an engagement team member will usually prepare a written record of the matters covered (including caveats). Wherever there is any subsequent follow-up, by letter, mobile application, short text messages, flash reports, red alerts or any verbal or any mode of gathering information or through whistleblowers or informers, all the caveats mentioned orally are repeated in writing. This typically follows the norms typically followed by lawyers in their profession.

Interim Reports

21.6 Where interim reports are issued prior to the completion of the engagement, the danger always exists that the recipient may place reliance on the report to an extent that is unwarranted in the context of the stage of completeness of the work. This danger can often be compounded if the client believes they have obtained comfort as a result of discussions or oral presentations about the engagement findings or report content. Therefore, it is important that the status of interim reports is clearly set out, and communicated to, the recipient in writing (for example, by a statement of the

status of the interim report in the covering letter and dating and stamping each page of the report as “Interim Report”). An explanatory transmittal letter to accompany any interim report is recommended and, where used, the interim report refers to the transmittal letter (for example, in a footnote on each page of the interim report)

Professional Standards

21.7 Care should be exercised to ensure that Investigative Audit Cell does not (or does not appear to), express an unqualified opinion where the work performed is insufficient to meet the professional definition of “opinion”.

Report Content

21.8 Reports must be customized to the circumstances of the “case”. It is important, however, that the report is free (and on the face of it or in contents appears to be free), from bias and prejudice. Reports are structured logically, to enable non-experts to easily understand the issues involved. Frequently, these readers have a limited knowledge of accounting, taxation or other similar technical areas.

21.9 The report includes details of the terms of the engagement as set out in the engagement contract. Specifically, the report:

- (a) Clearly indicates the client and the recipients of the report
- (b) Makes clear the purposes for which it has been prepared
- (c) Includes appropriate restrictions to prevent the use of the report for purposes other than those specified
- (d) Clearly sets out the salient background facts of the matter as understood by the Investigative practitioner and the issues at dispute to which the report is addressed.
- (e) Sets out the documentation reviewed and relied upon.
- (f) Sets out other procedures performed including interviews conducted (Refer Chapter 10)
- (g) Clearly sets out the key assumptions upon which conclusions are based.
- (h) Sets out any limitations imposed on our engagement. This will include

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details of all documentation requested but not available. To the extent that this information may have a material impact upon conclusions and work, an appropriate warning is included;

- (i) Is comprehensible to a non-expert, technical terms should be adequately explained.
- (j) Expresses clear and unambiguous conclusions;
- (k) Clearly mentions the date of issue. Consideration may be given to dating every page of the report.

21.10 Where material facts are in dispute, it may be appropriate to provide findings based on each alternate version of the facts or application of key assumptions.

21.11 Schedules, appendices and any other forms of addenda is cross-referenced to the main report.

21.12 When appropriate, the content of the report is discussed with the client and their lawyers prior to issuance. During this review any factual inaccuracies may be corrected. While the expert may consider points made by clients or lawyers in connection with their review of a draft report, care is taken not to compromise objectivity and integrity. The expert must be able to defend his conclusions and the underlying facts of the matter in a court.

Commenting on the Reports of Other Experts

21.13 Where expert reports are exchanged, Investigative cell may be asked to carry out a critical examination of the findings of an expert retained by another party to the dispute. The Standards mentioned herein are applicable to the Critique of the other expert's report.

Review Process

21.14 In general, the engagement mentors reviews any report (in any form) issued regarding the engagement.

21.15 It is the engagement mentor's responsibility to determine that the report and any opinion expressed therein do not conflict with any stated policy of the firm.

21.16 Where tax or other critical technical issues are referred to in the report, or are thought to be involved, these are preferably reviewed by the

tax or other appropriate professionals.

Concurring Mentor Review

21.17 Unless circumstances warrant a higher level of involvement, the concurring mentor's responsibility is to review reports, including interim and draft reports, prior to their issuance and to concur with the engagement mentor. It is the responsibility of the concurring mentor to determine that:

- (a) The report is supported by facts;
- (b) The conclusions reached are appropriate;
- (c) The report appears logical and clear to a reasonably informed, but uninvolved, reader.
- (d) Proof reading is done to ensure that it is grammatically correct and expressions used are in order and legally tenable.

21.18 In limited circumstances, where the engagement mentor and the concurring mentor agree that review of a report by concurring mentor is not required, their decision and the reasons therefore are documented in the Investigative Engagement Progress Record.

Expert Evidence

21.19 The role of an expert witness in legal or quasi-legal proceedings may be distinguished from that of a witness of fact in that the expert is called solely to either:

- (a) Express an independent and objective opinion in his own area of expertise; or
- (b) Assist the court in relation to matters within his area of expertise.

21.20 The expert does not adopt a partisan or advocacy approach in the formulation of his opinion.

21.21 It is anticipated that the engagement mentor will usually give expert testimony on behalf of Investigative Audit & Consulting cell. However, final decision as to the most appropriate individual to give expert opinion evidence is left to the judgement of the engagement mentor following consultation with the concurring mentor.

21.22 The engagement mentor is responsible for determining that the person who gives expert testimony on behalf of Investigative Audit &

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Consulting Cell has:

- (a) appropriate qualifications, experience and technical skills
- (b) an in-depth knowledge of the facts of the case
- (c) demonstrated strong oral communication skills for arguments, presentation in judicial proceedings.
- (d) an understanding of courtroom procedures, practices, processes and conventions.

21.23 Care is exercised by the expert to ensure that the current and one of the testimonies given conforms to that of the report. In particular, the expert does not express an opinion where the extent of work performed is insufficient to support an opinion.

21.24 The Manual or the relevant manual/ practice guide used by the member sub-division at country level describes circumstances where Investigative practitioners will not, generally, accept an assignment to act as an expert witness.

Key Components of an Engagement Contract

(Suggested for being considered by CA firms or Investigative Audit Cells)

It is a recommendation to the appropriate committee for investigative assignments as aforesaid (namely the Audit Committee, Ethics Committee or any other governing body) that Business Group or Industry house mandate that all the Investigative Audit Cell engagements be subject to a written contract or inter office memo or such other document as appropriate from a legal perspective admissible in a court of appropriate jurisdiction. It is recommended that, as a minimum, the written contract should include the following:

1. Identity of Investigative Audit Cell, Executives and External Firms or Contracting Entities

It is assumed that there will be a letterhead or other identifier as to the Entity engaging the services of Investigative Audit Cell.

2. Identity of the Client Entity

Particular attention needs to be paid where there is a Business Group or Industry house as to the exact client entity and if there is more

than one organization as parties to the contract.

3. Terms of Reference

Limitations in the scope of the work should be expressly set out in the contract. The engagement letter should be capable of being read on a standalone basis and there should not be any reference to a proposed document.

4. Scope of Work

If terms of reference do not fully set out the various components of the work that will be performed then the scope should be very carefully defined in this section.

5. Timetable

This would cover the communications and the termination dates for the assignment.

6. Responsibilities of the Client

This should spell out the information which is required and access which should be made available as well as any other tasks taken up by the client. If appropriate this would extend to representations made.

7. Confidentiality

It is important to define very carefully what amounts to confidential information. Investigative cell may be concerned about an obligation to return documents and about any over-ride to confidentiality through legal obligations. Non-disclosure agreements could be an added feature depending upon the nature of assignment.

8. Restrictions on Services

Care should be taken if there is an attempt to limit the work which the Investigative Audit Cell might undertake for other clients as a result of this contract including adherence to the code of ethics guidelines of the Institute of Chartered Accountants of India.

9. Fees

The currency in which payment or cost debits or transfer pricing regulations are at arm's length keeping the independent structure of

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the investigative audit cell should be set out and there may need to be clear to whether the fees are net or gross of any withholding taxes or goods and services tax (as applicable).

10. Engagement Team

It will usually be desirable to set out who will be undertaking the work for the client.

11. Limitation of Liability

Investigative cell policy is that a cap or limit of liability should be included in every engagement contract. There may be exceptions because of the operation of law and there may be unfair contract provisions which have to be adhered to. In no event, shall Investigative cells be liable for consequential, incidental or indirect damages. Where appropriate, attempts should be made to obtain an indemnity from the client.

12. Law and Jurisdiction

The contract should make it clear as to which law governs the agreement and where jurisdiction issue may be arise in connection with arbitration and dispute resolution and matters that relate to the local laws and regulations where under investigation assignment is carried out or entity is registered or the control of the entity or principal place of business exists.

13. Entire Agreement and Modifications to Contract

The engagement contract should provide that it constitutes the entire agreement and that all modifications are to be in writing and signed by the appropriate parties.

14. Acceptance of Agreement

The contract should be provided with an “acceptance” copy which the client or Head of the function or the entity or a representative of the Investigative Audit Cell engaging outsourced Chartered Accountancy Firms for Investigative Audits. The acceptance could in a formal manner and the parties should sign and indicate that they agree and accept it. It could be via e-mail or in any other legally acceptable manner.

NOTES:

1. The contract cannot grant “exclusivity” which commits other member Sub-Divisions at a country level without the express agreement of the affected Investigative cell Sub-divisions.
2. Contracts for large, high risk or complex engagements should be reviewed by legal counsel or the Investigative cell member for the sub-divisions. If issues arise with this document, refer to Business Head Quarters of the Principal authority of the investigative audit cell to see if limited assistance could be obtained from the General Counsel’s office or Contracts Business Group or Industry house of one of the major Investigative audit services.

