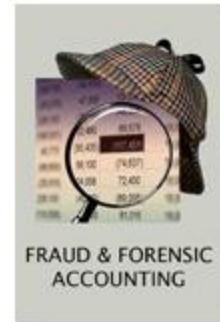




## **FORENSIC INVESTIGATION SPECIALIST**

A Newsletter – September 2013



Presented by

**J.S.CHOPRA & ASSOCIATES**  
**CHARTERED ACCOUNTANTS**

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### I. INTRODUCTION

Welcome to the first edition of the **FORENSIC INVESTIGATION SPECIALIST** Newsletter. Through this Newsletter we would endeavor to describe the nature of various services pertaining to Forensic and Financial Fraud Investigations, Corporate Business Intelligence, Fraud Risk Assessment and Litigation Support & Dispute services and Forensic & Financial Due Diligence.

We would also attempt to keep the readers informed of latest developments and news in these areas. Some articles of general interest would be included in various issues.

### II. FORENSIC INVESTIGATIONS & DISPUTE SERVICES

**Forensic investigations & Dispute services** : In an era of increased exposure to frauds and related activities, there is a rising trend among professional firms, especially in India, to provide an array of expertise under Forensic Investigations and Dispute Resolution services. It is general trend that all of the larger accounting firms, as well as many medium-sized and boutique firms, have specialist forensic accounting departments, and within this there are further specializations, as given below.

**Forensic Investigations and Dispute Resolution services practise normally involves an expertise in the following areas -**

- Fraud and Financial Investigations
- Corporate Business Intelligence
- Dispute and Litigation support services
- Foreign Corrupt Practises Act consulting
- Anti Money Laundering
- Analytic and Forensic Technology
- Anti Counterfeiting Services
- Pre Employment Background verification

In various issues of the Newsletter, we would briefly touch upon each of the practise areas stated above, followed by a case study which involves some aspects of a fraud investigation.



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**III. FRAUD INVESTIGATION – AN OVERVIEW**

**(part 1 of the article)**

The current world scenario of economic downturn and corporate fraud scandals of recent years have renewed interest in financial frauds in various organizations. Negative aspects of globalization and growing economy is white collar crimes. However, the threat of financial fraud is always existing and there is a need for the management, regulators and law enforcement agencies to deal with these situations. There is an increasing trend where various businesses are being victimized by serious internal frauds. Fraud by its nature is perpetrated through secrecy and deception.

Financial fraud investigations has a wide connotation. In this article, an attempt has been made to cover most of the aspects pertaining to financial fraud investigation. In this article we provide information and background in relation to fraud investigations.

The article comprises three sections, namely :

1. Audits or Investigations – essential difference between the two,
2. Forensic investigations and disputes services – areas normally covered under this practise,
3. Fraud investigations – a practical case study.

**1. AUDITS OR INVESTIGATIONS : MISTAKE OR FRAUD**

At the outset, it is essential to understand that there are fairly significant differences between an audit and an investigation. Corporate frauds are known to increase during situations similar to the current uncertain economic times world over.

Normally an audit involves inspection of financial statements, accounting procedures & standards and records to make sure that there is “ reasonable assurance about whether the financial statements are free from material misstatement ” and that they present a “ true and

fair view in conformity with the accounting principles generally accepted ". In other words, auditors look for errors, and not necessarily for fraud.

Fraud investigations focus on the unusual accounting irregularities that point towards a trend of criminal financial behaviour. Thus financial fraud investigations require deployment of professionals with expertise in detection and prevention of fraud. This requires the fraud investigators to determine occurrence of a fraud, its perpetrators and the implication of the fraud – monetary loss and damages.

Certain type of frauds may be due to deliberate inaccuracies in a financial statement that lead to someone benefiting financially. Usually frauds are detected through a whistleblower or anonymous inputs, or management having suspicions or noticing unusual financial fluctuations. It has been observed that fraud is detected less than 10 percent of the time during the course of audit of financial statements. This is primarily due to the reason that Auditors conduct their verification on the basis of sample checking of relevant documents, and look for a "reasonable assurance" and that the statements are free of "material misstatements." Sample checking is done as it is not practical to verify every transaction during the course of an audit.

