Shifting Use of Auditing: Tool of Strategic Financial Management to Assure Consistency of Financial Solution.

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Abstract
Development and performance of auditing required management and the control panel to insure consistency of financial solutions with established targets, achievement of goals as also the legal compliance. Yet, in spite all this, India loses billions of dollars to fraud each year. Since the peak body of auditors does not take the responsibility of fraud, there is need of a new milestone in the maturation of the auditing function called Forensic Auditing. This can assist an entity improve the bottom line without manipulating the financial statements. Preventive health checkup of finances to identify frauds is the demand of the hour. Forensic auditing principles carry the ability to demystify the financial uncertainties coming in the direction of organizations goals and aims, thereby making them a competitive edge over others.

The researcher will attempt to integrate views of listeners and employees on this topic. The aim of this paper is to give a new relevance to auditing by going beyond numbers and to build a transparent corporate culture by incorporating forensic accounting principles therein.

Keywords : Auditing tool, Strategic Financial Management, Forensic, Accounting

I. INTRODUCTION
Financial frauds of massive scale involving huge amounts have surfaced in India since few years. May it be Enron, Worldcom, or Reebok –Adidas, Harshad Mehta scam, Walmart lobbying expenses scam or credit card frauds, a monster called “Fraud” can occur in any shape, form and size. A recent article in Economic Times reads that the Corporate Affairs Ministry has over 100 cases to deal with in the year 2013, which are actually the cases overflowing from the year 2012. About one third of them come under serious frauds with a majority of them coming from Multi-level marketing. Corporate Affairs Minister of India, Sachin Pilot has come up with an idea of setting an intelligence unit to detect corporate frauds by data mining and linking of data from various sources. In an atmosphere of threat arising out of the possibilities of fraud, auditors have to be on their toes all the time. The expectations of stakeholders from the audit function in general are increasing a lot.

According to a global fraud survey conducted by ACFE in 2012, as much as 5% of the annual revenues could be lost to frauds. This naturally affects the profitability and is seen adversely by the stakeholders.

II- METHODOLOGY
The study being a theoretical study of forensic auditing as a next step on the field of auditing, the researcher has mainly used the secondary source of data collection by making use of available literature on forensic accounting and auditing. However a small survey has been done by the way of telephonic interviews in order to get a feel of the acceptance of the concept in the corporate world.

Statement of Problem
Development and execution of auditing required management and the board to ensure consistency of financial results with established objectives, achievement of goals as also the legal compliance. However, in spite all this, India loses billions of dollars to fraud each year. Preventive health checkup of finances to identify frauds is the need of the hour.
III- EVOLUTION OF THE CONCEPT OF AUDITING

Informed decisions can be made only when the decision maker has access to reliable and useful information. With increased complexities of business, advent of information technology and loss of trail of happenings due to the same has made it necessary for stakeholders and all those who want to rely on useful information to have some kind of verification of information. However different users of these statements have different disclosure requirements about those transactions which are critical and relevant to them.

The industrial revolution that took place in the 18th century brought in economies of large scale, developed factors of production and better means of communication. This resulted in the origin of Joint stock form of organizations. These were the organizations where shareholders contributed the capital, but did not have any control over the day to day working thereof. The need of an independent person who would check the accounts and report the shareholders on the accuracy of the financial statements and the safety of their investment arose at this point of time.

Financial statements depict the financial position of an entity at a particular period of time. It is management’s responsibility to establish an accounting system in order to identify, record and disclose the financial transactions and events by using appropriate rules and standards of accounting. An audit doesn't reduce this burden from the shoulders of management.