Chapter 22

Document Retention and Handover Norms

Chapter Summary

The documentations standards stipulated by the Institute of Chartered Accountants of India, USFDA, ISO9000 or any other excellence framework, do cover aspects of retention, preservation, custodians and relying on the work of an expert. In addition, there are regulatory guidelines on retention of documents, records where substance and form are required to be given adequate attention. Hence proper handover of documents and adequate sign off procedures are essential to documentation procedures.

22.1 There is an element of Investigative Audit in any merger, demerger, business process reengineering, integrity checks, due diligence reviews, vulnerability assessment and require appropriate documentation backup as evidential information. Documentation retention clauses are contained in various statics like the Prevention of Money Laundering Act, Companies Act or even under Insurance Act. Each of these situations requires appropriate independent validation check procedures whether it is change in technology, migration of data, transfer of roles & responsibilities or redefining an entire business process. This raises the significance of independent “due diligence” checks in conduct of investigative audit assignments, especially in profiling actions, decisions, documentary trails and representations that there is no override of controls.

22.2 The documentation needs of an investigation audit are no different from what is stated in Implementation Guide to Standard on Auditing (SA) 230 Audit Documentation (Revised 2018), except that placed on Indian Evidence Act, 1872 on capture of evidential information and retention procedures for ease of retrievals and presentation to management of the client and in court proceedings. An extract from the Implementation Guide to Standard on Auditing is reproduced below tuned to an investigative audit:

- (a) An investigation personnel, staff or auditor, during his Investigative audit may come across various materials in the form of deeds,

Document Retention and Handover Norms

agreements, contracts, invoices, vouchers, etc. which are the supporting materials to evidence the happening of an event/transaction. These are the basis for him to satisfy (or not to) himself in material aspects as to whether the financial statements give a true and fair view of the state of the affairs of the business and of the profit and loss for that period.

- (b) A document is any material which provides evidence of work performed, action taken or the happening of an event. It may be in paper or electronic form. Examples of documents include work papers, copy or abstract of signed agreements, videos, pictures, spreadsheets, transcripts, correspondences, data in electronic form containing the records in systemic manner etc. (for a detailed reading of the Implementation Guide click the weblink. <https://resource.cdn.icai.org/52985aasb42474.pdf>)
- (c) SA 230, “Audit Documentation” defines audit documentation as “The record of audit procedures performed, relevant audit evidence obtained, and conclusions, the auditor reached (terms such as “working papers” or “work papers” are sometimes used”).
- (d) Hence, “document”, in the context of audit refers more to that which is required to be maintained by an auditor to record his findings during the investigative audit.
- (e) Documentation is considered as the backbone of an investigative audit. The work that the auditor performs, the explanations given to the auditor, the conclusions arrived at, are all evidenced by documentation. Poor documentation may depict poor performance in an audit. The auditor may have executed appropriate audit procedures, but, if there is no documentation to prove and any material misstatement is reported, work done may become questionable. Improper and incomplete documentation, at times, may put the auditor in embarrassing situations and defeat the core purpose of investigation.
- (f) Documentation is essential because:
 - (i) It supports the auditor’s basis for a conclusion about achieving the audit’s objectives.
 - (ii) Provides evidence that audit was planned and performed.

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- (iii) It assists in supervision and review.
 - (iv) It results in better conceptual clarity as well as clarity of thought and expression.
 - (v) It facilitates better understanding and helps to avoid misconceptions.
 - (vi) It supports and evidences compliance with standards, applicable legal & regulatory requirements.
- (g) The form and content of investigative audit documentation should be designed to meet the circumstances as necessary for the particular audit. It should satisfy the requirements of the governing standards and substantiate the conclusions drawn at by the auditor.
- (h) The form and content of documentation depends on various factors such as:
 - i. Size, nature and type of entity.
 - ii. Risk assessment.
 - iii. Materiality.
 - iv. Sampling methods, etc.
- (i) Documents are segregated into those forming part of the Permanent Audit File and Current Audit File. Permanent audit file contains those documents, the use of which is not restricted to one time period and extends to subsequent audits. e.g. Engagement letter, communication with previous auditor, Memorandum of Association, Articles of Association, organization structure, List of directors/partners/trustees/bankers/ lawyers, etc. On the other hand, a current audit file contains those documents relevant for that time period of audit.
- (j) Documentation includes the following:
 - i. Understanding the entity.
 - ii. Time and cost constraints.
 - iii. Audit programme.
 - iv. Risk assessment.

Document Retention and Handover Norms

- v. Team discussion.
 - vi. Working papers pertaining to significant areas.
 - vii. Review points.
 - viii. Communication with those charged with governance.
 - ix. Basis for conclusions.
 - x. Reporting & completion.
 - xi. Quality/Engagement quality control review.
- (k) In general, a working paper may contain the following:
- i. Risk and controls relevant to the area.
 - ii. Assertions to be tested and satisfied.
 - iii. Substantive and analytical procedures performed.
 - iv. Persons performing/reviewing the work.
 - v. Dates on which the work was performed/reviewed.
 - vi. Extent of review.
 - vii. Documents prepared by client.
 - viii. Nature, type and size of the entity.
- (l) Audit documentation may be lesser in case of less complex and small entities as compared to large and complex entities especially in magnitude of task involved in the subject matter of investigation.

22.3 Standard on Internal Audit (SIA) 330 Internal Audit Documentation issued by the Institute of Chartered Accountants of India should be read in conjunction with the “Preface to the Standards on Internal Audit,” “Framework Governing Internal Audits” and “Basic Principles of Internal Audit” issued by the Institute. (For a detailed reading of it, please visit www.icaai.org). These are equally relevant for an Investigative Audit assignment.

22.4 The ownership and custody of the internal audit work papers shall remain with the Internal Investigative Auditor. Where part of the audit work is outsourced to an external audit service provider or an expert, and reliance is placed on the working papers to issue the internal investigative audit report,

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the ownership of the working papers shall be assumed by the Internal Investigative Auditor from the third party. However, where reliance is placed only on the report of the third party who insists on retaining ownership to their working papers, adequate provisions shall be in place to have access to the working papers, if and when required (e.g., for quality review purposes or presenting the same as a testimony in the judicial process). These decisions on custody of working papers depend on the subject matter of investigation and client engagement terms.

22.5 Documentation includes written records (electronic or otherwise) of various investigative audit activities and procedures conducted, including evidence gathered, information collected, notes taken, and meetings held. It includes, for example, internal memoranda, letters of confirmation and representation, Internal Audit Documentation, checklists, external reports and correspondence (including e-mail) concerning significant matters. Abstracts or copies of the entity's records, significant and specific contracts and agreements may be included as part of internal audit documentation, if appropriate. These documents need not necessarily be printed on paper and soft/ electronic/ digital version may be used and filed. However, where alternate method of recording and storage is used, it must be reproducible in print form if required, similar in nature to the original documents. (for a detailed reading of the standards click the link <https://resource.cdn.icai.org/52732iasb-sia330-8.pdf>).

22.6 Handover of working papers and communications related to any investigative audit requires adequate documentation standards for any corporate entity. The handover of vital documents should be indexed and taken on record formally.

22.7 Standard Operating Procedures for Handover responsibilities. Handover and takeover of roles and responsibilities in most corporate entities are perceived as not of regular occurrences. Guidelines are necessary in the daily work management procedures to expressly and impliedly define the due process of law in retention of every primary and secondary piece of evidential information, during normal working. It is preferable to hold all communication in whichever format being retained for posterity, duly archived, classified, and evidential trails preserved. A robust independent information system audit would ensure that due process of compliance with internal procedures on document retention is followed.

22.8 Safeguarding of Evidential Trails back up – supplements investigative process any destroying of files and records would need to be preferably

undertaken under the guidance of a committee for taking on record the handover and takeover procedures. Adequate care would need to be taken to document the password protected files and these should be handed over to responsible authorities as designated in the organization. A listing of all the approvals for a defined period is desirable and is a decision left to the governing boards of the organization. An independent propriety audit helps gauging any financial obligations on the company in posterity. As part of the handover of charge, it is preferable to codify, document and archive all the evidential trails duly indexed and signed by the outgoing officer.

22.9 Ensuring a due diligence process can be a handy measure for mitigating incidents of surprises or aftershocks in Investigative Assignments. Chartered Accountants in their varied roles as internal auditors, statutory auditors, and management positions are required to exercise professional diligence in adopting the right documentation standards in strengthening the line of defense against any potential litigation or dispute.

Points to Ponder

22.10 For example, the object of the Contract Labour (Regulation and Abolition) Act, 1970 is to prevent exploitation of contract labour and to introduce better conditions of work. A workman is deemed to be employed as Contract Labour when he is hired in connection with the work of an establishment “by or through” a Contractor. The regulations stipulate matters that are to be filed with the government authorities and quasi-judicial bodies that relate to the data retained in the company on manpower, work conditions and emoluments and that submitted by the contractor. The Act requires statutory filings by the Principal Contractor and a service receiver Company (“Contractee”). The tenor of the arrangement requires whether the job is of a permanent nature or a temporary nature. Most often the interpretations of the terms “workmen” and “establishment” may vary across the labour laws.

22.11 The payroll records, the job profiles and the number count of employees in the statutory filings require proper validation checks. The actuarial valuation certificate, the funding of investments with LIC and interest accruals thereon are dependent on the submissions by the Chartered Accountants working in Business Entity. These could be including the data submitted on migrant labour, casual workers, skilled labour, temporary labour and even the data on deceased employees would depend on the back up

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record maintained by the organization for stipulated period under the various labour laws.

For the employee benefits covered under Ind AS 19, one requires adequate backup records and working on employee benefits, probabilities, terminal benefits and other documentary trails to be maintained.