During the audit, it needs to be verified whether a company is in compliance with its governance and regulations, and whether the financial statements are accurate within a reasonable degree of materiality. Thus during an audit, the auditor would not be too concerned if an expense is misclassified. However, during a fraud investigation, he would further examine an expense misclassification and reasons behind the same, as it may be intentional. Thus the outlook while conducting an investigation undergoes a change as compared to an audit.

Public perception is that auditors' job is to detect fraud issues, while in fact the overall purpose of an audit is to ensure the true and fair presentation of financial statements. Auditors try to give full disclosure and transparency in their reports and financial statements audited by them. Present reporting format requires that auditors should report on certain elements of fraud as part of financial audit procedures.

However, a fraud investigation involves a detailed investigation into specific issues along with other processes like gathering evidence, conducting and recording (electronic or manual) interviews of employees and management.

Before requesting a financial statement audit, executives should know whether their company just needs an audit or something more serious, because the repercussions are far reaching when fraud goes undetected.

Corporate fraud investigation requires curiosity and tenacity along with the domain knowledge. The work may be time consuming and tedious, but the efforts usually are quite satisfactory. However, there may be instances where during the course of an investigation, considerable efforts put in do not yield commensurate results or findings, and there may be instances where the investigators hit the bulls eye by way of immediate findings in a short period. This in no way should be used as a yard stick in judging the competence or lack of it on part of the investigators. An investigation involves sifting, collating, verifying and interpreting through mountains of data and information.

Suspicion of occurrence of a white collar crime requires an immediate response with discretion along with an indepth knowledge of the legal and regulatory procedures involved.

Usually, corporate fraud investigators are retained by the corporate or outside counsel, hence they are bound by the lawyer-client confidentiality. As such, in spite of the fact that their findings may point towards an illegal activity, however they do not have a say in whether to prosecute a crime or not.

Investigators usually have backgrounds either in forensic accounting, finance, internal audit or law procedures. The expertise may be in either of the areas stated or may be a combination of these. They should have an ability to get people to talk during the course of discussions and interviews. The need to investigate frauds are increasing these days to the extent that temporary staff are hired ( in USA ) — including lawyers, private investigators and certified fraud examiners.

## **2. FORENSIC INVESTIGATIONS AND DISPUTE RESOLUTION SERVICES**

**In this Newsletter we would cover Fraud and Financial Investigations. Other practice areas, as defined above, would be covered in our subsequent issues.**

**(A). Dictionary meaning of Forensic accounting** indicates it to be the specialty practice area of accountancy and refers to assignments that result from actual or anticipated disputes or litigations. "Forensic" means "suitable for use in a court of law", and it is to this result and potential outcome that forensic accountants generally have to work.

**Forensic accountants** are also referred to as forensic auditors or investigative auditors, and are often called to give expert evidence at the eventual trial. Assignments relating to criminal issues arise subsequent to perpetration of fraud and usually involve accounts related issues and assessing the financial statements. By qualification, forensic accountants are Chartered Accountants / Certified Public Accountants or Certified Fraud Examiners.

Thus Forensic Accountants besides having expert knowledge of accounting & auditing standards and procedures, should have an understanding of business and financial reporting process. They should be well versed with the investigation techniques, evidence gathering and the related legal procedures involved during the course of their assignment. There is an increasing trend where the Forensic accountants are giving vital inputs for fraud risk reduction by way of conducting Fraud Risk Assessment assignments at various entities, thereby mitigating the fraud risk for that organisation. They are increasingly being involved to recommend and conduct forensic assistance as part of statutory audit. Their services are also being utilised as advisers to audit committees and fraud deterrence assignments.

