



AMERICAN TAX RESCUE

FORENSIC AUDITS

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What Is a Forensic Audit?

A forensic audit is an examination and evaluation of a firm's or individual's financial records to derive evidence that can be used in a court of law or legal proceeding. Forensic auditing is a specialization within the field of accounting, and most large accounting firms have a forensic auditing department. Forensic audits require the expertise of accounting and auditing procedures as well as expert knowledge about the legal framework of such an audit.

Forensic audits cover a wide range of investigative activities. A forensic audit may be conducted to prosecute a party for fraud, embezzlement, or other financial crimes. In the process of a forensic audit, the auditor may be called to serve as an expert witness during trial proceedings. Forensic audits could also involve situations that do not involve financial fraud, such as disputes related to bankruptcy filings, business closures, and divorces.

Reasons to Conduct a Forensic Audit

Forensic audit investigations can uncover, or confirm, various types of illegal activities. Usually, a forensic audit is chosen, instead of a regular audit, if there's a chance that the evidence collected would be used in court. Below, we cite instances that could necessitate a forensic audit:

Corruption or Fraud

In a forensic audit, an auditor would be on the lookout for

- Conflicts of Interest—when a fraudster uses his or her influence for personal gains to the detriment of the company. For example, if a manager allows and approves inaccurate expenses of an employee with whom he has personal relations.
- Bribery—offering money to get things done or influence a situation in one's favor.
- Extortion—the wrongful use of actual or threatened force, violence, or intimidation to gain money or property from an individual or entity.



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Hypothetical Example of a Forensic Audit Case

Let's say that a computer manufacturer, WysiKids, on the recommendation of its chief financial officer (CFO), entered into a contract with Smart Chips, Inc. to supply WysiKids with processors. At the time the contract was signed, Smart Chips was not authorized to conduct business; its license had been indefinitely revoked based on certain irregularities in a recent Internal Revenue Service (IRS) filing. WysiKids's CFO knew that Smart Chips' license was suspended, yet still suggested that his company sign on with Smart Chips, as he was secretly receiving compensation from Smart Chips for doing so.

The fraud depicted above could be uncovered by investigating the intrapersonal relationships involved and exposing a conflict of interest.

Asset Misappropriation

This is the most prevalent form of fraud. Examples include: misappropriating cash, submitting falsified invoices, making payments to non-existent suppliers or employees, misusing assets (like company equipment), and stealing company inventory

Financial Statement Fraud

A company can get into this type of fraud to try to show that its financial performance is better than it actually is. The goal of presenting fraudulent numbers may be to improve liquidity, ensure that C-level executives continue to receive bonuses or to cope with the pressure to perform.

KEY TAKEAWAYS

- A forensic audit is an examination and evaluation of a firm's or individual's financial records to derive evidence that can be used in a legal proceeding.
- A forensic audit may be conducted to prosecute a party for fraud, embezzlement, or another criminal behavior.
- Forensic auditing is an accounting specialty; most large accounting firms have a forensic auditing department.



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How Forensic Audits Work

The process of a forensic audit is similar to a regular financial audit—planning, collecting evidence, writing a report—with the additional step of a potential court appearance. The attorneys for both sides offer evidence that either uncovers or disproves the fraud and determines the damages suffered. They present their findings to the client, and to the court should the case go to trial.

Planning the Investigation

During the planning stage, the forensic auditor and team will plan their investigation to achieve objectives, such as

- Identifying what fraud, if any, is being carried out
- Determining the period during which the fraud occurred
- Discovering how the fraud was concealed
- Naming the perpetrators of the fraud
- Quantifying the loss suffered as a result of the fraud
- Gathering relevant evidence that is admissible in court
- Suggesting measures to prevent such frauds from occurring in the future

Collecting Evidence

The evidence collected should be adequate enough to prove the identity of the fraudster(s) in court, reveal the details of the fraud scheme, and document the financial loss suffered and the parties affected by the fraud.

A logical flow of evidence will help the court in understanding the fraud and the evidence presented. Forensic auditors are required to take precautions to ensure that documents and other evidence collected are not damaged or altered by anyone.

Reporting

A forensic audit requires a written report about the fraud to be presented to the client so that they can proceed to file a legal case if they so desire. At a minimum, the report should include

- The findings of the investigation
- A summary of the evidence collected
- An explanation of how the fraud was perpetrated
- Suggestions for preventing similar frauds in the future—such as improving internal controls



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Court Proceedings

The forensic auditor needs to be present during court proceedings to explain the evidence collected and how the team identified the suspect(s). He or she should simplify any complex accounting issues and explain the case in a layperson's language so that people who have no understanding of legal or accounting terms can understand the fraud clearly.

THE NEED FOR FORENSIC ACCOUNTING IN A DIVORCE

The work of a forensic accountant is critical when valuing and dividing property in a complex divorce. A forensic accountant analyzes documents to help the court decide on child and spousal support payments, as well as, how to divide community property.

Forensic accounting professionals work with a client's family law attorneys and utilize standard accounting practices in a legal case.

Tax returns, bank records, contracts, and other financial documents are assessed by a forensic accountant. In a divorce case, the accountant aims to reveal a spouse's financial information to ensure property valuation and division in the case are fairly split.

The forensic accountant digs deeper to look for hidden assets and inconsistencies between claims and financial records. The multi-faceted role of the accountant ultimately depends on the case's needs and its direction, and decided by the client and divorce attorney.

Hidden Assets and Inconsistencies

The forensic accountant looks closely at documents to determine their accuracy and corroboration records with certain financial claims. The accountant also verifies all assets and income are prepared and on record.

It's not uncommon for a spouse to forget or deny certain assets, such as in the discovery of an extra-marital affair. Whether it's forgetfulness and ill-will, the accountant has resources to search for off-shore accounts and other hidden property.



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Assist in the Discover Process

Discovery is the process of information gathering, and is when a forensic accountant is crucial to your divorce case. The accountant will work with your attorney to make sure all the right documents and information are gathered through motions and subpoenas. Additionally, the forensic accountant may provide input that helps your attorney prepare the Interrogatories to your spouse. Interrogatories are written questions that reveal information and aid in preparation for deposition and trial.

Valuing Assets

- A forensic accountant has the tools and knowledge to do the following:
- Value businesses and professional practices for clients such as doctors, lawyers, accountants, and other professionals
- Trace property to determine what is community and separate property
- Separate business expenses versus personal expenses to ensure the business is valued accurately
- Determine monthly cash flow

A forensic accountant hired for your case is also available to testify in a deposition or in court. If your case doesn't go to trial, then the accountant can provide input on tax implications that may result from dividing marital property.

PLEASE CONTACT US FOR MORE INFORMATION ABOUT FORENSIC AUDITING



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