22.12 Policy on maintenance and preservation of documents in Public Sector undertakings. A sample reference to a web search on public enterprise policy on retention of records revealed the following structure and format of the policy on Maintenance & Preservation of documents. The policy document typically consisted of a simple structured format and included Preamble, Objective, definitions, classification of documents, preservation of documents and records, custodians of documents, Archival policy and on authority and rationale on amendments to policy.

INVESTIGATIVE ENGAGEMENT PROGRESS RECORD

Client Entity

Code

Office/Department

Outline of engagement

.....

.....

Note: The engagement sign-off below should be completed as the engagement progresses. The attachments may be used depending on the policies and requirements of the services.

Engagement progress Sign-off

Note: This is a typical format used in most leading global Consulting firms engagement in investigation services. These maybe customized to suit the business entities work eco-system and adapted to a digitalized framework.

	Initials and date	
	Manager or in-charge	Mentor
Confirm that engagement team have read, are familiar with and have applied the relevant sections of the Investigative Services Guide.		
Preliminary actions complied with and completed, salient features discussed with mentor and problems resolved		
Operational procedures complied with and completed, salient features discussed with mentor and problems resolved		
Reporting procedures complied with and completed, salient features discussed with mentor and problems resolved		
Confirm that the second mentor has completed		

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the second mentor review as required in Investigative Services Guide		
Confirm that engagement is complete, and report (s) and/ or letter(s) may be signed		
Working papers complete and Investigative Engagements Progress Record is signed off		

Note: This is a typical format used in most leading global Consulting firms engagement in investigation services. These maybe customized to suit the business entities work eco-system and adapted to a digitalized framework.

Preliminary Actions

Attachment 1

Salient features for consultation with or review by engagement mentor

	File Reference
Number of additional pages attached	

Note: This is a typical format used in most leading global consulting firm's engagement in investigation services. These maybe customized to suit the business entities work eco-system and adapted to a digitalized framework.

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Procedures for in-charge or manager to carry out

√ Box when
completed

☐	Confirm with mentor that rules on independence permit acceptance of engagement
☐	Confirm that mentor has agreed there are no reasons for not accepting client (i.e., conflict of interest check has been performed)
☐	Ascertain nature of letter (s) and / or report(s) required from Investigative cell, their addresses and their purposes
☐	Establish timetable and budget for engagement
☐	Terms of engagement confirmed in writing with Client (engagement letter)
☐	Identify second mentor and obtain agreement to act in that capacity
☐	Inform auditors (if other than existing statutory auditor) of Investigative cell involvement (where appropriate and after obtaining permission from the client.
☐	Agree outline work programme with engagement mentor, either through discussion or by documenting the programme (If the policy of the practice is to document work programmes)

√ Box When
completed

☐	Instruct other Investigative Offices as appropriate
☐	Identify need for special expertise from Business Group or Industry house or External Consultants
☐	Consider the need to obtain a retainer from the client.

Note: This is a typical format used in most leading global consulting firm's engagement in investigation services. These maybe customized to suit the business entities work eco-system and adapted to a digitalized framework.

Document Retention and Handover Norms

Operational Procedures

Attachment 2

Salient features for consultation with or review by engagement mentor

	File reference
Number of additional pages attached	

Note: This is a typical format used in most leading global consulting firm's engagement in investigation services. These maybe customized to suit the business entities work eco-system and adapted to a digitalized framework.

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Procedures for in-charge or manager to carry out.

√ Box when completed	
☐	Identify any relevant legislation
☐	Obtain copies of relevant documents such as affidavits, statements of claim/ statements of defense and counterclaim
☐	Critical areas identified
☐	Formulate work programme and consider reviewing work programmes used for similar engagements (if the policy of the practice is to document work programmes)
☐	Consider the need for a database to manage the documentary evidence
☐	Determine whether a document brief will be required
☐	Consider matters related to insurance recovery

Note: This is a typical format used in most leading global consulting firm's engagement in investigation services. These maybe customized to suit the business entities work eco-system and adapted to a digitalized framework.

√ Box when completed	
☐	Notes of all-important meetings (such as witness notes for evidentiary purposes)
☐	Working papers complete and reviewed by manager
☐	All queries and outstanding points raised by in-charge resolved (if it is the policy of the services to document these matters)

Note: This is a typical format used in most leading global consulting firm's engagement in investigation services. These maybe customized to suit the business entities work eco-system and adapted to a digitalized framework.

Document Retention and Handover Norms

Reporting

Attachment 3

Salient features for consultation with or review by engagement mentor

	File reference
Number of additional pages attached	

Note: This is a typical format used in most leading global consulting firm's engagement in investigation services. These maybe customized to suit the business entities work eco-system and adapted to a digitalized framework.

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Procedure for in-charge or manager to carry out

✓ box when
completed

☐	Reports and letters drafted in conformity with guidance contained in the investigative service guide or service rules (country specific), if different
☐	Confirm that operational procedures have included gathering evidence appropriate to the specific findings contained in the report.
☐	Comments by the Investigative cell on matters of substance made at meetings with client approved by engagement mentor and confirmed to client in writing or discusses as appropriate
☐	Restrictions on distribution included in letter (s) and reports (s)
☐	Second mentor review procedures completed.

Note: This is a typical format used in most leading global consulting firm's engagement in investigation services. These maybe customized to suit the business entities work eco-system and adapted to a digitalized framework.

Document Retention and Handover Norms

Report Control Sheet

Attachment 4

Copies of Report

Dated	Approved By Mentor	Second Mentor Review Carried out	Signed and issued	Signed copy on file	Distributed to:	Date	No. of Copies

Note: This is a typical format used in most leading global consulting firm's engagement in investigation services. These maybe customized to suit the business entities work eco-system and adapted to a digitalized framework.

Chapter 23

Background Checks in Forensic Assignments

Chapter Summary

The term forensic provides a scientific and legal perspective to the evaluation of facts, gathering and preservation of evidence, which is admissible in a court of law and/ or facilitates deciphering criminal intent in any given situation. Forensic accounting can be said to involve profiling the legalities in accounting or financial transactional trails from the perspective of gathering objective evidence and substantiating facts. Investigation procedures aim to bring out the truth while validating facts involving profiling of the sequence of events to ascertain the intent, through screening the business decisions, accounting practices, disclosures and financial reporting in the light of company's policies, procedures, standards, internal process manuals, contractual arrangements, financial transactions, statutory filings, authorisations, transactional trails and end results. Shadow profiling is a continuous process that enables recreation of scenarios and develops strategies in progression to the next level of investigation.

(Source: Article published in The ICAI Professional Journal – June 2016)

What Does the Term 'Forensic' Imply?

23.1 The term 'forensic' provides a scientific and legal perspective to evaluate facts, gathering and preserving evidence that is admissible in a court of law and/or facilitates deciphering criminal intent in each situation. The term 'forensic' when aligned to any field of specialisation, namely ballistic or medicine or pathology, or even accounting gets a scientific and legal interpretation in analysing the evidential trail and sequence of events. Examples that could be cited include Forensic Ballistics, where the bullet is traced to the shooter or the weapon. Similarly, in case of Forensic pathology, the postmortem procedure involves examining a dead body for toxic trails that could aid gathering of indisputable evidence.

23.2 The term 'Forensic Accounting' in simple terms can be said to involve profiling the legalities in accounting or financial transactional trails from the point of view of gathering objective evidence and substantiating facts. This could include an investigation procedure where the accounting transactions, reporting and disclosures are subjected to a screening procedure to isolate aberrations that could impact the true and fair presentation of the accounting results. The procedure involves interpretation of the deviations based on empirical facts and evidence gathered as against the standard norms, policies and procedures and regulatory requirements. These deviations would need to be brought under the lens for further scrutiny of the motive and rationale in committing the deviation and distinguish mistake from misrepresentations.

Shadow Profiling

23.3 Investigation procedures have the prime objective of surfacing the truth and validating facts. These further involve profiling of the sequence of events with a purpose to ascertain the intent, motive by studying the evidential leads. This is generally achieved through screening the business decisions, accounting practices, disclosures and financial reporting in the light of company's ethos & pathos, policies, procedures, standards, internal process manuals, contractual arrangements, financial transactions, statutory filings, authorisations, transactional trails and end results. The independent validations through confirmations, background checks, due diligence checks further add credibility to the investigation processes. In simple terms, shadow profiling is a screening or filtering process of accomplished tasks, information and people with reference to a subject matter of investigation.

23.4 The shadow profiling is an enabler in recreating scenarios and developing strategies in progression to the next level of investigation. The shadow profiling is a continuous process and at the preliminary study phase, involves analysing the financial statements, ratios and benchmarking with general statistical trend of information under regular and irregular conditions. This is supplemented by reference to the memorandum records and operating MIS, an essential cross check to validate the financial figures in gathering evidential trails. The gathered evidential information would need to be evaluated for admissibility in court and would stand test of scrutiny as an aid to litigation support in any potential legal dispute.

Profiling of Data and Information

23.5 The concept of tracing and tracking is often practiced in evaluating a transaction and to evaluate the results of data analytics and processed information from the perspective as to whether this can stand a court trial. The sequencing of the events akin to a time and motion study and deciphering the aberrations is a method that facilitates progression of investigations. This is further extended to a multitude of transactions, cross-functional reviews, cross entity-reviews, cross industry reviews, across businesses duly supported by relational management system.

