

DUE DILIGENCE

Meaning & Scope

Due diligence is a process of investigation, performed by investors, into the details of a potential investment such as an examination of operations & management & the verification of material facts

Due diligence refers to an examination of a potential investment to confirm all material facts of the prospective business opportunity. It involves review of financial and non-financial records as deemed relevant and material.

To confirm that the business is what it appears to be

To identify potential deal killer' defects in the target company and avoid a bad business transaction.

To verify that the transaction complies with investment or acquisition criteria

Types of Due Diligence

Commercial/Operational Due Diligence

Financial Due Diligence

Tax Due Diligence

Information Systems Due Diligence

Legal Due Diligence

Environmental Due Diligence

Personnel Due Diligence

Areas for Verification

Brief description of the history of business

The background and standing of promoters

Accounting policies and practices followed by the organization

Management information systems

Details of management structure

Trading results both past and the recent past

Assets and liabilities as per latest balance sheet

Current status of Income tax assessments including appeals pending against tax liabilities assessed by tax authority

Cash flow patterns

Brief description of commercial and/or other activities conducted by the organization

The projection of future profitability

Hidden Liabilities & Over valued Assets

Hidden Liabilities

Any show cause notices which have not matured & disclosed

"Letters of Comfort" to banks and Financial Institutions

Product and other liability claims; warranty liabilities.

Indemnification of all liabilities and contingent liabilities

Tax liabilities & Pending Assessments

Agreement to buy back Shares at Fixed Price

Future lease liabilities or Environmental or 3rd party claims

Unresolved litigation including labor discussions

Over Valued Assets

Uncollected/uncollectable receivables

Obsolete, slow non-moving inventories or valued above NRV

Underused or obsolete Plant and Machinery

Assets carried at more than current MV

Litigated assets and property

Investments carried at cost though realizable value is much lower

Investments carrying a very low rate of income / return

Infructuous project expenditure / deferred revenue expenditure etc.

Group Company balances under reconciliation etc

Intangible assets of no value



FORENSIC AUDIT

Meaning & Difference

Forensic Accounting: The integration of accounting, auditing and investigative skills yields the specialty known as Forensic Accounting. It is the study and interpretation of accounting evidence. It is the application of accounting methods to the tracking and collection of forensic evidence, usually for investigation and prosecution of criminal acts such as embezzlement or fraud.

Forensic Investigation: Also known as forensic audit is the examination of documents and the interviewing of people to extract evidence. Forensic Accounting examines individual or company financial records as an investigative measure that attempts to derive evidence suitable for use in litigation.

Fraud Auditing: In a fraud audit one searches for the point where the numbers and/or financial statements do not mesh. It is a meticulous review of financial documents conducted when fraud is suspected. Some entities do them as a precaution to prevent fraud from happening and to catch it before the loss magnifies. A Fraud Audit however is not an investigation. Fraud auditing is used to identify fraudulent transactions, not to figure out how they were created. Fraud auditors often go outside the books of accounts to find fraudulent transactions.

Scope & Activities

Fraud Detection:

Investigating & analyzing financial evidence, detecting financial frauds & tracing misappropriated funds

Computer Forensics:

Developing computerized applications to assist in the recovery, analysis, and presentation of financial evidence

Fraud Prevention:

Either reviewing internal controls to verify their adequacy or providing consultation in the development and implementation of an internal control framework aligned to an organization's risk profile

Providing Expert Testimony:

Assisting in legal proceedings, including testifying in court as an expert witness and preparing visual aids to support trial evidence.

Services Rendered

Criminal Investigation:

Matters relating to financial implications the services of the forensic accountants are availed of. The report of the accountants is considered in preparing and presentation as evidence

Professional Negligence Cases:

Professional negligence cases are taken up by the forensic accountants. Non-conformation to GAAS or non-compliance to auditing practices or ethical codes of any profession, Forensic Auditors are needed to measure the loss due to such professional negligence or shortage in services

Arbitration service:

Forensic accountants render arbitration and mediation services for the business community. Their expertise in data collection and evidence presentation makes them sought after in this specialized practice area.