**According to a study on financial statement fraud** conducted by the nonprofit Institute for Fraud Prevention (IFP), a consortium of universities for research of the causes of fraud and how to reduce it, it is stated that internal controls were usually circumvented by a fraud network led by the CEO and assisted by outsiders. The CEO normally includes the CFO in the fraud network. It was further reported that these fraud networks cause extremely large losses that are far greater when the outside audit firm is alleged to have aided the fraud. It was additionally stated that in more than half the cases, an entity other than the organization where fraud is perpetrated, usually an investment bank, auditing firm, or colluding business partner were implicated as a party to the crime.

As Fraud investigations are usually initiated as a result of suspicion about certain type of fraud or suspected persons, it is always wise to engage the services of an expert fraud investigation specialist.

## **(B). Fraud and Financial Investigations**

These investigations involve conducting complex assignments including those pertaining to financial statement frauds, misappropriation of assets, corruption and bribery, and fraud risk evaluations. Broadly, services comprising Corporate Business Investigations, Forensic Accounting and Asset Misappropriation Investigations (Asset Tracing) form part of such investigations.

**Financial Fraud Investigations** : While conducting a financial fraud investigation, it is advisable to involve the management of the client at an initial stage itself. During the initial phase of discussions and interviews with the management, main issues involved in the investigation are identified and discussed. This always facilitates in putting a perspective to the whole investigation. Main ingredients of an investigation is that the findings should be able to stand up in a court of law. It thus has to be supported by properly documented evidence. Evidence in form of documents and discreet interviews of employees, customers, associates, competitors and other related parties form an important part of the investigations.

Successful investigation involves maintaining absolute confidentiality of the assignment, being familiar with court procedures, having requisite investigative experience and techniques. A person conducting the investigation should have adequate financial acumen and the ability to isolate issues. He should also identify and legally secure evidence and thereafter properly interpret the evidence.

While conducting an investigation into a Financial Statement Fraud, it should be considered that the most common way that financial statement fraud is carried out is through revenue overstatement. Further, the most convenient method to undertake this is to depict an apparent improvement in the financial position of the entity by fraudulently inflating revenue. Trends in revenue are compiled and revenue overstatement are thereby detected by analyzing these revenue patterns.

For example : Irregularities or unusual changes in cost of goods sold may indicate that fictitious revenue may have been accounted for without corresponding expenses. It has been noted that Revenue overstatement may also be suspected when an entity regularly has cash flow problems, even though the financials may indicate an apparent increase in sales and profits and a robust bank balance.

Another way to overstate revenue without arousing any suspicion would be a constant increase in sales or profits from period to period. This is more so for public companies where the shareholders have great expectations from the company management for good financial performance year on year. If the management wants to camouflage its intentions of fraudulent increase in revenue, it can do so by reporting increased sales and profits within the acceptable norms for that industry. The catch lies in reading between the lines.

The financial statements may indicate robust growth whereas the Notes to Accounts may indicate a different scenario, like significant increase in material cost which should adversely affect the profits while instead the financial statements may be indicating good profits year on year. In this situation, Profits would increase or remain stable, if there had been a

corresponding increase in sale prices, which however was not the case in this company as per independent evidence. This gave rise to doubts on the correctness of the financial statements leading to an depth verification process.

Thus on the face of it, the financial statements may appear reasonable, however the fraud is discovered when the facts are cross checked and outside evidence is compared with management's assertions.

A majority of Corporate Fraud cases involve devising accounting schemes with a purpose to deceive stake holders, auditors and various interested parties with regard to the accurate financial position of the entity. This inaccurate financial data and fictitious performance indicators result in the company artificially depicting good performance resulting in the rise of share price of the corporate. This translates into significant financial losses to investors which has the potential to shatter investor confidence and cause damage to the economy, once the correct financials of the company are revealed.

