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| Q.1 | <p><b>“Due diligence is different from audit” – Explain the difference between due diligence and audit. [Study Material – ICAI]</b></p>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                        |
|     | <p><b>Ans.: Difference between Due Diligence and Audit:</b></p> <ul style="list-style-type: none"> <li>• Audit is an independent examination and evaluation of the financial statements on an organization with a view to express an opinion thereon.</li> <li>• 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. Simply put, due diligence aims to take the care that a reasonable person should take before entering into an agreement or a transaction with another party.</li> </ul>                                                                                                                                                     |
| Q.2 | <p><b>XYZ Ltd. has bought a land in Nagpur for setting up a manufacturing unit in the year 2020 at a price of ₹ 10 crores. In the year 2021, one of the directors of company raised suspicion on the price and transactions related to purchase of land. Therefore, an investigation was ordered by the management and PV Associates were appointed to investigate the matter and submit their report accordingly. PV Associates were of the view that they need to take an expert’s opinion on the price of land. Whether PV Associates is authorized to take assistance of expert? If yes, what is the process they need to follow? [Study Material – ICAI]</b></p>                                                                                                                                                          |
|     | <p><b>Ans.: Assistance of Expert in due diligence activity:</b></p> <ul style="list-style-type: none"> <li>• If PV Associates feels the necessity of obtaining views and opinions of experts in various fields to properly conduct the investigation, they are allowed to do so.</li> <li>• It would be therefore, proper for the investigator to get the written general consent of his client, to refer special matters for views of different experts at the beginning of investigation and he should settle the question of costs for obtaining the views and other related implications.</li> </ul>                                                                                                                                                                                                                       |
| Q.3 | <p><b>What do you understand by the word “Forensic” and why the need for forensic audit arises? [Study Material – ICAI]</b></p>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                |
|     | <p><b>Ans.: meaning of the term “Forensics”:</b></p> <p>“Forensic” means “suitable for use in the court of law”. It is the application of financial skills and investigative mentality to unresolved issues, conducted within the context of the rules of evidence. As an emerging discipline, it encompasses financial expertise, fraud knowledge and a sound knowledge and understanding of business reality and the working of legal system.</p> <p><b>Need for Forensic Audit:</b></p> <p>Forensic audit is needed for various purposes including the following:</p> <p>(1) Fraud Detection: Area of Fraud detection comprises of:</p> <ul style="list-style-type: none"> <li>• Investigating and analyzing financial evidence.</li> <li>• Detecting financial frauds</li> <li>• Tracing misappropriated funds.</li> </ul> |

- (2) **Computer Forensics:** Area of Computer forensics comprises of developing computerized applications to assist in the recovery, analysis and presentation of financial evidence.
- (3) **Fraud Prevention:** Area of fraud prevention comprises of:
- Reviewing internal controls to verify their adequacy
  - Providing consultation in the development and implementation of an internal control framework aligned to an organization's risk profile
- (4) **Providing expert testimony:** Area of Expert testimony comprises of
- Assisting in legal proceedings,
  - Testifying in court as an expert witness
  - Preparing visual aids to support trial evidence.

Q.4

**BR Construction was into the business of building roads and other infrastructure facilities for government contracts. Mr. Tiwari, one of the senior official, was looking after the procurement of cement required at the construction sites. There was a substantial increase in the price of cement bags bought as compared to those bought prior to the appointment of Mr. Tiwari. The management of the company decides to get a forensic audit done for the transactions handled by Mr. Tiwari. What points should be kept in mind by the management while appointing a forensic auditor? [Study Material – ICAI]**

**Ans.: Characteristics and Skills to be possessed by Forensic Auditor:**

While appointing a forensic auditor, the Management of BR Construction must initially consider whether the firm has the necessary skills and experience to accept the work.

A Forensic Auditor should necessarily possess the following characteristics:

1. Strong Visualization and Imagination
2. Curiosity and Persistence
3. Detail-oriented and Inquisitiveness
4. Creativity and Out of the Box Thinking
5. Discretion, Rationalisation and Skepticism
6. Confidence and Sound professional judgement.

Forensic Auditor must possess skills related with the followings:

1. Standards of Auditing, Auditing Procedures and related methodologies
2. Accounting & Business reporting systems
3. IT and Data Analytics
4. Criminology, Legal Framework, Litigation processes & procedures
5. Investigative Techniques and Evidence gathering
6. Network of professional contacts in related fields' viz. enforcement, regulatory bodies, law, industry, peers etc.