IV - REVIEW OF LITERATURE

According to Lawrence R Dicksee, auditing can be defined as “examination of accounting records undertaken with a view to establish whether they completely reflect the transactions to which they relate. Latin word “audire” means to hear. In early days, auditor used to hear the accounts and check them. Current generation faces pressures due to advent of IT. Emphasis has been given on assurance services which are being viewed as extension of audit function. Early auditing was designed to verify the honesty of persons charged with fiscal, rather than managerial responsibilities (Littleton 1933). He identified two types of auditing – public hearings of the results of the government officials and scrutiny of charge and discharge accounts. Purpose was to keep a check on accountability. However, with the changing business scenario, auditing began to lay more stress on the visual scrutiny of written records and the testing of entries by documentary evidence. Later on, the Joint stock companies act 1857 contained provisions regarding annual audit of company accounts. In post-independence period, professional accountants in the country were increasing and thus parliament passed Chartered Accountants Act in 1949. A new Companies Act came in force in the year 1956 which took the place of the Act in 1857. This new act further formalized the structure of accounting and accounting governance in India. Cost and Works Accountants Act in 1959, Income Tax Act in 1961 were the signs of further developments in the field of accountancy and auditing. Constitution of Accounting Standards Board in 1977 and Auditing Practices committee in 1982 harmonized the existing policies and procedures and brought more development in them. Vedas and Arthashastra by Kautilya have references to rules of accounting and auditing of public finance. Why only in India, lots of traces of auditing have been found across various countries and communities.

Following is the table showing them at a glance-

<table>
<thead>
<tr>
<th>Mesopotamia</th>
<th>Tiny marks, dots, ticks at the side of figures showing that they have been checked.</th>
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<tbody>
<tr>
<td>Egypt</td>
<td>Fiscal receipts recorded separately by two officials while the third checked it.</td>
</tr>
<tr>
<td>Greece</td>
<td>Checking clerks to scrutinize the accounts of public officials at the expiry of their term of office.</td>
</tr>
<tr>
<td>Rome</td>
<td>Separate persons for authorizing expenditure and for actual receipts and payments. Also designed a system of checks and counterchecks.</td>
</tr>
<tr>
<td>India</td>
<td>Pre-vedic and vedic references. System became sophisticated under the tenure of Mauryas and hindu kings. Kautilya classified major and minor heads of accounts of government. Also mentioned forty ways of frauds and embezzlements in his book “Arthashastra”.</td>
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The original motive behind conducting audit is to detect frauds and errors and to see whether the books of accounts reflect a true and correct picture of the financial health of an entity. This slowly got replaced with the words 'true and fair' view of books of accounts. However, the concept of true and fair will be relevant only when the auditor is efficient, experienced and has prudence and wisdom in decisions. Slowly auditing shifted from arithmetical accuracy to reliability of financial statements as the primary goal. However, if auditor while in the process of auditing finds some material misstatements, either frauds or errors; shall probe deep into them and find out the reality.

V - PRESENT CHALLENGES

Internal auditors, external auditors, board of directors and executive management are said to be the cornerstones of corporate governance. They all need to work hand in hand for success of an entity. However various accounting scandals and frauds have time and again proven that the governance systems today are not really capable of preventing businesses from the risk of financial statements being misrepresented.

Regardless of the nature and size, all entities use economic resources to achieve their goals, i.e. profit earning being the most important one. Frauds not only make an entity inefficient as far as resource utilization goes, but also gets its repute hampered.

The concept of Strategic financial management speaks about effective allocation of scarce resources to the advantage of an entity. A robust strategic plan is one which encompasses and focuses on financial forecasting, matured analysis and reporting of financial statements, establishment of internal controls and allocation and utilization of limited resources. Entities with such a robust strategy in place obviously aim at reducing fraud incidences, maintaining an ethical atmosphere in the organization and would usually incorporate proactive fraud risk management as a step towards better governance.

Auditing has seen a major change in its relevance and procedures being adopted. Convergence of accounting standards with IFRS is going to be the biggest challenges in front of auditors as well as the accountants. The other major challenge that auditors have always faced is that of evidence gathering and understanding the sufficiency thereof. This has become even more difficult in the increasing requirements of financial reporting.

Internal audits have also become more and more challenging owing to the complexities of business, threats of frauds etc. It is due to this that the key priorities of audit executives and stakeholders have shifted from compliance and financial controls to risk coverage and business relevance. In a survey conducted by Ernst and Young in July 2012, respondents said that internal audit function has positive impact on overall risk management which in turn gears up the long term earnings performance. Internal audit that aligns its strategies with those of the organization at large, will in true sense help an organization achieve its goals.

VI - LIMITATIONS

There are certain inherent limitations of auditing which limit its scope and relevance.