Financial Reporting and Disclosures

23.6 The Companies Act, 2013 has stipulated certain norms on fraud reporting to the Ministry of Corporate Affairs and some extra judicial powers through the establishment of the Serious Fraud Investigation Office. This factor coupled with the progressive steps in the form of strengthened IT enabled Services, labour law reforms, revamping of banking system, the opening of insurance sector and technological advancement in terms of telecom, satellite, mobile banking and digital economy provides an excellent set of trails to detect wrongful activities. The regulators such as SEBI, IRDA, NHB and RBI too have guidelines to report on frauds and investigations in progress. This may require a synchronisation of the penal provisions of the Companies Act, 2013 with other related regulations namely Indian Evidence Act, 1872 as read with the Criminal Procedure Code, 1973 and the Civil Procedure Code (1908).

23.7 In Corporate entities, despite a robust internal audit system, the focus is not always on detection of fraud but on strengthening the GRC system (Governance Risk Control System). Under these circumstances, any inadvertent erroneous reporting of fraud by Statutory Auditors to the Ministry of Corporate Affairs would eventually surface due to robust financial intelligence gathering mechanism of the Government and more so in recent years due to factors including access to insurance, banking sector, enforcement directorate, filings under FEMA regulations, Income tax department etc. Thus, there are multiple avenues to ascertain incidents of fraud through these channels for the regulator. In contrast, corporate entities, seldom have a Fraud Intelligence Unit unlike the banking and Insurance industry where the same is mandated by regulations. Hence, the corporate entities will need to gear up in a proactive manner to ensure robust financial

research and intelligence gathering mechanism as a safeguard against improper disclosures.

External and Internal Business Intelligence

23.8 The seamless integration of information across regulatory bodies is yet to be wired or networked across the Indian Territory and therefore court proceedings, filing of affidavits, first information report (FIR), police complaints, Income tax proceedings, etc. are prone to manual intervention. There are ambiguities in interpretations of evidential trails that impacts the timely completion of the process of investigation. The systemic breaks in information and lack of synchronised effort poses a major impediment in timely conclusion of the investigation process leading to impediments in settlement of fidelity insurance claims with insurance companies. Under these circumstances, the source of information, interpretation and due synchronisation with the sequence of events, are essential in driving conclusive results.

23.9 Anti-money laundering measures are another area that would need to be strengthened in terms of being watchful of the source of funds of business associates, vendors and fixed deposit holders. The money does not have colour and indirect link to a money laundering activity with these investments can impact the 'brand reputation' of the corporate entities. Hence a shadow profiling of the investments and financials of the business associates and a robust financial intelligence alert mechanism is desirable. For example, the collection of fixed deposits by companies is an important source for fund generation. The fixed deposit collections at a granular level are not under the direct purview of the regulators except for the mandatory filing of returns under the governing statutes. In these circumstances, proper accounting, differentiation of advances collected, refunds on account of non-adherence to KYC norms would need to be monitored diligently. Cross validation/confirmation of Fixed Deposits in investor records and KYC checks is recommended in profiling the credibility of investment retained by deposit holders. The profiling of the fixed deposits retained by high net worth individuals and a declaration on source of funds could be a sound hygiene measure for the corporate sector.

News Analysis in Public Domain

23.10 An Eye Opener for Fraud Diagnostic Reviews. To quote from an

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article in The Economic Times, the unprecedented mob attack at the plant of Automobile Company, which claimed the life of a senior HR manager, was a strong signal of the excessive use and (mis) management of contract labour. In this article there was a mention about unequal treatment between permanent and contract labour for doing almost similar jobs, prevalent in almost all manufacturing establishments in India. The incident as referred in the article caused a major financial loss of Rs 500 crore to Rs 600 crore to the company. More than the financial impact, there was a huge reputation loss for a company known worldwide for its employee relationships and best human resource practices. This was a major setback for the company as it affected its market share as well as relationship with the employees.

Taking a cue from this story published in public domain, corporates could review and inspect their internal control procedures as a proactive measure in the form of periodic fraud diagnostic assessments by independent functionaries. This should be extended to validate the payroll records, contractual payments, declarations to statutory bodies, parity in information across entities within the group (especially for consolidated accounts) and consistency in information filed with various agencies. The interpretation of applicable statutes and statutory filings would need to be scrutinised through cross validation checks between a 'contractor' entity and a 'contractee' entity. The parity in job profiles by whatever name or designation, wage structure and manpower strength would need to be evaluated in an independent manner. Care should be taken to decipher the penal offenses and procedural aberrations. Abundant caution is necessary in classification of various violations into cognizable and non- cognizable offenses. The consequences in terms of offences impacting civil or criminal procedures would need to be assessed. There is a need to ensure that a violation at the grassroots level does not impact the senior functionaries and vice versa.

23.11 The parity of terminologies between Shops and Establishments Act (as applicable in various states of India) and under various labour laws, the Factories Act, 1948 have varied interpretation in terms of defining establishment, manpower strength for each of the establishment, payment of appropriate license fee by the contractors, proper wage record etc. The remittance of statutory dues and related filing of returns for provident fund and pension benefits though being the responsibility of the Contractor may under certain circumstances impact the serviced company as a principle employer. The shadow profiling of extent of employees not reporting to duty

Background Checks in Forensic Assignments

for substantial period without a leave application provides a good data to ascertain presence of ghost employees, whether their KYC papers are valid or whether there are other reasons that they are not traceable. Often these remain unattended in the payroll system for substantial periods of time. Similarly, unclaimed salaries are an area that can provide sufficient leads on veracity of employee records. While profiling the master payroll record, death cases, absconding cases, resignations and retrenchment proceedings would require different profiling methods in line with prescribed regulatory norms.

23.12 Often the designation, roles, activity, tasks for regular permanent employees may overlap with the role of contractual employees, though termed differently in personnel department records. This results in ambiguity in terms of work content, tasks and nature of employment and should not appear to be masking the intent in deployment of such labour in the eyes of the regulatory authority. Hence, the nomenclature in terms of definition of the Job profile is subject to interpretation and may tend to circumvent the objective of labour regulations. Abundant caution is needed in ensuring that 'cost reduction' being the business objective does not override principles of 'natural justice'. Such ambiguities in interpretation may impact the disclosure norms.

23.13 Another factor is the Union Management relations and the concept of ONE RANK ONE PENSION could be cited as a classic example, in terms of interpretation of the parity between the 'contractual labour' and 'regular permanent employees'. The extent of companies which have not provided for retirement benefits or those which have classified the financial figures as non-funded retirement benefits would need to ensure appropriate exemption from designated authority as per statutes. In this context, abundant caution needs to be exercised in submission of data for actuarial valuation for retirement benefits for appropriate disclosure in books of account.

23.14 The outsourcing of jobs is a factor often interpreted to be out of bounds of the Contract labour Operations. The influx of consultancy and other types of service providers have probably resulted in an extensive ambiguity on applicability of labour laws. The same concept can be extended to operating of the E-Business Startups and universally applied to Global Consulting firms.

23.15 It is important to take note of these statutory filings, challenges in interpretation of statutes and representations in financial statements. The

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shadow profiling akin to a reality check aids in establishing the veracity of the existence of these activities or perhaps trace fictitious consultancy expenses booked in the system. In addition, the digitalization of the records and functional 'silos' in the system provide ample avenues to mask these dealings. Corporate entities may need to ensure that proper listing of contracts as distinguished between (a) contract labor (b) Consultancy arrangement (c) Outsourcing arrangements (d) Related Party Transactions and ensure that these are not expensed out directly in the system without routing through a dedicated control ledger account.

Profiling Banking Habits and Money Trail

23.16 Most monetary trails against wrongdoings are tracked to bank accounts that are opened by the alleged offender either in his personal capacity or routed through several entities. The biggest brand erosion is when employees/business associates operate proprietary firms misusing the logo and emblems of Branded Corporates. These are surrogate methods of misrepresentation of brands and diverting business or siphoning off dues of corporate entities to their personal account. The shadow profiling of such activities would require a web search of such entities in the public domain under various similar sounding names. Thereafter, establishing a trail of monetary transactions through confirmation from external customers. The alert trigger for stakeholders could be an abrupt decline in business volumes or rising defaulters, disparities in business performance that could be perceived as adversely impacting the corporate entities.

23.17 Within the entity these are generally parked in inactive, redundant ledger accounts through Journal Adjustment entries or adjusted against unrelated vendor accounts. Externally these are retained in bank accounts as proprietor of an enterprise or in proxy/ surrogate bank accounts to camouflage these financial dealings. To mask the money trail proxy operators through impersonated/surrogate bank accounts are introduced. These dealings generally proliferate 'benami' businesses and contractual arrangements that perhaps would be detrimental to the noble objective of financial inclusion and ethical conduct of business operations. These are generally uncovered through data analytic checks and external validations/ confirmations.

Data Analytics and Simulation Helps in Fraud Diagnostic Reviews

23.18 The art of visualisation is often recommended by motivational speakers and in spiritual practices in some parts of the globe. The same concept is of extreme relevance in investigation assignments where any business activity or aberration in processes has to be subjected to the 'visualisation technique' of the end results. This practice is comparable to the term 'goal seek' in excel templates. These can be summarised as under:

- (a) Defining the objective of the assignment and activities/ tasks impacted.
- (b) This is then broken down into sub parts through the use of 'Operations research' techniques in terms of sequencing the activities/tasks.
- (c) The third concept that is of extreme use is lead generation using the 'decision tree concept'. ('What if' and 'so what' questions). This is followed by a scenario planning technique. The scenario planning technique opens multiple windows or avenues to be explored.
- (d) The next step is to apply 'probability' theory of justification of leads. The risk weights are applied to these probabilities and scenarios.
- (e) This is followed by a lead generation of areas to explore. The leads are evaluated over a frequency distribution curve of hits and misses. This narrows down the 'decision points' to the most probable leads that would need to be pursued.
- (f) The primary factors and secondary factors are isolated called conditions for linking actions, tasks, activities, people and end results. Once the primary factors or conditions are identified this leads down a person, action or result of wrongdoing.
- (g) Prejudice and bias in processing of information is to be evened out at this stage. Thereafter, the process of shadow profiling commenced in terms of establishing whether a wrong has been committed to narrow down on suspicions. At each of these stages materiality is ignored, and the focus is on the identification of the first aberration.