Q.5

**CA Robo has been appointed as Forensic Auditor by BMY Bank Limited for one of its borrowal accounts WRONG Ltd. CA Robo started the audit by first reviewing the transactions of the borrower in Bank statement as per Bank records to identify any hidden patterns in that information. She had to review huge volume of data, as the number of transactions per day were in hundreds and the data was to be reviewed for the last three years. So, she was stuck up as to how to proceed further to identify any hidden patterns in information, if any. Guide CA Robo, suggesting which technique to be used for identifying any hidden patterns in the information. [Nov. 20 – New Syllabus (4 Marks)]**

**Ans.: Technique to be used for identifying hidden patterns:**

Detecting fraud is difficult, especially frauds involving material financial statement misstatements, which occur only in about 2% of all financial statements. Fraud is generally concealed and often occurs through collusion. Normally, the documents supporting omitted transactions are not kept in company files. False documentation is often created or legitimate documents are altered to support fictitious transactions. While fraud detection techniques will not identify all fraud, the use of sound techniques can increase the likelihood that misstatements or defalcations will be discovered on a timely basis.

In the given situation, CA Robo can use Data Mining technique.

- Data Mining Technique is a set of assisted techniques designed to automatically mine large volumes of data for new, hidden or unexpected information or patterns.
- Data mining techniques are categorized in three ways: Discovery, Predictive modelling and Deviation and Link analysis.
- It discovers the usual knowledge or patterns in data, without a predefined idea or hypothesis about what the pattern may be, i.e. without any prior knowledge of fraud.
- It explains various affinities, association, trends and variations in the form of conditional logic.

Q.6

**LMN Ltd. entered into a deal with SP Ltd. for buying its business of manufacturing wooden products/ goods. LMN Ltd. has appointed your firm for conducting due diligence review and they want to know the cash generating abilities of SP Ltd. What points will you check in order to ensure that the manufacturing unit of SP Ltd. will be able to meet the cash requirements internally?** [MTP – March 21]

**Ans.: Conducting Due diligence to examine cash generating abilities:**

In order to ensure that the manufacturing unit of SV Ltd. will be able to meet the cash requirements internally, one is required to verify:

- (a) Is the company able to honor its commitments to its trade payables, to the banks, to the government and other stakeholders?
- (b) How well is the company able to convert its trade receivables and inventories?
- (c) How well the Company deploys its funds?
- (d) Are there any funds lying idle or is the company able to reap maximum benefits out of the available funds?
- (e) What is the investment pattern of the company and are they easily realizable?

Q.7

**Write Short note on: Important issues to be kept in mind by the investigator while preparing his report.** [RTP – May 21]

**Ans.: Issues to be kept in mind while preparing the report:**

1. The report should not contain anything which is not relevant.
2. Expressions used should be properly considered so that the possibility of arriving at a different meaning or interpretation other than the one intended by the investigator can be minimized.
3. Relevant facts and conclusions should be properly linked.
4. Bases and assumptions made should be explicitly stated.
5. Report should clearly spell out the nature and objective of the assignment, its scope and limitations, if any.

6. Report should be made in paragraph form with headings for the paragraphs.
7. Report should also state restrictions or limitations, if any, imposed on the instructions given by the client.
8. Opinion of the investigator should appear in the final paragraph of the report.

**Q.8 Write Short note on: Technology based /Digital Forensics Techniques. [RTP – May 21]**

**Ans.: Technology based/Digital Forensics Techniques:**

- Every transaction leaves a digital footprint in today's computer-driven society. Close scrutiny of relevant emails, accounting records, phone logs and target company hard drives is a requisite facet of any modern forensic audit.
- Before taking steps such as obtaining data from email etc. the forensic auditor should take appropriate legal advice so that it doesn't amount to invasion of privacy.
- Digital investigations can become quite complex and require support from trained digital investigators. However, many open-source digital forensics tools are now available to assist in this phase of the investigation, for example:
  1. Cross Drive Analysis
  2. Live Analysis
  3. Deleted Files
  4. Stochastic Forensics
  5. Steganography
  6. EnCase
  7. MD5
  8. Tracking Log Files
  9. PC System Log
  10. Free Log Tools

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**Law stated in this publication is upto 31.10.2020 and is relevant for May 2021 Exams and onwards.**

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