
FORENSIC AUDIT – A NEW BRANCH OF AUDIT

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Abstract: Forensic audit is a newer discipline within auditing that is aimed at detecting fraud in financial statements. Unlike the classic audit, which is primarily aimed at issuing an opinion on whether the financial statements are free from material misstatements, the forensic audit is aimed at detecting fraud. In fact, the forensic audit fills the "expectation gap" that occurs among the users of the financial statements who mistakenly believe that the audit of the financial statements "reveals everything", even though the audit reports themselves emphasize that "due to the nature of the audit work some material misstatements may go undetected by the audit".

Forensic audit is an extensive investigation of accounting records carried out by independent and expert persons in order to detect fraud or to eliminate the suspicion of the existence of fraud, during which evidence is collected that is usable in court proceedings, and which the forensic auditor, if necessary, presents in court.

The company may initiate a forensic investigation to dispel rumors of bribery and extortion among its employees. They may also initiate investigations to learn more about these workplace activities and identify the individuals involved in them.

The purpose of research in this paper will be to identify the importance and role of forensic audit in detecting fraud in financial reporting, misappropriation of funds and other criminal acts in entities from the economy, public and non-governmental sectors.

Keywords : forensic audit, forensic auditor, fraud, financial statements, judicial authorities, crime

1. INTRODUCTION

In developed countries, the auditing of financial statements has been limited by auditing standards for many years, and everything that is outside the scope of these standards, auditing companies are not allowed to work. The scope and content of the audit of financial statements are distinctly complex and dynamic, so the audit of financial statements, as an instrument for successful business decision-making, in current conditions acquires a new content, expanding the boundaries of the traditional to a modern concept, which among the other is characterized by the expansion of audit services and requests made by users. In that context, in the last few years as a result of the increasing number of cases of corporate scandals worldwide, more and more attention is being paid to the area of fraud detection in financial statements and forensic audit.

Forensic auditing first originated in the United States of America, where the Association of Certified Fraud Examiners (ACFE) was founded, and is the world's largest organization for detecting fraud and educating people about operational fraud detection.

Within the association, education is organized for potential candidates who, after passing the prescribed exams, receive the title of Certified Fraud Examiner. The Association of Certified Fraud Examiners has set high standards and criteria for membership, which contributes to increasing the reliability of its work. Using various investigation and research techniques this organization contributes to the development of forensic audit.

Forensic auditing in recent literature in the field of accounting and audit is increasingly cited as one of the most important measures to prevent and detect fraud in financial statements, but this area is still not significantly regulated by professional regulations and standards. In conditions in which audit practice offers and implements services that are not yet shaped and channeled by certain guidelines and standards, a major challenge for audit theory is to give forensic audit an appropriate place in the set of audit services, primarily through its correct definition, but also recognition of its goals, characteristics and correct expression of its results and findings.

2. DEFINING FORENSIC AUDIT

Considering the fact that forensic audit is a new practical discipline within audit, there is still no comprehensive and unified definition for it. However, a large number of theorists, as well as numerous national and international organizations and associations, offer their answers regarding the question of the place and role of forensic audit in audit theory and practice, thus providing a starting point for its correct definition.

According to the Association of Certified Fraud Examiners ACFE, **a forensic audit is the use of professional accounting skills in cases where there is a potential or actual civil or criminal proceeding, and it involves**

generally accepted accounting and auditing principles; determination of lost profits, income, property or damages; assessment of internal controls; fraud and any other need to involve accounting professionals in the legal system.

The Institute of Forensic Auditors - a non-profit organization founded in 2001, with the aim of professional organization of forensic auditors in Belgium, defines forensic audit as "the activity of collecting, verifying, processing, analyzing and reporting data for the purpose of for obtaining facts and evidence that can be used in court - financial disputes, arising as a result of fraud in financial reports and providing preventive advice". According to Paul Thangam, forensic auditing is "the application of accounting methods to the tracing and gathering of forensic evidence, usually for the purpose of investigating and prosecuting crimes, such as embezzlement and fraud." The aforementioned author also points out that forensic auditing is "a new branch of auditing that creates great opportunities for certified accountants and auditors."

Taking into account all the stated views and opinions, the forensic audit can be defined as a type of audit service that is based on the application of accounting and auditing skills in order to carry out targeted, detailed procedures, and for the purpose of detecting fraud in financial statements and presenting them in a manner acceptable for court proceedings.

