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AUDIT, FRAUD, AND FORENSIC ACCOUNTING

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Abstract

First, the paper will define fraud and analyze a fraudulent accounting situation and the responsibilities of a forensic accountant. Then, the paper will examine and analyze an accounting fraud case involving a money laundering scheme involving a retired couple who own a business and their son. Lastly, the paper will offer insight into the differences between an accounting audit and a fraud examination of financial statements and recommendations on what current fraud model offers the best explanation for the actions of the fraudulent retired couple.

Keywords

Audit, Forensic Accountants, Fraud Model

Carmichael (2018) defines accounting fraud as the intentional misstatement of financial statements to mislead the end users of financial statements, including financial investors, financial regulators, and bond and stock market analysts. When conducting an audit, the AICPA and the PCAOB both support that auditors are responsible for detecting fraud during the audit process (Carmichael, 2018). Kranacher and Riley (2020) explain that fraud or a fraudulent act is an intentional deception, usually by an error that affects the victim suffering economic loss.

Forensic accounting is the intersection between the laws governing accounting and accounting (Kranacher & Riley, 2020). Huber (2017) explains that forensic accounting researchers and experts must realize that the audit process and forensic accounting are defined differently and that when conducting a forensic accounting investigation, the accounting fraud triangle does not apply to fraudulent cases as there are so many different elements then the three recognized in the accounting fraud triangle model. When investigating financial crimes, a forensic accountant needs an academic model that includes the following elements that attempt to predict, detect, prevent, explain, and how and when to prosecute accounting financial crimes (Huber, 2017).

Fraudulent Situation

There are numerous examples of potentially fraudulent accounting situations. Kranacher and Riley (2020) provide an example of a fraudulent situation where one works in the accounts payable department, and it is discovered that the boss is adding personal expenses to be reimbursed through the reimbursable travel expenses accounting process. One of the Board of Directors for Walmart created fake, fraudulent company invoices to receive company pay for personal expenses (Kranacher & Riley, 2020).

Differences between Audit and Forensic Accounting

Jenkins and Negangard (2018) explain that financial statements and reporting have become increasingly complex, which presents and creates challenges for the modern-day auditor. The greater the financial complexity of financial statements, the more there is often an increase in the need for a higher degree of confidence in the auditor's judgment that the financial statements are free of error or fraud (Jenkins & Negangard, 2018). Jenkins and Negangard (2018) explain that with the complexity of financial statements, organizations, and businesses rely on auditors and other specialists in the auditing field to help during the audit process to ensure the accuracy and reliability of the financial accounting statements to the end users of this information.

Jenkins and Negangard (2018) explain that the modern-day auditor, during many routine audits, relies on forensic accountants and other forensic specialists to provide reliable assurance beyond the traditional audit that the organization or business is free of fraudulent and material misstatements in their utilization of accounting practices. Research survey results suggest that forensic accountants and specialists are commonly used during riskier audit engagements involving investigations by financial regulators, financial restructuring, financial restatements, and initial public offerings (Jenkins & Negangard, 2018). In many of these cases, the forensic accountant will provide support, leadership, and guidance to the audit team in areas of the audit that include high areas of fraudulent risk.

What is the forensic accountants' responsibility in many of these audit cases? The forensic accountant might assist in the fraud brainstorming process or help draw the blueprint for fraudulent test controls and then analyze the fraud testing results (Jenkins & Negangard, 2018). The research also reveals that a majority of auditors and forensic accountants have a high degree of confidence that the value obtained by including a forensic accountant during the audit process dwarfs the associated costs even when no form of fraud comes to light during the audit process (Jenkins & Negangard, 2018). Under today's auditing standards, the complexity of financial statements in the auditing environment is changing to include a forensic accountant to seek more confidence and comfort by using a forensic accountant during the auditing process (Jenkins & Negangard, 2018).

One of the fundamental differences between a forensic accounting engagement and an audit is that an audit focuses on forming and stating an opinion on the financial statements (Jenkins & Negangard, 2018). On the other hand, forensic accounting engagement usually focuses on investigating accounting transactions of specific interest (Jenkins & Negangard, 2018). During the auditing process, auditors commonly request accounting records, such as data relating to accounting transactions and other financial documents based on the auditor's auditing plan (Jenkins & Negangard, 2018).

Forensic accountants usually request financial data and documentation in an investigative manner and are less routine in forensic accounting investigations (Jenkins & Negangard, 2018). Jenkins and Negangard (2018) explain that forensic accounting investigations tend to be more informal and unplanned in routine, while accounting audits tend to be consistent with a coordinated auditing plan. An audit has a complete plan from the beginning to the end. The audit team coordinates it by following professional auditing standards outlined by the AICPA and the PCAOB (Jenkins & Negangard, 2018).

Other differences between a financial accounting audit and a forensic accounting investigation include the following. First, client audits are performed visibly and openly with the client's permission and understanding of the auditor's scope of work. Forensic investigations can be conducted without any client knowledge of the scope of work to be performed by the forensic accountant (Jenkins & Negangard, 2018). Jenkins and Negangard (2018) explain that the experience in the field is likely to be different, as forensic accountants are often highly experienced professionals in their respective fields, while much of the audit work is performed by less knowledgeable professionals.