Alternative Thinking and Exaggerations

23.19 In extreme cases, the evidential trail may not get identified or detected in the short dry runs. Under these circumstances, alternative thinking and exaggerations or bloating the problem out of proportion is suggested in terms of bringing the focus on investigation, to establish whether a wrong has been committed. For example, where the 'fictitious payment' has complete adherence to the bill passing processes, it is advisable to look for alternative evidence beyond the control of the certifying authority such as stock reconciliations, gate controls, aberrations in regulatory filings, improper classification and disclosure under labour laws. These indirect evidences could be measures to narrow down on the suspicious activities. The structuring of contracts camouflages the bill passing process resulting in inflated/fictitious billings. These can perhaps be uncovered by breaking the contractual rates in sub elements and evaluating the rationale in defining the contract rates, duly benchmarked with prevailing market rates. The difficulty is that facilitation payment in contract fraud is generally routed outside the accounting system.

23.20 Categorisation of Wrongdoing and Standardisation in Investigation process conceptually, forensic audit assignments for ease of understanding can be categorised into:

- (a) Operational frauds which are simple and generally identifiable to the last person where the action of wrongdoing takes place
- (b) Management frauds are difficult to establish where the authority and responsibility are not clearly defined, or business decisions are not backed by empirical study. In these circumstances, the surfacing of the fraudulent activities gets deferred over a prolonged period.
- (c) Fraud on the Company (entity) by external persons is the most difficult to uncover due to legal and other limitations.

In these circumstances, a simulated research and data analysis, akin to a dry run of the impacted activities is recommended before reaching any form of conclusion as to whether a fraud has been committed in/or against the organisation.

23.21 In conclusion, the forensic audit does entail extreme uncertainties in gathering of evidences and establishing a wrongdoing. This calls for a multipronged strategy, a disciplined rational approach backed by scenarios,

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simulation techniques, due diligence checks leading to an objective assessment as to whether a wrongful act has been committed. The concept of shadow profiling involves screening of activities, tasks, results and actions in the light of established policies, procedures, financial reporting and disclosure norms in the true spirit of 'art of visualisation'.

Code of Governance

Chapter Summary

In today's work ecosystem, there is a need to balance 'agility' in conduct of business in the backdrop of intensified vigilantism. This brings us to a point of tussle between one hundred percent compliance to regulatory norms, manage businesses in a competitive environment and tightening of governance measures in safeguarding the reputation risk for any organisation. In all this, the significance of corporate houses having a Uniform Code of Governance increases all the more.

(Source: Article published in The Chartered Accountant Journal – January 2020)

Why do We Need a 'Uniform Code of Governance'?

24.1 With the recent incidents of violation of governance code and gaps in financial reporting in public domain, especially in the banking sector and NBFCs, and with the world becoming a global village, exploring the need of and charting a 'Uniform Code of Governance' for corporate houses duly supplemented by a 'Ethics and Governance Taxonomy' becomes a requirement. The Code may act as a reference book, which will enormously benefit in the ease of doing business and will facilitate in building a robust corporate brand. Such reference book would be of paramount importance for:

- (a) Key Managerial Personnel – the CFOs and CEOs in meeting their fiduciary responsibilities.
- (b) Training Board Members and Independent Directors.
- (c) Officers defined under section 2(60) of the Companies Act, 2013.
- (d) Clarifications on interpretation of Statutes governing a business entity.
- (e) Understanding the term 'offence' under various regulations and its consequences.

- (f) Assurance role of Chief Risk Officer and Chief Internal Audit Executives.
- (g) Engagement of management with statutory auditors. This would provide a structured approach and essential aid to Board Decisions, working of Ethics and Disciplinary Committees, aid in litigation support and strengthening the line of defense for corporate functionaries.

Journey of Indian Corporates to be Global Players

24.2 In most Indian corporate houses that have evolved into large businesses, there is a need for a process of consolidation to emulate the brand image of any Global MNC. Each individual business has its own policies on governance, code of ethics and generally operates in 'independent silos'. For any aberrations to governance norms is primarily due to lack of informed decision making or perhaps due to conflicting business policies and information breaks (in technology terms is called noise) as between Directors, Employees, Corporate functionaries faltering in understanding the mechanics of governance. This requires avoidance of ambiguity in interpreting policies in each given situation, addressing ethical dilemma with due explanations, improve upon erroneous words/ grammatical expressions, defending a decision or gauging any form of misinformation, dealing with fake news or distortions.

- (a) A uniform code of governance would enable to mitigate situations of conflict and tussle between cross section of business policies and regulatory norms.
- (b) Ensure credibility of information shared with various agencies including corporate statutory filings as between parent, subsidiary or group companies. In proper managing of 'Principal contractor' and 'contractee entity' dealings; 'shared business relationships', or engagements those impact 'intra-business' and 'inter-businesses' dealings; strengthening the relationships with JV partners, and business associates. Having a 'uniform code of governance' does enable a common understanding of its varied elements, thereby creating an awareness of its nuances in driving business interests and enhancing governance premium.
- (c) Working around service level agreements and business

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arrangements within the entity's functions and amongst the businesses arising out of multiplicity of policies, governance processes and norms.

- (d) Fine tuning governance norms to local customs, business practices, country specific risks and regulations.

24.3 This narrative is aimed at strengthening the immunity system in dealing with Compliance Risk and Governance Risk for Corporate Houses and constituents of governing bodies spread across organisations. Having a 'uniform code of governance' does enable a common understanding of its varied elements, thereby creating an awareness of its nuances in driving business interests and enhancing governance premium.

Symptomatic Disorders – Course Corrections

24.4 Ignorance of law cannot be an excuse and employees at helm of affairs, need to be aware of the governing policies. The upholding of core values, equity, fairness, truth, honesty and transparency in dealings and working in a responsible manner are inherent to meet the varied expectations of stakeholders.

24.5 To avoid situations of undesirable outcomes and as an aftermath of indulging in 'suppression', 'oppression' or 'tampering with' or tweaking the governance systems, processes are impediments that delays in lead to deciphering the 'disease' in governance parlance. This results in the need to distinguishing between 'mistake of facts' and 'mistake of law'. Efforts are directed towards administering an 'antibiotic' to contain the aberrations in system and on 'curing' the disease. Eventually these lead to closure of an entity, mergers, demergers are a result of such deviation from established governance norms. These are last measure formalities when an organisation exhausts all other options of damage control mechanisms, especially on nonadherence to robust governance norms.

24.6 These are forms of disruptions to businesses that cannot operate due to rising compliance costs or stringent regulations or complicated tax structures or 'out-of-date' revenue models that make the business unviable. These factors operate counter to sustaining the business goals and objectives. Hence the 'uniform code of governance' would need to be supplemented by a reference book on governance taxonomy that would need to define the various connotations, terms, expressions, usages, illustrations,

case studies, selective judicial pronouncements and storytelling as a shared learning from happenings in the corporate world. Like the doctrine of caveat emptor meaning 'buyers beware' (under the sale of goods act) or 'investor beware' (initiatives of the Stock exchanges), 'employees beware' would need to be given prominence.

Experience and Expertise – Building Legacy Systems

24.7 In most organisations, especially in Indian Conditions there are external factors and the apprehensions of loss of reputation in the public domain that brings restraint on corporate governing bodies to get into knee-jerk reactions to allegations or suspected misadventure or override of authority. Special care needs to be taken on the immediate impact on the stock prices and mass of investors operating in the stock market. At the outset, often these result in respecting the sentiments of stakeholders with empathy and as a matter of prudence and pragmatism, treating these as procedural aberrations.

24.8 This frustrates the governance mechanism and eventually leads to out of court settlements. This would mean rewarding the loyalty of employees who have served the organisation for long term and act as an incentive to build good governance mechanisms, practiced in most leading Indian corporates. This helps in setting up legacy systems that are built on core values.

24.9 Business leaders especially in incubation businesses, startups or new acquisitions would need to be guarded against errant/ disgruntled employees getting into shortcuts in overruling governance norms. These situations lead to 'match fixing' the authorised signatories or heads of departments as pawns in achieving their ulterior motive of sabotaging of operations in extreme conditions of greed and opportunism. Daily work management systems work on the principles of trust and faith between a superior and a subordinate employee, where one must rely on inherent controls to validate each action/ decision of employees in a live environment. Seen from a legal perspective, often the leaders or others become scapegoats in not exercising due professional care and eventually succumb to the situations of losing their hard-earned reputations in the organisation.

Role of Audit Committees/ Ethics and Governance Boards/ Disciplinary Committees

24.10 Audit committees are responsible for mandating an investigation process for any aberration to governance norms. Any forward action depends on the outcome of such investigative assignments as to whether a wrongdoing is established or otherwise. Under these circumstances, normally a 'benefit-of-doubt' to the alleged wrong-doing is a pragmatic approach and to move on with building a robust control measures to prevent recurrence of such undesirable events. The single most escape window for these employees is the inability of organisations or investigative agencies in establishing a situation of wrongful gain to the individual or wrongful loss to the organisation. For this reason, corporate houses with matured systems and processes, ensure that these exceptions do not become precedents that embolden errant employees to move beyond the concept of 'first time right' and unnecessarily dragging the entity towards fighting a legal battle, leaving no room, to challenge these governance norms by exploiting the loopholes, gaps, words, expressions and bias in singling out deficiencies in policies, processes and internal documentation. These incidents lead to a continuous learning for governing boards that enable strengthening the governance processes and controls. This is somewhat comparable to deployment of professional hackers in plugging control gaps in developing algorithms or isolating intrusions in operating of ATM processes or testing procedure for a secure website.