Financial frauds and falsification of financial information are usually perpetrated in a combination of following schemes :

- incorrect depiction of financial statements,
- inappropriate revenue recognition including revenue overstatement and fraudulent reporting of fictitious sales,
- incorrect expense recognition,
- overstatement of assets and understatement of liabilities,
- concealment of transactions through off balance sheet items and entities,
- misappropriation of assets,
- fraudulent conduct by senior management and fraud unrelated to financial statements (e.g., corruption),
- improper ratios pertaining to inventory or accounts receivables, recording of large amounts being written off immediately after closure of the accounting period are indicators for fraudulent manipulation of revenue,
- false accounting entries.

Financial investigation involves using accounting expertise, documents and critical transaction analysis combined with witness and third-party evidence. Usually such investigations require conducting a review of various documents and electronic evidence, then collating and managing these documents to aid in further analysis. Interviews with employees and persons with specific knowledge relating to the investigations underway, form a part of the process aimed at exposing such fraud schemes and aiding expeditious recovery of amounts defrauded.

In this age of computerization, experienced professionals in Analytic & Forensic Technology (covered separately in the article) usually form a part of the investigations by collecting, controlling and analyzing huge and often complicated data through their proprietary modern technology tools. The computer forensic analysis so conducted provide vital inputs to the whole investigation process, by indicating the trends and information arising from their analysis.

**Methodology normally adopted to investigate financial statement misstatement would be given in subsequent Newsletter.**

(..... TO BE CONTINUED IN SUBSEQUENT MONTHLY ISSUE)

#### **IV. NEWS - LATEST IN FRAUD & INVESTIGATION**

**(1)**

##### **“HP claims Autonomy is under investigation by Serious Fraud Office**

**British technology firm faces inquiries over accusations of suspect accounting, according to HP**

**(news source – The Guardian, March 2013)**

The Serious Fraud Office (SFO) and US department of justice have opened investigations into the accusations of suspect accounting at the British technology firm Autonomy before its 2011 acquisition by Hewlett-Packard, the US technology company said on Monday.

In a regulatory filing with the US Securities and Exchange Commission (SEC), HP said it had been told that investigations were under way by the US and UK authorities on 21 November and 6 February respectively.

Ironically, the SFO is itself an Autonomy user – in order to work through voice calls and emails for relevant information. On 11 February, a spokesman there declined to comment on whether it had opened any investigation.

Mike Lynch, the billionaire co-founder and former chief executive at Autonomy – who left the company and HP in May 2012, just seven months after the acquisition – said at the start of March that he had heard nothing from HP and had heard nothing about investigations.

A spokesperson for Lynch declined to comment on Monday night. The Guardian also understands that the SEC has approached Lynch in the past few days about the subject.

HP announced last November that it was writing down the value of Autonomy by \$8.8bn (£5.9bn), having bought it for more than \$10bn in summer 2011.

Meg Whitman, the chief executive who took over as the acquisition was being completed, blamed a "wilful effort" to inflate the company's figures, and that they "severely impacted HP management's ability to fairly value Autonomy at the time of the deal".

Lynch has blamed the problems – and the outflow of Autonomy staff from HP following the acquisition – on stifling management processes that made it impossible to keep the same startup spirit that he had aimed to foster with the staff.

HP has alleged that there were "serious accounting improprieties, disclosure failures and outright misrepresentations" in Autonomy's business, but has provided no other detail.

Lynch has repeatedly challenged the company to specify what it thought was wrong in the way that the business – once the biggest technology company on the London stock market – had misrepresented its accounts.

Until the announcement, the only known investigation was by the FRS, the body which oversees accounting standards.

In its filing, HP says that it has "provided information to the UK Serious Fraud Office, the US department of justice and the SEC related to the accounting improprieties, disclosure failures and misrepresentations at Autonomy that occurred prior to and in connection with HP's acquisition of Autonomy".

It said: "On 21 November, 2012, representatives of the US department of justice advised HP that they had opened an investigation relating to Autonomy.