Economics and financial expert witnesses too participate in the process of determining facts pertinent to a case. The need for a forensic examination in legal proceedings arises when the court does not have the knowledge necessary to determine all relevant facts and render a final judgment, which is the reason why courts engage expert witnesses to determine facts by applying knowledge and skills within their expertise. (A.Cudan & D. Cvetkoic, 2019, p.39)

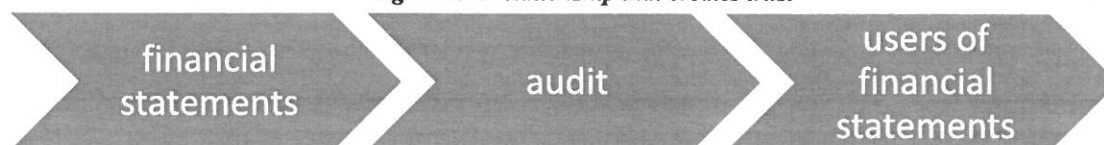
According to International Standards on Auditing (IAS), the objective of an audit of financial statements is to enable the auditor to express an opinion on whether the financial statements are prepared, in all material aspects, in accordance with an identified financial reporting framework. An audit in accordance with ISAs is designed to provide reasonable assurance that the financial statements taken as a whole are free from material misstatement.

An external audit provides the higher level of assurance, since a positive opinion is used to provide reasonable assurance that the financial statements are not materially misstated. The negative assurance given in a review engagement is a lower level of assurance, since the practitioner only states that nothing has come to their attention that indicates that the financial information is materially misstated. (*Audit & Assurance (AA)*, 2019, p.95)

Financial fraud is an intentional, deliberate false statement or omission of material statements or accounting data which, taken with other information as a whole, causes the perpetrator to change or rearrange his judgment or decision. (Rezaee & Riley, 2010)

Very often the question "Why is there a need for the audit" is asked? The answer to this question is often sought in the economic relations of the business entity. If by the main task of the audit we mean examining and giving an opinion regarding the objectivity and truthfulness of the information presented in the financial statements, then the audit represents a "relationship that creates trust" between the company that presents and prepares the financial statements and the users of that information. This can be vividly explained as follows (Dimitrova, 2020 p. 31).

Figure 1. A relationship that creates trust



Source: Dimitrova, J. (2020) *Audit (theoretical and practical aspects)*. Shtip: University Goce Delchev Shtip - Faculty of Economics, p.31

This diagram represents an understanding of the purpose of the audit, which according to the IAS is defined as "an opportunity for the auditor to express his opinion as to whether the financial statements have been prepared according to all significant aspects in accordance with the established framework for financial reporting".

Financial fraud or criminal activity in financial statements is a challenge on a global scale. Namely, even the most developed market economies with a regulated economic and legal system are unable to cope with the problem of financial fraud. (Spalevič & Višentijevič, 2017)

On the other hand, although the forensic audit, as a new type of audit of financial statements, does not yet have specially developed generally accepted standards, which, among other things, will emphasize its most important goals, in the theory and practice of the forensic audit in relation to this issue, there are no essential disagreements.

3. PURPOSE OF THE FORENSIC AUDIT

Basic purpose of the forensic audit is the detection of fraud in the client's financial statements, regardless of its materiality, that is, the degree of its influence on the reliability and objectivity of the financial statements. Financial statements are the basis for assessing the future profitability and financial position of the company, which can affect the movement of the market value of individual shares and the value of the company's total capital. (Vuković Perduv & Babić, 2021)

The comprehensive realization of the basic objective of the forensic audit implies, to the greatest extent possible, the realization of the goals of a lower level, that is, of the individual objectives of the forensic audit that creates prerequisites for the preparation of the report and the expression of the opinion of the forensic auditor.

Organizations that may have been involved in financial crime may need a forensic audit, which means it can be a key part of either identifying specific circumstances where fraudulent activity may have occurred or helping to prepare for legal proceedings through detailed financial analysis.

From the point of view of **the individual goals of the forensic audit** (Petković, 2010), the prevailing views are that the forensic auditor has the obligation to:

- identify perpetrators of fraud in financial statements;
- determine the place of execution of the frauds;
- determine the time of execution of the frauds;
- determine the material damage caused as a result of the frauds;
- determine the techniques ie. the way of committing the frauds.

