THE ROLES OF THE AUDITOR AND THE FORENSIC ACCOUNTING INVESTIGATOR

To understand the forensic accounting investigator's role in deterring, detecting, and investigating fraud—as distinct from the independent auditor's role as a financial statement examiner—we need to first recall the differences between what auditors do and what forensic accounting investigators do and why. In addition, their professional worlds have changed in recent years, in ways that bear close examination. The auditor's concern is that the financial statements of an entity be stated fairly in all material respects. Accordingly, the auditor's responsibility is to design and implement audit procedures of sufficient scope and depth to detect material deficiencies in the financial statements—essentially, without regard to the source or origin of the deficiency. Auditors are charged with (1) making appropriate, reasonable efforts to detect material misstatements in financial statements and (2) causing management to correct material misstatements or misrepresentations before the financial statements are shared with the user community or, alternatively, alerting investors not to place reliance on the statements through qualification of their professional opinion issued as part of the company's public filings. Even this seemingly simple statement of the auditor's mission brings into play a series of interrelated and complex concepts, including: ***Reasonable assurance; Material misstatement; Detection, as distinct from deterrence and investigation; and Expectations about the efficacy of the auditing process***

The forensic accounting investigator has a largely separate set of concerns based on a different role that calls for different tools, different thought processes, and different attitudes. The forensic accounting investigator's concern is not with reaching a general opinion on financial statements taken as a whole, derived from reasonable efforts within a reasonable materiality boundary. Instead, the forensic accounting investigator's concern is, at a much more granular level, with the detailed development of factual information—derived from both documentary evidence and testimonial evidence—***about the who, what, when, where, how, and why of a suspected or known impropriety***. Sampling and materiality concepts are generally not used in determining the scope of forensic accounting procedures. Instead, all relevant evidence is sought and examined. Based on the investigative findings, the forensic accounting investigator assesses and measures losses or other forms of damage to the organization and recommends and implements corrective actions, often including changes in accounting processes and policies and/or personnel actions. In addition, the forensic accounting investigator takes preventive actions to eliminate recurrence of the problem. The forensic accounting investigator's findings and recommendations may form the basis of testimony in litigation proceedings or criminal actions against the perpetrators. They may also be used in testimony to government agencies such as the Securities and Exchange Commission in the United States or the Serious Fraud Office in the United Kingdom. Accordingly, the scope of the investigation and the evidence gathered and documented must be capable of withstanding challenges that may be brought by adversely affected parties or sceptical regulators.

Clearly, there are many commonalities between auditing and forensic accounting. Both rely on:

i. Knowledge of the industry and the company, including its business practices and processes
ii. Knowledge of the generally accepted accounting principles of the jurisdiction in question
iii. Interpretation of business documents and records
iv. Independence and objectivity—perhaps the most important commonality

Another commonality is that both the auditor and the forensic accounting investigator must function effectively in the complex and ever-changing business environment. However, despite many common bases, audits are not the same as forensic accounting investigations. Two simple analogies will help convey the differences.

The Patrolman and the Detective

Neither auditors nor forensic accounting investigators are law enforcement officers; however, while imperfect, a simplified analogy to patrolmen and detectives can help illustrate the auditor's challenge to detect material misstatements in financial statements in contrast to the forensic accounting investigator's mission to fully investigate allegations of a suspected impropriety.

A patrolman, working a particular shift, circulates through the community inspecting and observing its visible elements for signs of improper behaviour ranging from minor infractions of municipal ordinances to evidence that a major crime may have been committed. The patrolman selects his route based on past experience, the time of day, and the length of his shift, and adjusts it for any particular observations during his patrol. He knows these judgments and adjustments to the patrol are necessary because no matter how much he might like to be continuously present at every location in the community, it is impossible to do so. So, too, with the auditor, who examines a selected sample of transactions to support the opinion on the financial statements and, based on those results, decides whether to examine more, whether to change the audit technique or test, or whether to conclude on the basis of procedures already completed. These decisions are based in large part on his or her assessment of the risk of material misstatement based on both past experience and current evidence. Auditors might like to go everywhere in a company and examine every transaction but, because, like the patrolman, they cannot be every place at all times, they must determine when and where to concentrate their procedures. The analogy of detective work is similarly instructive of the forensic accounting investigator's mission. As compared to patrol officers, who circulate throughout the community concentrating on high-risk areas, detectives are not on patrol. They are called in once a crime is suspected or observed. These related but differing activities—routine patrolling and criminal investigation—can be balanced with relative ease. If greater deterrence is needed, more patrol officers covering more territory more often is a solution. Similarly, if there are many crimes or if there is a highly complex situation to investigate, then assigning more detectives, or in the financial context, more forensic accounting investigators, is a solution. While it is clear that forensic accounting and detective work are roughly analogous, the analogies between issues confronting the auditor and the patrol officer—namely, how detailed should observations be in varying circumstances— are less obvious.