"On 6 February 2013, representatives of the UK Serious Fraud Office advised HP that they had also opened an investigation relating to Autonomy. HP is co-operating with the three investigating agencies." "



(2)

## **“UK-US Couple Held In China For 'Selling Data'**

(news source – skyNEWS, August 2013)

A British corporate investigator and his American wife have been arrested in Shanghai on suspicion of illegally buying and selling personal information about Chinese citizens.

Former journalist Peter Humphrey and his wife Yingzeng Yu are accused of obtaining people's addresses, as well as information about their families, homes and cars, and selling the details to lawyers, manufacturers and financial companies. Police in Shanghai claimed the pair had "seriously violated the legitimate rights of citizens" and said they were formally arrested earlier this month.

Humphrey, speaking in Mandarin as he appeared on state television with his face blurred, said: "To obtain this information, I sometimes used illegal means. I want to apologise to the Chinese government." A spokesman from the British Embassy said: "We are aware of reports in the Chinese media relating to Peter Humphrey. "We were concerned to see that Peter Humphrey was interviewed about the details of a case which is currently under investigation and has yet to come to trial. "We are continuing to provide consular assistance to Mr Humphrey and his family."

Humphrey and Yu run a company called ChinaWhys, which offers services including the screening of potential employees or business partners.

Chinese companies use such firms to protect themselves against fraud, embezzlement or misconduct by employees or business partners.

Humphrey, who worked as a foreign correspondent for 20 years, studied at Durham University and founded ChinaWhys in 2003.

He was detained as police investigated bribery allegations against drugs company GlaxoSmithKline, one of the companies he worked for, Reuters said.

Chinese police have detained four GSK executives claiming they organised a scheme to funnel bribes to doctors in return for buying its products.

It is not clear whether Humphrey's arrest is linked to the probe.

A report last week claimed that western firms were warned about illegal practises at a meeting in a Beijing hotel in July. China's National Development and Reform Commission (NDRC) held a closed-door meeting with representatives from around 30 foreign firms, including Siemens and General Electric. At the meeting, the firms were reportedly warned about corruption and violating Chinese law.

One source claimed the Chinese official had said half of the companies in the room were either being investigated or had been probed by the NDRC. Sky's China Correspondent Mark Stone, in Beijing, said: "Over the past few months, the Chinese operations of a number of foreign companies have been subjected to probes by Chinese investigators, ostensibly as part of a country-wide crackdown on corruption. "The focus on foreign firms is seen as being increasingly aggressive and could threaten foreign investment in China.

"Given how important the Chinese market is to foreign companies, none will want China to become too risky a market in which to operate."

According to a profile on his company's website, Humphrey's achievements include eliminating fraud in the buying operation of a well-known chain of stores, uncovering fraudulent deals for a global appliances manufacturer and helping recover a kidnapped child in China. ”

## **CORRUPTION - A WAY OF LIFE?**

**By CA Vipon Kinger**

Corruption is a widespread phenomenon in today's public life. It is lack of integrity which could be moral, intellectual or financial.

Bribery, money laundering, incentives, fees for services rendered and scams have become a way of life. Corruption at high levels of political leadership percolates downwards, first, into the entire bureaucratic system and then amongst the civilians. The government can tackle corruption only if serious efforts are made to improve the socio-economic conditions of the people.

Proper utilization of funds is necessary in the sectors of health, education and infrastructure. Corruption has widened the gap between the 'have' and 'have not's' considerably which needs to be abridged by taking adequate action. However, the urgent need of the hour is to adopt a zero tolerance attitude towards corruption.

The best way to deal with the problem of corruption is to eradicate it from its roots. Rules and regulations must be simplified so that they are easily understandable to the common man. Only persons of high moral character and proven integrity should be chosen for a government job. People should be educated and well aware of their rights and duties. They should be bold enough to assert their rights. The best way to fight this problem is to develop vigilance machinery within one's own country. This is possible only when there is a wholehearted support and cooperation of the people of the country.

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