Role of Key Managerial Personnel

24.11 It is pertinent to note that every key managerial personnel must be aware of the penal provisions of host of laws/ regulations applicable to a business entity as differentiated from actions which do not cast penal consequences and are procedural in nature. While there could be a standard norm of zero tolerance to non-compliances to laws and regulations, these would need to be backed by a certification by the designated authorities that the requisite mandatory regulations are compiled with due professional care. Any deviation is diligently reported by certification authority to the governing body on priority at the immediate available opportunity for timely resolution. Considering that these are self-declarations, these do not stand testify legal scrutiny as technically no person can self-incriminate or stand witness for his own actions.

24.12 Corporate houses depending upon their risk appetite may need to define a quantum of risk cover including or extending to signing an indemnity bond by such designated authorities who are statutorily responsible for taking due professional care in their assigned roles (normally done by code of conduct compliance procedures in most corporate entities). Such indemnity bonds could be operating with retrospective effect or during the tenure of the assigned responsibilities solely a decision left to the discretion of the business promoters, investors and stakeholders.

Governance Taxonomy – A Reference Book

24.13 A 'governance taxonomy' is a dictionary of terms, case studies, explanatory notes, illustrations, stories that would explicitly and impliedly help in understanding these terms in the same manner by each of the constituents in signing contracts or agreements or in their business dealings. This would enable building cohesive working relationships amongst constituents of a business entity to relate to business associates, joint venture partners, extended world of customers, vendors, distributors and dealers.

24.14 This would be a fundamental document comparable to the nervous system of the human body that connects to the brain (meaning the governing body of the corporate house) and operates with a specific purpose, energising, controlling and monitoring the functioning of the entire spectrum of businesses across such corporate houses/ business group in a coordinated manner. These could be further scalable at a global, country, industry, business, sector, individual entity, divisions, function and employees. With the target user audience being board members, business partners, KMPs and other designated officials.

24.15 A reference guide on code of governance would help employees to be aware of the meaning of various terms (governance taxonomy) in defending their actions. Whilst each entity within a corporate house, would have its own code of ethics and governance norms suited to the business needs, a reference book on 'governance taxonomy' would enable these businesses to retain their individual federal character and yet relate to the overall ethos of a business group when it comes to defining the various terms of references as one 'global brand'.

24.16 These reference guides would need adequate customisation and would vary from one corporate business house to another and specific

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characteristics of the Industry. It is desirable to engage the services of leading Indian Chartered Accountancy firms as management consultants, adept in understanding the entire eco-system, nuances of regulatory requirements, borrowing covenants and robust financial management. These require a process of collating a host of compliance requirements, authority-responsibility charts, fiduciary responsibilities under the Companies Act, 2013, the SEBI guidelines, labour laws, environmental laws and industry specific regulatory norms. Assimilating information is next prerequisite through surveys, interviews and questionnaires and get an understanding of key job roles, responsibilities, authorisations, board resolutions, the Memorandum of Associations, the Articles of Association, the minutes book, banking covenants, patents, trademarks, contracts, arrangements, MoUs, agreements, non-disclosure agreements, drawings, structural designs, location, geography, logistics, country of origin, the local currency and include study of the risk register. Care should be taken to ensure that all these efforts are without access to key strategic plans and projections or any information that is sensitive in nature and is privy to the top management only.

Engaging Consultants – to Build on Governance Architecture

24.17 Understanding governance norms by the authorised personnel is important as these carry a fiduciary responsibility. Despite engaging of consultants, corporate functionaries, risk officers, internal auditors, legal support, none of these consultants or legal counsel in their advisory capacity can assure the role of the designated authorities towards a shared responsibility. What can be delegated and what cannot be, under the legal parlance cannot be explicitly stated in the Code of Ethics document as prevalent in most of the organisations across the corporate world. In the event of a court battle or a notification from a regulator, the decisions and actions by designated officials would need to be defensible. These documents and terms therein could help in drafting responses to such regulatory notices to be on the right side of legal spectrum.

24.18 These concepts on governance framework help leaders and employees to exercise due professional care and always be on the right side of the law. This would help to preserve the fabric of good business ethics, honesty and integrity in dealings amongst the constituents. This would be an

enabler to defend employee actions in the eyes of law backed by orderliness and discipline. These would eventually lead to unison of purpose in binding entire Indian corporate houses to enhance the governance norms and further their Business interests and thus being elevated to the status of being amongst the league of globally admired brands. The COSO framework adopted by matured businesses is a good example that cuts across the businesses and would need to be ably backed by governance taxonomy.

Practices for Consulting Assignments – A Top Down Approach

24.19 This would require a blend of maturity, wisdom, non-disclosure agreements and access to this information would need to be restricted to authorised officials (in confidentiality) of the entity and not to consultants or external Chartered Accountants Firms.

In other words, these would require an in-house Cross Functional Teams (CFTs) and blend of external and internal domain experts to participate in the process of developing a governance framework and sharing of information only on 'need to know' basis. For this purpose, such projects would need to be broken up into submodules and fragmented wherein no individual or firm or authority within the organisation has access to entire governance framework in its development stage. Preferably these efforts would therefore need to be directed under the guidance of the topmost authority of the entity, namely the chairman of the company.

24.20 Approval of the governing board would be needed in adopting such a 'uniform code of governance', in building global brand and perhaps extended aid in performance evaluation of the Board members once consensus on broad framework of governance is reached representing in one voice what the respective 'Indian corporate brand' signifies to the world.

Scoping of the Consulting Assignments on Building a Governance Code

24.21 Scoping of the consulting assignments on developing a governance framework would require a clear understanding of the entities to be covered, the timelines, the fee structure, the extent of business size and geographical operations. These would depend on the futuristic aspirations and objective of the business promoters in terms of country risk; creating a global brand or for

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rural market penetration or entering into a 'public-private partnership' or even participating in 'make in India', start-ups or building smart cities, etc. These could relate to funding arrangements, capital structuring or even acquiring new businesses, mergers or entering into joint venture arrangements or technological collaborations.

24.22 Once the objective or scope is identified, the next step would be to carry-out a listing of the roles and responsibilities and mapping of key tasks of the key managerial personnel, statutory auditors, board members, of Chartered Accountant members in industry responsible for financial reporting, experts on tax matters, financial forecasting, project report finalisation, related party certifications, adoption of accounting policies, adherence to auditing standards, Industry specific research on governance norms, feedback from financial analysts, business valuers, mergers and acquisitions guidelines, evaluating the prudence of financial decision making, budgetary norms, internal control manuals, vulnerability assessments, internal audit report findings, Risk alerts by risk officers, information risk management, forensic special audits, insurance claim settlements and many other areas of specialisation.

24.23 These consultancy assignments would need to be regulated by the appropriate governance norms including declaration of any form of confidentiality clause and perhaps a signed indemnity bond in the eventuality of any disclosure that is detrimental to the interest of the organisation. The awareness of conflict of interest in these varied roles is an important step that would require a discussion at the highest levels in building the governance architecture. These would require experienced professionals adept in gauging the undercurrent of businesses, business and financial decisions independent of the above roles and normally assigned to forensic accounting professionals. These consulting assignments would need to distinguish from the role of being statutory auditors or other designated roles within an organisation.

Exclusions from Scope and Limitations

24.24 The regulations applicable to an entity add an extra dimension to these assignments and are beyond the scope of this narrative in terms of regulatory compliances, the focus being on governance mechanisms. It is a presumption that ignorance of law is no excuse for any official of an organisation and would be dealt with in accordance with the due process of

law. This cannot be compromised under any circumstances and no individual or designated authority can interpret the legal provisions to suit the business conditions or events on hand. A legal right is assumed unless proven otherwise under a given set of circumstances. However, there is a need to distinguish between the role of an employee and that of an organisation governance norm, in terms of adherence to such a legal condition.

Deficiency Costs to be Factored in Consulting Assignments

24.25 Such assignments on building governance architectural framework normally would require full-time efforts of at least 18-month man-days to take care of qualitative aspects and a 3 years period of statistical records to test the governance modules, inherent checks and balances. Digitalisation would take another 12 to 18 months for a matured governance process. Most organisations do not have a ready list of contracts or arrangements, authority or responsibility charts and even the policy documents are generally outdated without revisions. Considering the dynamics of the businesses most of the policies or agreements, standard operating procedures remain in draft stages or get diluted due to attrition of employees and each new employee bringing their experiences in redefining the processes and controls.

24.26 Tuning the business to a digital age is redefining the tasks and job roles in most organisations and with redundant roles these policy measures become outdated. Where there is no manual intervention in the business/accounting activities and extensive use of technology, the governance norms would need to factor an additional timeline depending upon the extent of activities where technical information security audit clearance is essential in defining the governance norms. Use of robotics/technology does not absolve the key managerial personnel from their fiduciary responsibilities. A coordinated effort would reduce time and cost of the project in the building up on digitalisation processes and system. Use of artificial intelligence is an emerging area for gathering intelligence on governance system and issuing alerts in a proactive manner to appropriate authorities is desirable.

Resources Planning for Consultancy Assignment in Building Governance Model

24.27 It would be prudent to study the various governance nuances and sourcing the domain experts from within the organisation and taking help of

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forensic accountants (Chartered Accountants adept in unearthing financial irregularities and addressing matters related to violation of governance norms). To drive consensus, a CFT team of champions representing each of the business interests within the entity of the corporate house would help in building on a 'uniform code of governance' and tuning the governance concepts to individual business practices and country specific requirements.