Fraud Investigation and Risk/Control Reviews:

Forensic accountants render such services both when called upon to investigate specific cases as well for a review of or for implementation of Internal Controls. Another area of significance is Risk Assessment and Risk Mitigation.

Settlement of insurance claims:

Insurance companies engage forensic accountants to have an accurate assessment of claims to be settled.

In case of policyholders, seek the help of a forensic accountant when they need to challenge the claim settlement. A forensic accountant handles the claims relating to consequential loss policy, property loss due to various risks, fidelity insurance and other types of insurance claims.

Dispute settlement:

Business firms engage forensic accountants to handle contract disputes, construction claims, product liability claims, infringement of patent and trademarks cases, liability arising from breach of contracts and so

FORENSIC AUDIT

Forensic Audit Approach

Initialization: Understand the key facts of the assignment and understand the requirement. Also, Client Acceptance Procedures

Develop Plan: Gather Information and plan the procedures to be performed to achieve the objectives of the assignment.

Obtain Relevant Evidence: By performing the procedures gather the necessary evidence to support the facts and the objectives.

Perform the Analysis: Corroborate the evidence gathered with the facts identified at the start and understand whether the objective is fulfilled.

Reporting: Issue the report containing the assignment scope, objectives, methodology adopted to gather & analyze the evidence, the evidence gathered, the findings and the conclusion.

Court Proceedings: Be prepared for the submission at court and for testimony.

Forensic Audit Techniques

General Audit Techniques: Testing the defenses or Controls (identify the weakness)

Statistical & Mathematical Techniques:

- Trend Analysis
- Ratio Analysis

Technology based /Digital Forensics Techniques

Computer Assisted Auditing Techniques (CAATs)

Generalized Audit Software (GAS)

Common Software Tool (CST)

Data Mining Techniques

Laboratory Analysis of Physical and Electronic Evidence

Forensic Audit Report

Executive Summary: Background of the assignment, Objective, Output Expected, and Approach Adopted - BOOA

Risk Analysis – Internal & External

Audit Process – Procedures Performed, Evidence gathered, Analysis performed, Conclusion

Audit Recommendation

Investigation

Meaning & Approach

An investigation requires special in-depth examination of the records or transaction with the objective of establishing a part, happening, or assessing a particular situation

Approach

Determination of objectives and establishment of scope of investigation

Formulation of the investigation program

Collection of Evidence

Analysis and Interpretation of Findings

Reporting of findings

Prominent issues

The report should not contain anything which is not relevant

Every word or expression used should be properly

Relevant facts and conclusions should be properly linked with evidence

Bases and assumptions made should be explicitly stated

The report should clearly spell out the nature and objective

The report should be made in paragraph form with headings

The report should also state restrictions or limitations

The opinion of the investigator should appear in the final paragraph

Types of Investigation

Statutory Investigation

Investigation into the affairs of a company

By inspector through an order of the Central Government (Section 210)

By Serious Fraud Investigation Office (Section 212)

Other cases (Section 213)

Investigation of ownership of a company (Section 216)

Non - Statutory Investigation

- Investigation on behalf of an incoming partner
- Investigation for valuation of shares in private companies
- Investigation on behalf of a bank proposing to advance loan to a company
- Investigation of frauds
- Investigation on behalf of an individual or a firm proposing to buy a business
- Investigation in connection with review of profit/financial forecast

Indicators of Fraud

Discrepancies in Accounting Records including non-recording or partial recording or incorrect recording or delayed recording of amounts, misclassifications, etc.

Conflicting or missing evidence including missing documents, altered documents, significant unexplained items in reconciliations, discrepancies between entity's records and confirmations received etc

Unacceptable management responses such as – denial of access to records/facilities/employees, undue time pressure to resolve complex issues, unusual delays in providing requested information, denial for use of Computer Assisted Audit Techniques, unwillingness to address identified deficiencies in internal control etc.

Other indications such as – Accounting Policies in variance with Industry Norms, Frequent changes in accounting estimates etc.