What Is Forensic Auditing?

Checklist Description

This checklist provides an overview of forensic auditing and examines how managers can put the techniques to work to protect their businesses against waste, abuse, and various forms of economic crime, such as fraud.

Definition

Forensic auditing is a blend of traditional accounting, auditing, and financial detective work. Technology has an increasingly important role to play, with complex data analysis techniques employed to help flag areas that warrant further investigation.

Forensic auditing offers a toolset that company managers can use to help detect and investigate various forms of white-collar financial impropriety and inappropriate or inefficient use of resources. As company structures and controls become ever more complex, so too does the scope for employees with specialized knowledge of the way control systems work to bypass them. In the past, various forms of auditing have been employed after a major control breach has come to light, but executives are now increasingly looking at forensic auditing to help identify vulnerabilities in financial control.

Advantages

• Forensic auditing strengthens control mechanisms, with the objective of protecting the business against financial crimes, be they potentially catastrophic one-off events that could threaten the viability of the business, or smaller-scale but repetitive misappropriations of company assets over a number of years.
• Forensic auditing can play an important role for companies under review by regulatory authorities and can also be invaluable to ensure regulatory compliance. For example, forensic auditing can be useful in helping companies to ensure that their anti-money laundering procedures are both effective and robust.
• Forensic auditing can help protect organizations from the long-term damage to reputation caused by the publicity associated with insider crimes. A forensic audit also provides a sound base of factual information that can be used to help resolve disputes, and can be used in court should the victim seek legal redress.
• Forensic auditing can improve efficiency by identifying areas of waste.
• Forensic auditing can help with the detection and recording of potential conflicts of interest for executives by improving transparency and probity in the way resources are used, in both private and public entities.

Disadvantages

• A poorly managed forensic audit could consume excessive management time and could become an unwelcome distraction for the business.
• Forensic audits can have wide-ranging scope across the business. Under certain circumstances, the scope of the audit may need to be extended, with an increase in its budget.
• Some employees can interpret a proactive forensic audit as a slight on their integrity, rather than as a means to improve control procedures for the benefit of the business.

Action Checklist

• Understand your risks, routes to their potential exploitation, and the tools available to detect abuses, fraud, or wastage.
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- Analyze numerical data, comparing actual costs against expected costs.
- Investigate possible reasons for inconsistencies.
- Consider whether covert detection techniques might be more appropriate when investigating cases of possible fraud. Higher-profile full forensic audits can deter future fraud but could also reduce the likelihood of witnessing the culprit carrying out a fraudulent act.
- External auditing specialists with extensive experience of complex forensic audits can offer industry-specific experience, auditing management expertise, and advanced interviewing techniques. A combination of these external specialists and companies’ internal accountants/auditors can achieve shorter audit timescales and lower levels of disruption to the business.

Dos and Don’ts

Do
- Remember that well-resourced forensic auditing processes can help to identify misreporting at many levels of an organization.
- Bear in mind that regular proactive forensic audits can help businesses to ensure that their processes stay robust.
- Be prepared to widen the scope of a forensic audit to ensure maximum effectiveness.
- See forensic auditing as a continuous process, rather than a one-off event. On completing one audit, restarting the process could uncover something that was previously overlooked.
- Be prepared to share the findings of the forensic audit with other areas of your company, and take into account industry best practice to improve efficiency and combat fraud.

Don’t
- Don’t lose sight of the objective of a forensic audit. The cost can be high, but the potential cost of not undertaking an audit and implementing its findings can be even higher.
- Don’t fall into the trap of overlooking the importance of the “forensic” element of the audit. With the results of such a process deemed suitable for inclusion in legal proceedings, the high potential costs of the forensic audit process could easily be recovered from dispute resolution or higher levels of loss recovery.

More Info

Book:

Articles:

Websites:
- American Institute of Certified Public Accountants (AICPA): www.aicpa.org
- Institute of Chartered Accountants in England and Wales (ICAEW): www.icaew.com
- Institute of Forensic Accounting and Investigative Audit (IFAIA): www.ifaia.org

See Also

Best Practice
- Fraud: Minimizing the Impact on Corporate Image
- How Internal Auditing Can Help with a Company’s Fraud Issues
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- Designing and Implementing Effective Internal Control Checklists
- Internal Auditing for Fraud Detection and Prevention
- Nonperformance and Breach of Contract
- The Principles of Litigation

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