24.28 In conclusion, it could be stated that the need of the hour towards sustainable business organisations would require a robust code of governance that would speak a uniform language across the length and breadth of the corporate houses and thereby enable building a global brand image. It is like undertaking a space missions to discover the unknown, where each constituent the orbiter, lander, rover must communicate in unison following a defined path as defined by the 'rule book in taking care of the stakeholder interest'. For this purpose, the governing bodies at the helm of the affairs are required to skillfully manoeuvre through the dependent and independent variables that impact the business dynamics, guided by the torch of uniform code of governance mechanisms.

The above procedures are integral to conduct of any investigative audit and allied consulting services for any subject matter and these help in preparation, planning, defining scope, engagement approach, understanding the policies, procedures, contractual obligations financial reporting procedures, and scrutiny of the books of account with reference to the organization, ethos and work eco-system.

Regulatory Expectations on Fraud Risk Reporting

Chapter Summary

This is penultimate chapter of this technical guide and is a convergence of thoughts on summarizing the book. The increasing role of Regulators whether the Accounting Regulator (ICAI), Market Regulator (SEBI) or Banking & Monetary system (RBI) and the Ministry of Corporate Affairs has brought in significant shift in focus in regulating the Forensic Accounting and Investigation Services and fraud risk reporting requirements.

The Importance of Investigative Audit

25.1 The concept of “goodness” prevailing over “evil” is inherent to various stages of advancement of human civilisation and is duly codified through the judicial process across the globe to bring discipline and orderliness in civil society. This requires following the ideals of Right Mindset, Adapt to Situations, Manage Risks, Action based directed results that would require tough decisions, alignments to business conditions, networking with various stakeholders, ground level assessment, nurturing trust based relationships, taking everyone along to RISE for a cause and sacrifices of a lifetime in upholding truth, honesty and righteousness in business dealings. The business leaders while seeking remedies to business risks, would need to ensure that the core ideals remain intact in business transitions.

25.2 In dealing with business risks, to be on top of matters, under any complex situation requires management client to follow the principles of the Knowledgeable wisdom, Role Based Approach, Intelligence Gathering, Safety Standards, Harnessing opportunities, Networking and Aligned to Business Interests. This adaptation is necessary to the changing needs of businesses to redefine the policy, procedure and tuning to VUCA (Volatile, Uncertain, Complex, Ambiguous) world. Whilst soft controls are essential, for regulators/investors, the expectations from management are a hard-visible control mechanism and a concerted action in addressing compliance risks.

Tackling Fraud Risk

25.3 A manipulative mindset leads to a “Fraud Risk” and can be gauged by symptomatic disorders through fraud diagnostic reviews in key business areas as a regular practice. And a prudent first step would be to treat any “fraud risk” as an aberration from the normal business conditions, frequency of past occurrences, probability of occurrences, validations and use of dry run. Techniques such as scenario planning, simulation, use of time and motion study, techniques used in Project Management such as PERT, CPM, Operations Research, Decision tree analysis, use of flowcharting tools, data analytics, predictive analytics and all these efforts in the backdrop of a robust intelligence gathering mechanism.

This exercise would require assessing the impact, prioritizing the fraud risk in high risks, medium risks, and low risks. The risk remedies would need to be identified by a brainstorming session between a CFT (Cross Functional Team) within a business entity. The next step would be breaking the circuit not to spread the impact of “fraud risk” in damaging the vital business organs, resources, and capabilities. An overdose of curative measures or experimentations by trial and error, can damage the vital business functions in driving the routine processes. Businesses must recognize, adjust, adapt, and introduce robust fraud risk management framework, adequate scanning, and continuous improvement measures to mitigate the impact of perceived fraud risks. (Refer Annexure 1)

Regulatory Reforms and Digital Transformation

25.4 The government of India, including the state government and local affiliated bodies have embarked on IT projects of integrating the banking system backed by regulatory reforms and tax compliances, that is yielding dividends. The notable reforms include the Companies Act, 2013, The Companies (Auditor's Report) Order, 2020 (CARO 2020) and converging the global standards of accounting, auditing, and ethical guidelines. Examples include, mandatory adoption of Indian Accounting Standards (Ind AS), the Income Computation and Disclosure Standards (ICDS), indirect tax reforms Goods and Services Tax (GST); the digitalization of the monetary system (through demonetization); the Anti-Corruption and Anti Bribery Act and regular notifications by the market regulator the Security Exchange Board of India (SEBI).

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25.5 With digitalization and integrated solutions adopted by the Government of India and the regulatory agencies, this has widened the scope of accessing information at a macro level to validate the regulatory filings by individual corporate entities. The credibility of data in statutory filings, financial reporting and management reporting to governing boards is being regulated through mandating procedures voluntarily thereby providing a breather to the governing boards, the audit committees and the management to mend their broken fences and gaps in their internal GRC mechanisms.

25.6 The above steps are an enabler to empower the investigative agencies and intelligence arms of the Government of India such as the Serious Fraud Investigation Office under the Ministry of Corporate Affairs, the Central Bureau of Investigation, the State Investigation agencies, Economic Offences Wing, the Anti-Corruption Bureau, Enforcement Directorate. The exchange of information and state of art techniques on isolating the evidential leads, deciphering connections and decoding the mindset of a wrongdoing especially in the backdrop of rising corporate frauds, embezzlements and diversion of funds particularly in establishing links, tracking and tracing of transactions across entities, individuals and related and connected parties.

25.7 The proactive steps on part of the Government of India, was to evaluate the legal system, and revisiting the time tested regulatory mechanisms and empowering the regulator such as the Institute of Chartered Accountants of India (ICAI), the Securities & Exchange Board of India (SEBI); The Reserve Bank of India; The Financial Intelligence Unit and sprucing up the legal system through in camera trials to expedite the pending litigation cases in the Indian system. This vast transformation is happening in the Government departments, investigative agencies with the integration of the banking system and linking the transactional trails including the monetary trails. The recent developments in this empowerment process includes:

- (a) Developing the Forensic Accounting and Investigation Standards by the Apex regulator body, the Institute of Chartered Accountants of India. The ICAI press release reads "With an increasing number of Accounting, Financial and Loan irregularities, there is a pressing need of Forensic Accounting and Investigation professionals in India to conduct their professional assignments in a manner which is based on the comprehensive, qualitative and prudent set of Standards, and also to collect evidences which may be subject to high level of scrutiny in a court of law. Benefits of these standards would enable

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- (i) Process standardization across the board.
 - (ii) Collection of evidences based on a process which may be subject to high level of scrutiny in a court of law.
 - (iii) Would be used in all the professional assignments relating to engagement of Forensic Accounting and Investigation
 - (iv) As the Forensic Auditor can identify the Fund Diversion, Siphoning of Funds and other related activities, relating to Corporate, these standards would be helpful to the Public Interest Entities as well.
- (b) The Securities and Exchange Board of India is a market regulator on the lines of securities exchange commissions of the United States. The Times of India dated Sep 30, 2020, 04.00 AM IST headline reads:
 - (i) “Forensic audit information to stock exchanges must: SEBI” Markets regulator SEBI on Tuesday made it mandatory for all listed entities to disclose to the stock exchanges any forensic audit that a company carries out. The entity is also required to intimate to the exchanges when a forensic audit is initiated, the regulator said after its board meeting earlier in the day.
 - (ii) Relating to forensic audits, a SEBI release said this decision has been taken “to address the gaps in availability of information on forensic audit of listed entities”. At present, listed companies usually do not make forensic audits public, mainly for fears of negative impact on the stock price and the company’s brand. However, forensic audits initiated by regulatory or enforcement agencies have been excluded from this list.
- (c) The Live Mint dated 24th October 2019 reads “SEBI probes insider trading of whistleblower claims”. The markets regulator is investigating a huge buildup of derivatives positions in a leading Indian IT company’s stock before allegations of accounting malpractices raised in a whistleblower complaint were made public.
 - (i) Regulator takes Suo Motu action, huge short positions built just before complaint under lens.

Regulatory Expectations on Fraud Risk Reporting

- (ii) The Bombay Stock Exchange (BSE) said Indian IT company failed to disclose the whistleblower complaint to exchanges as per listing norms
- (iii) According to Listing Obligation and Disclosure norms, all material information needs to be disclosed, and whistleblower allegations are not material until proven to be true.
- (iv) The whistleblowers accused the company's chief executive officer and chief financial officer of unethical accounting practices in a bid to boost revenue and profit.

From the above perspective Corporates by themselves may have varied perspectives and work ethics philosophy. And the regulator to supplement these efforts encourages direct whistleblowing to SEBI.

- (d) The Economic Times dated December 24, 2019 reads "Insider Trading cases: SEBI comes out with new informant mechanism to reward whistleblowers
 - (i) Markets watchdog SEBI on Tuesday came out with a new mechanism to reward whistleblowers and other informants for sharing information about insider trading cases.
 - (ii) Under the new framework, it would be mandatory to disclose the source of information, besides, confidentiality regarding the identity of the informant would be protected, the regulator said in a statement.
 - (iii) Insider trading refers to trading of securities while in possession of Unpublished Price Sensitive Information about the securities.
 - (iv) The Securities and Exchange Board of India (SEBI) said "reward would be given in case the information provided leads to a disgorgement of at least Rs 1 crore in accordance with the PIT (Prohibition of Insider Trading) Regulations".
 - (v) The regulator said that Office of Informant Protection (OIP) has been established by it as an independent office for receiving and processing Voluntarily Information Disclosure Form (VID form).
 - (vi) The OIP would serve as a medium of exchange between the informant or legal representative and the regulator.