A forensic audit should **identify the perpetrator of financial statement fraud** and his job position at the time the fraud was committed, as well as to establish whether the fraud was committed independently or in collaboration with other employees within or outside the entity.

Determining the place where the fraud was committed is necessary in the forensic audit because the finding and opinion of the forensic audit in conditions of detection of fraud, among other things, results in court proceedings. The resolution of several issues depends on the determination of the place of execution of the frauds, and above all the determination of the territorial jurisdiction of the court.

The forensic audit should determine **the time of the fraud**, because several issues related to the temporal validity of the criminal code, the issue of statute of limitations for criminal prosecution, etc. depend on this fact. Namely, after the expiration of a certain period of time from the execution of the fraud, defined as the statute of limitations in the criminal code, criminal prosecution of the perpetrator of the fraud cannot be carried out.

After the fraud in the financial statements is discovered, the forensic audit should determine **the material damage caused by its execution**. The reasons and needs for determining the material damage caused as a result of the fraud are multiple. From the perspective of the client of the forensic audit, the damaged entity based on the reported damage in disciplinary and court proceedings can submit to the perpetrator of the fraud a request for compensation for the damage, make corrections in the financial statements, and in certain cases submit a claim from the insurance company for insurance payment. From the point of view of the possible court procedure which can take into account the findings of the forensic audit as evidence and attachments, the determination of the material damage is necessary due to the correct determination of the competence of individual courts, and possible withdrawal from the court procedure of those imams who caused insignificant material damage.

It is extremely important for the forensic audit and the forensic auditor himself to **determine the techniques ie. the method of execution of the fraud**. From the client's point of view, the forensic audit, by determining the fraud execution techniques, reveals the weaknesses of the internal control system and the mechanisms by which it was overcome by the perpetrators of the fraud. Consequently, the entity that is affected by the fraud in the financial statements will have the opportunity in its further operation, following the recommendations of the forensic auditor, to take actions in terms of strengthening the system of internal controls and preventing the occurrence of new frauds. From the point of view of the possible court procedure, the determination of the fraud execution techniques will allow the court authorities to carry out the legal qualification of the crime more easily.

In the forensic function, the auditor must understand that he is not a judge, that he does not judge that his role is only to discover the truth in the transaction which forms the object of his expert opinions and evidence. In performing these tasks, he is an expert, and that means he is only expert testimony in the function of proving the truth in the dispute for which it is engaged (Grujić – Kalkan, 2014).

The big audit companies (they are also called the "Big Four", operate in more than 150 countries in the world and audit the largest corporations. The Big Four are made up of the companies: PricewaterhouseCopers, KPMG, Ernst & Young and Deloitte), which, among other things, implement and forensic audit services, within their interdisciplinary teams have also included legal experts from the field of criminal and criminal procedural law, usually former lawyers, prosecutors or judges, who can help assess whether execution techniques essentially

reflect a particular crime prescribed in the criminal code.

4. DIFFERENCES BETWEEN THE AUDIT OF FINANCIAL STATEMENTS AND THE FORENSIC AUDIT

Given the specificity of the basic and individual objectives of the forensic audit, forensic auditors have a completely different approach to the verification of financial statements, both in terms of the materiality and scope of the checks, and in terms of reporting the results of their work.

The audit covers an examination and evaluation of the work, the organization and business functions, the way of making business decisions, the functioning of the information system at the subjects of the audit, as well as other issues significant for their work. (Nikolovski, 2004)

For this reason, a distinction should be made between the audit of financial statements and the forensic audit.

Table 1. Differences between the audit of financial statements and the forensic audit

	Characteristics	Audit of financial statements	Forensic audit
1.	Purpose of examination	Forming and expressing an opinion on the reality and objectivity of the audit entity's financial statements.	Determining the accuracy of each account and transaction and whether there is any fraud related to them.
2.	Examination techniques	Basic and essential consent procedures in the preparation of financial statements	Analysis of trends from past periods and thorough verification of transactions
3.	Examination period	Transactions from a specific time period	Full verification of all transactions, sometimes including those from the beginning of the operation
4.	Report and opinion	Expressing an opinion with or without qualifications, disclaiming from giving an opinion or an adverse opinion	Expressing an opinion regarding the place, time and manner of committing the fraud, determining the material damage and identifying the perpetrators.