Lastly, financial auditors and forensic accountants collect and approach evidence and documentation differently. The auditor assumes the documentation collected is valid unless the data becomes accessible, which denies validity (Jenkins & Negangard, 2018). Forensic accountants are much more cynical and collect and assess each document for misleading or altered financial data (Jenkins & Negangard, 2018). These differences between auditors and forensic accountants clearly describe the difference between an auditor's approach and a fraud examiner/ forensic accountant's approach to financial investigations and financial audits. The services provided by the forensic accountant usually include an investigation into certain accounting transactions that are thought to be misleading or altered in the form of fraud. Forensic accounting services are used in other cases to obtain a more secure judgment in an auditing case.

Financial Abuse and Fraud

What is the difference between fraud and abuse? Scott (2023) explains that financial abuse is different as financial abuse restricts or, in some cases, removes another human's access to financial resources. Financial abuse also limits a financial abuse victim's participation in the financial decision-making process and forces the victims into financial dependence on the abuser (Scott, 2023). In other cases, victims of financial abuse are exploited for their assets, money, and economic resources for the abuser's gain (Scott, 2023). The financial abuser, in many cases, takes total control of all financial instruments, and the victim becomes powerless against the abuser (Scott, 2023).

Özcan (2018) explains that the world economy has become a vast melting pot, and the businesses competing in this world economy face a series of financial risks and financial fraud in this business environment. With modern-day organizations facing much more financial risk, forensic accounting has become a significant component in combating accounting fraud (Özcan, 2018). Over the last two decades, the world has witnessed all kinds of accounting fraud and scandals involving organizations of all sizes, including private firms and large publicly traded companies (Özcan, 2018). As technology changes, detecting and preventing fraud have become challenging for all accounting personnel, including forensic accountants, internal auditors, and external auditors (Özcan, 2018).

With all the accounting fraud happening worldwide, forensic accounting has become a prominent tool in identifying fraudulent financial statements and reports. In addition to investigative services, forensic accounting includes comprehensive services such as litigation (Özcan, 2018). Özcan (2018) explains that the modern-day fraudster is improving at concealing their fraudulent traces and tracks. Therefore, forensic accountants have developed new concepts and methods to detect this ever-revolving white-collar crime.

The Case and Fraud Examination Methodology

DeZoort and Harrison (2018) explain that two significant forms of governance within an organization are designed to identify and manage fraud risk. The first form of governance is the organization's internal accountants and auditors, and the second is external auditors (DeZoort & Harrison (2018). Both the internal accountants of an organization and external and internal auditors have long been educated and are experienced in combatting accounting fraud efforts.

Fraud examination methodology was developed and implemented by the ACFE for resolving fraud allegations. Kranacher and Riley (2020) explain that the process is designed to handle all fraud allegations identically, from the initial allegations to the resolution of the fraudulent allegations. Each fraud allegation is taken very seriously and needs to be resolved promptly (Kranacher & Riley, 2020).

Each fraud case is different, and assuming there is a predication to conduct a forensic fraud examination, the fraud examination methodology has a particular set of instructions and steps designed to identify the specific focus of the fraud inquiry (Kranacher & Riley, 2020). The fraud examination methodology includes developing a hypothesis to describe how the fraud was committed, and by whom the fraud was committed, and as more evidence is collected during the investigation process, the hypothesis will also be modified to reaffirm what has happened (Kranacher & Riley, 2020). Kranacher and Riley (2020) explain that the role of the fraud examiner, as defined by the ACFE, is a person with a role in assisting, preventing, deterring, detecting, investigating, and remediating accounting fraud investigations.

Vousinas (2019) explains that there are several accepted models for explaining and detailing why individuals commit fraud. The models for identifying fraud include the following: The fraud triangle, the fraud diamond, the fraud scale, and the M. I. C. E. model (Vousinas, 2019). The models and theories build on the theoretical background to create a new model in order to fully understand the driving forces behind why individuals commit accounting fraud. To enhance understanding of the significant factors leading to fraud commitment (Vousinas, 2019), Voisinas (2019) explains that the SCORE model offers a more modern theoretical background behind the driving factors that influence people to commit fraud. The SCORE model is an acronym for stimulus, capability, opportunity, rationalization, and ego. All five factors likely played a role in our example case of financial accounting fraud (Vousinas, 2019). The ego of the business owners had the most significant influence, as the owners felt they would never be caught as they were not profiting off the money laundering scheme (Vousinas, 2019). All five elements are visible in the example case as the owners were capable, had the opportunity, rationalized that they were helping their son, and had an ego, thinking the likelihood of getting caught was very low (Vousinas, 2019).

Conclusion

Researching and examining current and past accounting fraud cases will help further understand why accounting fraud continues to happen and how accounting fraud can be prevented in the future. Vallaster, Lindgreen, and Maon (2012) explain that it starts at the top of an organization with a strong management team, including the financial accountants and the internal auditors, to monitor ethical choices and how they can impact the organization's image and financial position. Tyler, Dienhart, and Thomas (2008) explain that if the entire organization's workforce views the organization's management team as reasonable and genuine, most of the organization's employees will abide by the organization's policies and standards and act ethically while representing the organization.

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