	Audit	Forensic Accounting Investigation
Objective	Form an opinion on the overall financial statements taken as a whole	Determine the likelihood and/or magnitude of fraud occurring
Purpose	Usually required by third-party users of financial statements	Sufficient predication that a fraud has or may have occurred
Value	Adds credibility to reported financial information	Resolves suspicions and accusations; determines the facts
Sources of evidence	Inquiry, observation, examination, and reperformance of accounting transactions to support financial statement assertions	Review detailed financial and nonfinancial data, search public records, conduct fact-finding as well as admission-seeking interviews, including third-party inquiries
Sufficiency of evidence	Reasonable assurance	Establish facts to support or refute suspicions or accusations

WHAT AUDITORS DO

Why is it unrealistic to assume that all material financial statement frauds can be detected? This can be answered by the Statement on Auditing Standards (SAS) No. 1, which sets out the auditor's fundamental responsibility:

The auditor has a responsibility to plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud. This Statement establishes standards and provides guidance to auditors in fulfilling that responsibility, as it relates to fraud, in an audit of financial statements conducted in accordance with generally accepted auditing standards.

To further understand this answer, three fundamental concepts must be examined. They are

i. the difference between error and fraud as it relates to the auditor's responsibility,
ii. the meaning of reasonable assurance, and
iii. materiality

Fraud versus Error

U.S. auditing standards state that the main difference between fraud and error is intent. Errors are unintentional misstatements or omissions of amounts or disclosures in financial statements. Errors may involve:

- Mistakes in gathering or processing data from which financial statements are prepared
- Unreasonable accounting estimates arising from oversight or misinterpretation of facts
- Mistakes in the application of accounting principles related to amount, classification, manner of presentation, or disclosure

Fraud, on the other hand, is an intentional act that results in a material misstatement. The motive or intent of an individual in making accounting entries is not the primary focus of the auditor's procedures.

Reasonable Assurance

Why is it that auditors cannot provide better than reasonable assurance? Why not provide absolute insurance?

Professional auditing standards explain that the auditor cannot guarantee that the financial statements are entirely free of material misstatement and cannot provide absolute assurance for two reasons: the nature of audit evidence and the characteristics of fraud. The **first reason** audits cannot provide absolute assurance— the nature of audit evidence—springs in part from the fact that **auditors test only selectively the data being audited**. They do not audit all subsidiaries and divisions, all accounts, or all transactions. There are not enough auditors in the world to audit everything, and even if there were, a company's operations would grind to a halt, timely audited financial statements would be an impossibility, and the cost of an audit in strictly financial terms—that is, the auditor's fee—would be prohibitive. Auditors, by necessity, make judgments about the areas to be audited and the nature, timing, and extent of the tests to be performed. In addition, auditors use their judgment in interpreting the results of their work and in evaluating audit evidence, especially with regard to areas dependent on management's judgments, such as significant accounting estimates. As a result of these factors, the auditor often has to rely on evidence that is persuasive rather than conclusive. This distinction is important when it comes to the subjective areas of an audit such as estimates and as discussed later, in certain situations in which a fraud is being concealed. The distinction is explicitly cited in auditing standards concerning audit evidence.

The **second reason** audits cannot provide absolute assurance involves the **characteristics of fraud**, particularly fraud based on collusion among management or falsified documentation, including forgery that serves to inhibit or prevent the auditor from detecting the related misstatements. Fraud, by nature, is hidden. It is buried in financial statement accounts and hidden in transactions in sub-ledgers and account reconciliations. If buried in an account that rolls up with hundreds of others into one line item on the income statement, it then gets transferred to retained earnings and becomes hidden from sight in future periods. Most people would agree that auditors cannot provide absolute assurance that material misstatements do not exist. This is so despite the best efforts of auditors and despite the desire and the unrealistic expectation on the part of the user and regulatory communities that auditors will provide that assurance. Because of the matters noted above, there exists a difference between what auditors actually do and what the public may expect them to do.