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25.8 The economic times dated 18 October 2020, 02:12 PM IST reads “Companies must disclose all whistleblower complaints to auditors”. The Companies (Auditor’s Report) Order, 2020 (CARO 2020) will be applicable for audit of financial statements of eligible companies for financial years commencing on and after April 1, 2019 and would be applicable to all those companies on which CARO 2016 was applicable. The salient aspects from an Internal audit and management covers:

- (i) The corporate affairs ministry on Wednesday notified the Companies (Auditor’s Report) Order, 2020 (CARO 2020), making it mandatory for companies to disclose all whistleblower complaints to the auditor while paving way for enhanced due diligence and disclosures on the part of auditors.
- (ii) CARO 2020 will be applicable for audit of financial statements of eligible companies for financial years commencing on and after April 1, 2019 and would be applicable to all those companies on which CARO 2016 was applicable.
- (iii) “CARO 2020 is expected to significantly improve the overall quality of reporting by the auditors on the financial statements of the companies and thereby lead to greater transparency and faith in the financial affairs of the companies,” the ministry said in a statement.
- (iv) In an order issued on February 25, the ministry had made it clear that listed companies will have to disclose all whistleblower complaints to the auditor, and these will have to be mentioned in the audit reports.

25.9 In conclusion, the reporting of investigation in progress in a corporate entity, could be intruding into the internal matters of an organization, that is unprecedented in any form regulatory reforms. Whilst, this could be perceived as dilution of the independence of governing boards, this facilitates transparency in sharing of information on fraud risk management that enables connecting the dots in interpreting the business performance and financial results in the larger interest of informed decision making by stakeholders.

Annexure 1 (Para 25.3)

Illustrative checklist normally used in investigative assignments to gather persuasive evidence:

1. Regulatory Violations. Ascertained through notices from regulatory authorities, Insurance policies claims, FIRs on employees, Litigation cases, out of court settlements and rejection of claims with reasons or important disclosures in financial statements.
2. Shadow Profiling of Policies – to evaluate the decision-making process in the organization
3. Repeated Internal Procedural violations impacting the organization significantly
4. A snapshot of date & time stamp - with reference to timing of wrong actions/reporting
5. Unreported/ improper disclosures to board/regulatory authorities
6. Misinterpretations of board directives by executive managers w.r.t minutes of board decisions
7. Override of authority detrimental to organization interests.
8. Force fitting of e-mails implicating reporting superiors - misleading or portraying collective decision by wrongdoer
9. Adjustment in accounting entries without proper or masked narrations
10. Loss of trail in sequence of activity flow and misleading capture of information
11. Surrogate books of accounts (ledger accounts) and mirror entries in several subsidiary or personal books of account of employees/third parties.
12. Operating personal bank Account using company logo as proprietary entity misleading bankers/stakeholders.
13. Multiple books of account maintained for the same Company in various software platforms including operating proxy servers controlled by the wrongdoer.

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14. Tracking of Financial Transactions across each employee personal account vis-a-vis Companies account in case of alleged irregularities against such employees.
15. Contracts profiling – dealings with relatives not under the definition of related party transactions - namely Brother In law, Sister in law, Father in law, Mother in law, Uncle, Aunt, Niece, Nephew.
16. Profiling of 'barter' financial transactions between two entities akin to independent 'quid pro quo' dealings.
17. Financial Transactions by Agents, Brokers, Consultants, personal assistants on behalf of company acting as proxies to the beneficiary 'owner', 'promoter' or employees of the company.
18. Disclosure/representation of employees of other organizations/ outsourced/contract employees in organizations as Company employees
19. Ill-gotten money of third parties channelized through Company's book of Accounts in the form of loans, fictitious contracts, fictitious billings, expense booking to evade tax implications.
20. Forming association of persons - proprietor on paper - with control over bank accounts by the Department Head/Owner of Business- pre-signed cheques, will, probate, agreements, arrangements, MOUs. The beneficiary having control over the dealings through use of third parties.
21. Improper month-end cut-off procedures- with Re. 1 entries/suspense entries in books/suspense ledger accounts that is intended to be readjust/realign accounting entries in the system by replacing the amount - without the need for booking adjustment entries.
22. Chain financial transactions in the books to divert attention of wrongdoing.
23. Banking transactions routed through multiple Ledger account with different names for the same customer/vendor.
24. Solitary Financial Transaction in Books - Back up in Files can be in excel spreadsheet or hard copies signed by the Head of Accounts. The supporting schedule of payees does not form a part of the books of account. These are either retained with respective functional heads.

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The overall amount in books remain in-tact- the supporting contents are modified or replaced - generally the payroll, contract labourers, Consultants, Employee Stock Option Entries, system, loans and advances, third party collections on behalf of debtors, donations from unknown sources, are booked through secondary memorandum records in many smaller and medium sized entities. These practices allow manipulation in the schedules without changes to the overall books of account.

25. Off-Shore financial dealings - where the stock records and finished goods inventory is controlled by outside entity such distributors, franchisees etc. There is no assurance on existence of customers and largely books are maintained by declaration by such operators. The same situation of misrepresentation could prevail within the country where the top line is dependent on declaration by distributors, dealers, and external agents where the manufacturer or marketing company does not have direct control over inventory with such external business associates.
26. Financial instruments/contracts/ dealings/projects/proposals/lead and lag between commitment and delivery - beyond the lifetime of the employees services tenure or over a substantial period greater than 5 years.
27. Fictitious arrangements between Company's country of origin and offshore entities, across subsidiaries - with debit notes and credit notes being used without persuasive evidence in accounting records .
28. Duplicate expense booking in various entities of the same transaction and double payments generally across different accounting periods.
29. Profit planning through dubious means by channelizing fictitious business through dealer network. So that all wrongful activities happen in such outside entities and Company being insulated from legal action.
30. Extensive cash dealings with employees retaining float outside the system.
31. Employees starting their own parallel Entities (in friend's name) in diverting business and collections to such entities.

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32. In large companies generally there is a threshold limit below which client deals are not accepted. It would be pertinent to verify whether employees are resorting to splitting the contract value and passing on information to friends or surrogate entities.
33. Employee making personal gain arising out of major contracts, deals and funding arrangements.
34. Excessive unutilized surplus cash and bank balances, inventory in system in Company/branch accounts.
35. Manipulation of standards - in manufacturing process, vendor quality management, quality standards dilution in yield analysis, manipulating costing and product pricing procedures, force fitted schemes to manipulate results with retrospective effect, illogical incentives in contrast to market trends. Not maintaining a history card of business schemes by overwriting the same in system.
36. Operating Company within a company by a group of employees - through their own recruitments in key positions and managing the funds.
37. Operating for Competitors generally involves corporate espionage. To ensure propriety audit in organizations for business decisions and commitments especially for senior employees (decision makers) leaving the organization.
38. Business partners in JVs engaging in activities contrary or misleading to business arrangement and diverting funds unknown to the business partners. Violation of patent rights detrimental to interest of business partners in a JV or business arrangement.
39. Poaching on R & D and Key personnel by competitors.
40. Operating a Company for a fixed tenure (non-going concern concept) is a common method to fraudulently conduct business and exit after making a decent profit. Use of web-based fictitious entities as consultants or misrepresenting as agents or brokers or consultants, investment advisors on behalf of the client.
41. Misleading advertisement inserts, misuse of social media and create a frenzy to get into make believe business arrangements on behalf of clients.

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42. Loss booking and converting black money into white money by lending or borrowing from fictitious or non-operating business entities.
43. Converting a profit-making entity into a sick unit to avail concessions thereby resulting in personal gain to promoters.
44. Memorandum of Understanding being signed in a manner that the ownership is divested from users of property often leading to wrongful misrepresentations and proxy dealings.
45. System being formatted frequently and records being re-created or entire data being replaced, multiple e-mail IDs are some other methods practiced by wrongdoers or unethical companies, software changes are a mechanism to cover up inaccuracies in the system - often the old software and new software applications - would give different results for the same transactions. Data migration is often replete with major deficiencies that impact financial investigations.
46. Corporate espionage, sabotage and poaching on distributors, logistics operators, lawyers, frivolous litigation suits and class action suits being filed on corporate entities.
47. Force fitted pricing arrangements/contracts to benefit the wrongdoer or towards personal gain.
48. Outdated contracts, non-moving financial ledger accounts, non-moving e-mail accounts are prime targets of improprieties
49. Frustrated employees, insecurity and uncertainty in engaging brokers, dealers, distributors, agencies, business associates, and business partners are prime reasons for improprieties resulting in financial frauds.
50. A background check of resigned employees, inactive brokers, dealers, and such other persons provides vital information to investigative assignments. Mapping of income earnings and disproportionate assets are mechanism to establish wrongdoings.

Appendix A

Recommended Reading Material/ Website References for Readers

Recommended Reading Material

- Constitution of India
- Prevention of Corruption Act, 1988 (applicable mainly to public servants)
- Foreign Corrupt Practices Act of 1977 (applicable to Indian companies having overseas operations)
- The Indian Penal Code, 1860
- The Indian Evidence Act, 1872
- The Code of Criminal Procedure, 1973
- The Civil Procedure Code, 1908
- The Indian Contract Act, 1872
- Law of Torts
- Industrial Disputes Act, 1947
- The Companies Act, 2013
- The Companies (Amendment) Act, 2020

Recommended Websites

<https://sfio.nic.in>

<https://www.sebi.gov.in>

<https://www.rbi.org.in>

<https://cvc.gov.in>

<http://cbi.gov.in>

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