Source: Petković, A. (2010) *Forensic audit*, Orfelin Izdavastvo Novi Sad, p. 194

Purpose of examination - The audit of the financial statements is primarily aimed at checking the accuracy and reality of the financial statements. So, after the reports are ready, they should be checked by an independent person, which is the auditor. Forensic auditing is aimed at determining the accuracy of each account and transaction and whether there is some fraud related to them.

Therefore, the main difference between these types of audits is that the audit of financial statements is not conducted with the sole purpose of detecting fraud, but auditors must be prepared to identify it if it exists, while forensic auditors investigate specific fraud for which there is certain doubt or it has already been realized.

Examination techniques - For a successful comparison of the audit of the financial statements of the business entity, for the auditor's opinion to be reliable, objective and reasoned, the materially significant items or balance positions should be examined. But such an examination requires a longer engagement time of the auditor, the costs are higher, and it is justified only in cases where abuse, fraud, theft or if there is a suspicion of concealment of deviations in the operation of the business entity. Therefore, with the increase in the size and volume of activities among business entities, the auditor's need to use a sample in his investigations is emphasized. Namely, during the audit engagement, the auditor bases most of his knowledge on the study and evaluation of a carefully selected sample of items and transactions.

A forensic audit takes a different approach to verifying financial statements than a financial statement audit, because in areas of operations where symptoms or indications of fraud will arise, it examines in detail most or all of the individual transactions. Accordingly, a forensic audit and an audit of financial statements differ significantly on the issue of materiality. Namely, the forensic audit is not aimed at detecting only materially significant misstatements as a result of fraud, but at detecting any fraud regardless of its significance and size. Consequently,

the level of materiality in a forensic audit is much lower than a financial statement audit engagement.

Examination period - The audit of the financial statements covers a specific period for examination, usually one business year for which the audit of the financial statements is carried out. However, this approach does not provide the historical perspective that is significant for detecting illegal behavior, given the fact that fraud can be hidden in financial statements for years.

When comparing the forensic audit, the forensic auditor does not only audit the financial statements for a particular business year, but, guided by the symptoms and indications of illegal behavior, performs a thorough investigation in order to discover the foundations of the fraud, regardless of the time period of the execution.

Report and opinion - The independent auditor, as a result of the audit, issues a report in which he expresses his opinion on whether the financial statements have been prepared, in all material aspects, in accordance with the applicable financial reporting framework, while the form and content of the audit report are prescribed by the International auditing standards.

On the other hand, starting from the fact that the forensic audit has a specific purpose, and its report (although it still does not have a generally accepted and prescribed form) with its content must satisfy certain, basic criteria, which primarily refer to its suitability and usefulness for a possible court procedure.

The methods applied in the forensic audit are mostly based on the techniques and methods applied in the audit of financial statements (inspection, observation, analytical procedures, recalculation, inquiry). The methods and techniques applied in forensic auditing enable forensic auditors to determine whether suspicions of fraud are justified.

5. FORENSIC AUDITOR, SKILLS AND KNOWLEDGE

Forensic auditors as we mentioned are professionals in their field, and forensic auditors can be:

- certified auditors and certified accountants with more experience in their work;
- forensic experts;
- tax inspectors and advisers;
- inspectors from the financial police.

The forensic auditor should possess certain knowledge and skills, namely:

- professional knowledge and experience in fraud detection, which knowledge should be continuously improved;
- professional skepticism is emphasized, which according to the International Auditing Standards is defined as a situation in which the forensic auditor must not believe in the honesty of any of the employees under his observation. Given that the forensic auditor is operating under reasonable suspicion of fraud, this means that the skepticism of the forensic auditor should be at a higher level than the skepticism of the auditor;
- should have interdisciplinary knowledge from several areas that will help him detect fraud, such as audit, accounting, forensics, tax system, IT skills and other similar knowledge that will help him detect fraud and analyze it from several aspects;
- excellent knowledge of audit methodology, as many audit procedures are also applied in forensic audit (eg examination and observation, inspection, analytical procedures, recalculation, etc.);
- excellent knowledge of international financial reporting standards, primarily in areas where management applies estimates to bring some balance sheet items to market value;
- excellent knowledge of financial theory and practice, that is, the techniques of performing monetary transactions, foreign exchange transactions, money laundering, etc.
- excellent knowledge of local tax and financial and commercial laws.