Materiality

The standard auditor's report includes the following expression or its equivalent: "In our opinion, the accompanying financial statements present fairly, *in all material respects* …" [emphasis added]. In other words, auditors are responsible for providing reasonable assurance that the financial statements are stated fairly—but only with regard to material matters.

The Financial Accounting Standards Board describes the concept of materiality as follows:
The omission or misstatement of an item in a financial report is material if, in light of surrounding circumstances, the magnitude of the item is such that it is probable that the judgment of a reasonable person relying upon the report would have been changed or influenced by the inclusion or correction of the item.

The concept of materiality recognizes that some matters, either individually or in the aggregate, are important to the fair presentation of financial statements in accordance with GAAP, while other matters are not important.

Overview on the Roles of A Forensic Accountant

Frauds have risen vigorously which has led to a high demand of investigators in the industries. Forensic accountant takes assignment as an investigating officer and litigating officer in examining these frauds. Skills and professionalism of the forensic accountant are different from the auditor; they investigate each case considering a fraud involvement. They have expert knowledge on accounting, law, computer forensic and hence accountability to establish these frauds becomes necessary on them. Their findings on these frauds are considered as evidence in the court of law. They require great professionalism and transparency in completing their assignments. Their assignment consists of just like an audit, but not the audit which you schedule on a bi-yearly or yearly basis. Frauds are unpredictable, they can occur anytime and anywhere and hence the role of forensic accountants becomes important to control such fraud. Forensic accountant has knowledge of legal as well as accounting, it becomes easy for them to calculate the damages and prove the quantum of fraud incurred in the court of law. They not only detect frauds but also prevent occurrence of fraud. A new avenue has increased because of demand by various regulatory bodies for preventing and regulating the fraud. Professionals, especially Chartered Accountants, have good scope to extend their services as Forensic accounting professional. Forensic services go beyond the organization level to personal level. They play important role in divorce cases, personal damages in form of insurance or detecting terrorism finance activity.

Forensic accountants not only take up the organization cases but sometimes they need to take the cases of some other professionals so as to identify their cases on professional negligence. Professional negligence can be understood as where the auditor has not performed his duties to identify fraud. The gravity of professionalism is based upon the analysis done by the forensic accountant. They also provide the services to personal grounds which involves financial impacts such as alimony or calculating revenue available for child support and equal distribution of money within the family in case of legal heirs. They are hired only after frauds take place in the organization. They are expert with sound knowledge on accounting and law. Hence, they involve themselves and understand the internal accounting systems of the organization.\

The major role of the forensic accounting investigator is as an expert witness. The forensic accountant's role can be broadly classified into two categories;

A. Litigation support

Litigation simply means to conduct a lawsuit. In relation to accounting, litigation support is the provision of assistance of an accounting nature in a matter involving existing or pending litigation. It is primarily focused on issues relating to the quantification of economic damages, which means a typical litigation support assignment would involve calculating the economic loss or damage resulting from a breach of contract. However, it also extends to other areas involving valuations, tracing assets, revenue recovery, accounting reconstruction and financial analysis, to name a few.

Litigation support also include working closely with lawyers in matters involving, but not limited to, contract disputes, insolvency litigation, insurance claims, royalty audits, shareholders disputes and intellectual property claims.

B. Investigative accounting:

Investigative accounting is concerned with investigations of a criminal nature relating to finance. A typical investigative accounting assignment could be one involving employee fraud, securities fraud, insurance fraud, kickbacks and advance fee frauds.

Wallace, (1991) assert that these roles can more specifically be highlighted as follows:

- **Litigation support:**

1. Assisting in securing documentation necessary to support or deny a claim.
2. Reviewing relevant documentation to provide a preliminary assessment of the case and identify potential areas of loss and recovery.
3. Assisting in the examination and discovery process, including the formulation of relevant questions regarding financial evidence.
4. Attending to the examination and discovery process to review the testimony, assisting with understanding the financial issues and formulating additional questions for counsel.
5. Reviewing the opposing expert's reports on damages and the strengths and weaknesses of the positions taken.

6. Assisting in settlement meetings and negotiations.
7. Attending the trial to hear testimony of opposing experts and assisting in the cross-examination process.

- **Investigative Accounting:**

1. Reviewing the factual situation and providing suggestions on alternative course of action.
2. Assisting in the preservation, protection and recovery of assets.
3. Coordinating with other experts, including private investigators, expert document examiners, consulting engineers and other industry specialists.
4. Assisting in the tracing and recovery of assets through civil, criminal and other administrative or statutory proceedings.