They are as follows-

1) Nature of financial reporting-
Financial statements involve many judgments e.g. RDD, provision for outstanding expenses etc. Due to this auditor cannot add exactness and certainty to financial reporting.

2) Nature of audit procedures-
For an auditor, reliance is compulsory on the information provided by management. Fraud may involve sophisticated and carefully designed scheme to hide it. Since audit is not an investigation into alleged wrongdoing, it may remain undetected.

3) Timeliness of financial reporting –
Because the auditor is expected to present his report within a reasonable period of time and with reasonable cost, he follows sampling technique of auditing which in itself is a deterrent.
Due to these limitations, auditing cannot necessarily detect frauds. Also auditors are not dutybound to detect frauds as such. Since the apex body of auditors does not accept the responsibility of fraud, there is need of a new milestone in the growth of auditing function called Forensic Auditing. Forensic auditing principles carry the ability to demystify the financial uncertainties coming in the way of organizations goals and targets, thereby giving them a competitive edge over others. However, mere detection of frauds once they occur will not mean much. It becomes a post mortem analysis then. The purpose of forensic accounting principles will be served if they can be applied to early detection of frauds and to fraud prevention as well.

VII - FORENSIC AUDITING

It is an examination of legalities of events by taking together the techniques of propriety, investigative and financial audits. It aims at finding whether true business value has been reflected or not. It can be best explained as “you are searching for something that you aren’t sure exists!” It starts with some suspicion and goes on to find out whether any fraud actually occurred or not. Mr. Kessler, a field auditor in health care industry in early 70's, was the one who gave birth to the concept of “Forensic auditing”. Field of forensics arose as a result of economic crime, may it be in the form of fraud or corruption.

Mr. Mayur Joshi, Chartered accountant and director at Riskpro Management Consulting Pvt. Ltd., Pune, commented that “Conducting the forensic audits regularly can act as the insurance for the company. The company will pay the premium every month for these audits but in case of the contingencies the ROI will be much higher than they can even think about”.

Forensic auditing has been used mainly for investigation of a fraud or a possibility of fraud and goes on to gather evidences that can be presented in the court of law. However, forensic auditing skills can also be used for fraud prevention by identifying and correcting, situations, events or systems which could lead to frauds in future if not curbed at the right time. Managers today are considering forensic auditing as a tool to identify the vulnerability in financial as also internal controls at large. It also helps in investigation, detection and prevention of financial impropriety, inefficient use of resources, improper financial reporting etc. However, this avenue of forensic auditing is in nascent stage yet.

A. N. Chatterji, in his article written in Asian organization of Supreme Audit Institutions (ASOSAI) in the journal of year 2001, has mentioned about reactive and proactive forensic auditing. Proactive auditing is a general review of all transactions, events and procedures carried out to highlight risk areas and to target the specific threats to business. Reactive auditing on the other hand, aims at investigating cases of suspected fraud in order to prove or disprove the suspicion.

There are three broad categories of fraud –

1) Corruption – Bribe (taking or giving), undue advantage / favour
2) Asset Misappropriation – misuse, theft, inventory related frauds (happen to be most common)
3) Financial Statement Fraud – falsification / misstatement, wrong application of accounting standards and policies etc.

Forensic auditing at its best can help curb the fraud possibilities in case of asset misappropriation and financial statement fraud.

ADVANTAGES OF FORENSIC AUDITING

1) It helps organizations in strengthening controls in order to protect them from threat of frauds.

2) From the procedures of forensic auditing, the management and accounts department can get a hint of the possible misstatements or misappropriations of finances by looking closely into the fraud indicators (popularly known as red flags). Red flags speak about deviations from the norms or expected activity. They indicate anomalies or unusual events that occur in an organization.
They are nothing but warning signals that warrant accountant's attention to some abnormality in the finances of an organization.

3) Fraud causes irreparable damage to the name and reputation of an organization. This can be avoided by forensic auditing techniques which guard the business against possibilities of fraud, thereby safeguarding its repute.

4) Since forensic auditing identifies areas of improper or wasteful use of resources, it in turn helps an entity improve the bottom line without manipulating the accounts / financial statements.