The range of ethical and professional issues is similar to any other audit engagement. However, the importance of ethics is undoubtedly much greater in the context of forensic auditing. Most forensic auditors work for auditing firms that have their own codes of ethics, practice or conduct. Such codes can be extremely useful in determining appropriate measures in situations where forensic auditors are faced with ethical dilemmas, or when they need to be consulted in certain questionable situations. The Association of Certified Fraud Examiners has adopted a Code of Professional Ethics and a Code of Professional Standards to provide guidance and clarify the activities and behavior expected of Certified Fraud Investigators.

6. CONCLUSION

Forensic audit as a newer discipline within auditing, as it is primarily aimed at detecting fraud in financial statements, fills the "expectation gap" that occurs among users of financial statements who mistakenly believe that auditing financial statements "reveals everything" (Dimitrova et al, 2018).

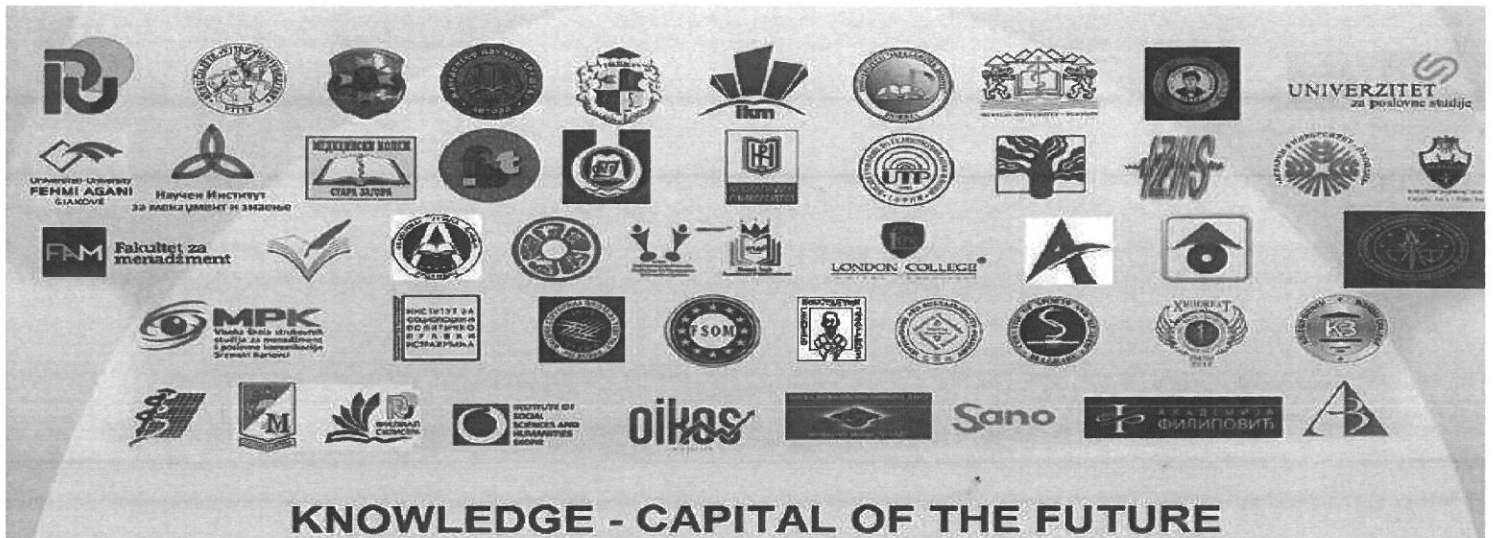
The main difference between the audit of financial statements and the forensic audit consists in the fact that external auditors issue an opinion on the reality and objectivity of the financial statements of the entity - the client of the audit, while forensic auditors do not issue an opinion but a report that states all the facts about existence of fraud. Hence, the main objective of the forensic audit is to detect fraud in the client's financial statements, regardless of its materiality, that is, the degree of its influence on the reliability and objectivity of the financial statements.

Although there is a big difference between the forensic audit and the audit of financial statements, both in terms of the materiality and scope of the checks, as well as in terms of the reporting of the results of their work, they still have many common points of contact.

The methods applied in the forensic audit are mostly based on the techniques and methods applied in the audit of financial statements (inspection, observation, analytical procedures, recalculation, inquiry). The methods and techniques applied in forensic auditing enable forensic auditors to determine whether suspicions of fraud are justified.

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