"forensic audit" means audit aiming at prevention and detection of irregularities, such as fraud, embezzlement and corruption, and application of auditing skills to situations that have legal consequences;

There are three types of corruption fraud: conflicts of interest, bribery, and extortion. Research shows that corruption is involved in around one third of all frauds.

**FRAUD QUESTION**

A client heard through its hot line that John, the purchases journal clerk, periodically enters fictitious acquisitions. After John creates a fictitious purchase, he notifies Alice, the accounts payable ledger clerk, so she can enter them in her ledger. When the payables are processed, the payment is mailed to the nonexistent supplier’s address, a post office box rented by John. John deposits the check in an account he opened in the nonexistent supplier’s name.

Adapted from the CIA Examination.

1. **Define fraud, fraud deterrence, fraud detection, and fraud investigation.**

Fraud is gaining an unfair advantage over another person. Legally, for an act to be fraudulent there must be:

1. A *false statement, representation, or disclosure*
2. A *material fact*</emphasis>, which is something that induces a person to act</para></listitem>
3. An *intent to deceive*
4. A *justifiable reliance;* that is, the person relies on the misrepresentation to take an action
5. An< *injury or loss* suffered by the victim

―Fraud can be perpetrated for the benefit of or to the detriment of the organization and by persons outside as well as inside the organization.

―Fraud deterrence is the actions taken to discourage the perpetration of fraud.

―Fraud detection is using any and all means, including fraud symptoms (also called red flags of fraud) to determine whether fraud is taking place

―Fraud investigation is performing the procedures needed to determine the nature and amount of a fraud that has occurred.

1. **List four personal (as opposed to organizational) fraud symptoms, or red-flags, that indicate the possibility of fraud.</para></listitem> Do not confine your answer to this example.**

* High personal debts or significant financial or investment losses.
* Expensive lifestyle; living beyond your means.
* Extensive gambling, alcohol, or drug problems.
* Significant personal or family problems.
* Rewriting records, under the guise of neatness.
* Refusing to leave custody of records during the day.
* Extensive overtime.
* Skipping vacations.
* Questionable background and references.
* Feeling that pay is not commensurate with responsibilities.
* Regular borrowing from fellow employees.
* Collectors and creditors appearing at the place of business.
* Placing unauthorized IOUs in petty cash funds.
* Pronounced criticism of others.
* Association with questionable characters.
* Annoyance with reasonable questions; replying to questions with unreasonable answers.
* Unusually large bank balance.
* Carrying unusually large amounts of cash.

1. **List two procedures you could follow to uncover John’s fraudulent behavior.**

1. Inspecting the documentation supporting the release of a check to a vendor. There would be no receiving report. There might be a fake PO (not clear from the problem if John documents the fake purchase or if it is just oral).

2. Tracing all payments back to the supporting documentation. The receiving department would have no record of the receipt of the goods. The purchasing department would have no record of having ordered the materials or of having such materials requested.

**Question n Forensic Accounting**

A bank auditor met with the senior operations manager to discuss a customer’s complaint that an auto loan payment was not credited on time. The customer said the payment was made on May 5, its due date, at a teller’s window using a check drawn on an account in the bank. On May 10, when the customer called for a loan pay-off balance so he could sell the car, he learned that the payment had not been credited to the loan.

On May 12, the customer went to the bank to inquire about the payment and meet with the manager. The manager said the payment had been made on May 11. The customer was satisfied because no late charge would have been assessed until May 15. The manager asked whether the auditor was comfortable with this situation.

The auditor located the customer’s paid check and found that it had cleared on May 5. The auditor traced the item back through the computer records and found that the teller had processed the check as being cashed. The auditor traced the payment through the entry records of May 11 and found that the payment had been made with cash instead of a check.

**What type of embezzlement scheme does this appear to be, and how does that scheme operate?**  *Adapted from the CIA Examination*

The circumstances are symptomatic of lapping, which is a common form of embezzlement by lower-level employees in positions that handle cash receipts.

In a lapping scheme, the perpetrator steals cash, such as a payment on accounts receivable by customer A. Funds received at a later date from customer B are used to pay off customer A's balance. Even later, funds from customer C are used to pay off B, and so forth.

Since the time between the theft of cash and the subsequent recording of a payment is usually short the theft can be effectively hidden. However, the cover-up must continue indefinitely unless the money is replaced, since the theft would be uncovered if the scheme is stopped.

8) Which of the following is NOT the primary focus of a fraud examination by a forensic accountant?

A) Who committed the fraud?

B) How was the fraud committed?

C) When was the fraud committed?

D) Why was the fraud committed

9) Which of the following is a difference between fraud examination and fraud detection?

A) Fraud examination is done before a fraud has been committed, whereas fraud detection is done after a fraud has been committed.

B) Fraud examination is the investigation specific allegations or suspicions of fraud, whereas fraud detection is the identification of an error or irregularity after it has occurred.

C) Fraud examination focuses on the time and duration of the fraud, whereas fraud detection focuses on the need or motive of the fraud.

D) Fraud examination adapts proactive strategies, whereas fraud detection adapts reactive strategies.

3. Which of the following is outside the area of forensic accounting?

a. Corporate acquisitions.

b. Divorce.

c. Contract disputes.

d. None of the above.

.2   Multiple-Choice Questions

1) Which of the following best describes the term forensic accounting?

A) It is a discipline that deals with the preparation and analysis of financial statements of companies.

B) It is the use of accounting principles to consolidate financial statements of foreign corporations.

C) It is a discipline that primarily deals with methods of preparation of financial budgets of a company.

D) It is the use of accounting theories, principles, or analyses in a legal action, often through expert witness testimony.