It creates a threat to the wrongdoers that they can be caught and punished with the help of evidence gathered by forensic auditors.

DISADVANTAGES OF FORENSIC AUDITING

1) Forensic auditing can become a disturbance in the normal working of the business and may consume time and efforts of the management if not managed diligently.

2) Sometimes they turn out to be very costly depending upon the scope and time period involved.

3) Employees may show reluctance to give the necessary information considering it to be a process to check their integrity.

4) Success of forensic auditing to a large extent would depend upon the security provided to a whistle blower / the informer after he shares some crucial information.

VIII - AIDITING TECHNIQUES

However in spite of these disadvantages, forensic auditing is still a very powerful tool of fraud detection as also prevention. Sometimes prevention is impossible in certain cases. But mere detection at the early stage will also save a lot of future damage to the finances and the repute of an organization.

There are many techniques and procedures which are used in this field. Which of these techniques should be used depends upon the judgment and experience of the auditor. It also would vary depending upon the size, nature, money involved etc. Following are some of the most common techniques used

1) Theory of relative size factor (RSF):

The relative size factor is calculated as the ratio of the largest number to the second largest number of a given set. If there is any remote instance of single transaction that is far beyond the normal range, then forensic accountant would investigate further into it as these could be probable frauds or errors. RSF highlights all unusual fluctuations and warn the management to probe further.

2) Ratio Analysis:

Another useful technique for early detection or even prevention of fraud is the calculation of data analysis ratios for key variables. They diagnose the fraud health by identifying possible symptoms of fraud. Commonly used ratios are ratio of the current year to the previous year, ratio of the highest value to the lowest value (max/min) etc.

Using ratio analysis, a forensic expert studies relationships between specified costs and some measures of production, such as units sold, rupees of sales or direct labour hours. Ratio analysis may help a forensic accountant estimate expenses and find out deviations.

3) Computer Forensics:

Investigation of cybercrimes starts with confiscation of computers and then goes about to preserve the data in it which may act as proof at a later stage. e.g. System intrusions, software piracy. The data is then analyzed with the help of computer software packages available in the market. Forensic Tool Kit, EnCase Enterprise forensic are some of the popular ones. Loop completes with the feedback given to the management for further actions.
(4) Computer Assisted Auditing Tools (CAATs):
It helps forensic auditors to perform various auditing procedures such as finding out the inconsistencies or significant fluctuations, recalculating some numbers which have already been performed by accounting systems etc.

Interviews:
Telephonic interviews of a few auditors and employees working in audit department in industry were taken to understand the general opinion about the forensic auditing and its usefulness in accounting and auditing domain.

Following were the general opinions -
1) Employer's opinions:
   a) Forensic auditing is yet a new concept to many entities. Some of them said they have faced a few incidences of fraud. It has arisen out of the fact that lower level employees are not always aware of the fraud possibilities. They can't think forensically. As a result, many a times accounts department staff cannot really understand the loopholes in the system and thus cannot stop frauds.
   b) Formal training about this new stream of auditing should be given in India by professional bodies so that lower and middle level managers as well as accounts staff can learn the techniques of fraud and those of early detection of frauds.
2) Opinion of Expert in Forensic Accounting:
   a) Retaining the forensic auditors will typically help the companies in the banking, retail and telecom domain in today's scenario.
   b) In the organized retail space, fraud is a perpetual phenomenon. There are daily innovations in this space in committing the frauds. Here the margins are very low and uncontrolled frauds can ruin the futures of these companies.
3) Opinions from others working in finance domain at large:
   a) Employers are not yet really comfortable sharing the crucial information of existence of fraud and as such many do not come up in public to seek the help of experts.
   b) Usefulness of forensic auditing and the value addition it can make is yet not known to a majority in the field of finance.

IX - CONCLUSION
Auditing changed over decades as per the needs of the economy and industry. Role of the auditor also evolved over time and today has gone beyond giving opinion and has embraced risk management and assurance services also. Forensic auditing is taken as the next step on this path. Since it goes beyond numbers to find out the possibilities of fraud, forensic auditing will gain more and more relevance in the coming future.

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