FRAUD AUDIT AND FORENSIC ACCOUNTING

THEORY AND CONCEPTS

Tanggor Sihombing | Ali Syah Putra | Valentine Siagian
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PREFACE

In an increasingly complex and dynamic business world, fraud and cheating practices are serious challenges faced by various organizations. Fraud auditing and forensic accounting have emerged as very important disciplines to detect, prevent, and overcome these problems.

This book is designed to provide an in-depth understanding of the theories and concepts underlying fraud auditing and forensic accounting practices. Through a combination of theory and practical application, this book aims to provide comprehensive insights for professionals, academics, and students interested in this field. In each chapter, readers will be introduced to various techniques, tools, and methodologies that can be used to identify and investigate fraud in financial statements and other business practices. We hope that this book will not only be an academic reference, but also a useful practical guide for auditors, accountants, and parties involved in maintaining financial integrity. With the knowledge gained from this book, it is hoped that readers can contribute to creating a more transparent and accountable business environment.

Finally, we would like to thank all parties who have contributed to the preparation of this book. Hopefully this work will be useful and inspire more proactive steps in facing the challenges of fraud in the business world.

Oktober, 2024

The Authors

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Dr. Tanggor Sihombing, BA,. MBA

Universitas Pelita Harapan

CHAPTER 1
FRAUD AND FORENSIC ACCOUNTING: INTRODUCTION AND BACKGROUND

The discussion in this chapter will focus more on fraud and abuse of authority and responsibility in the work environment, both corporate and government, especially corporations or companies. It will not be related to practice in practical political or governmental environments. In financial reports, it is very possible to find misstatements as a result of errors or fraud, in the form of overstatements or understatements. Sutherland in his research stated that there is a triangle which results in fraud. Following:

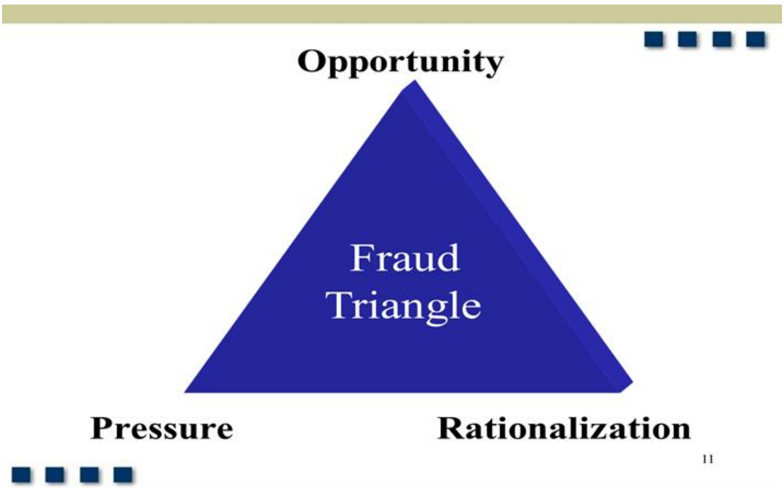

Figure 1. Wells. T

Fraud occurs because of 3 things. Firstly, there is an opportunity, the opportunity to commit fraud due to weak supervision. Second, because there is pressure. Pressure originating from within the company or organization or from the perpetrator himself. Third is Rationalization, the values held by employees in their work environment.

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FRAUD AUDIT AND FORENSIC ACCOUNTING THEORY AND CONCEPTS

CHAPTER 2: PRINCIPLES, SCHEME AND REDFLAG

Dr. Ali Syah Putra, S.E., M.M.

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CHAPTER 2
PRINCIPLES, SCHEME AND REDFLAG

A. INTRODUCTION

In a corporate climate that is becoming more dynamic and unpredictable, proficient risk management is crucial for accomplishing strategic objectives and guaranteeing the longevity of the enterprise. Negligent risk management can jeopardize the company's operations, damage its reputation, and have an adverse effect on its financial performance. As a result, it is crucial to have an auditing strategy that can proactively detect and manage risks.

An audit is a crucial procedure for evaluating how well management systems are working, and its success depends on efficient communication. Comprehensive advice on communication in audits is provided by the International Standard ISO 19011:2018, which emphasizes the value of fostering positive relationships, communicating information properly, and being aware of the needs of all parties involved.

An harmonic team is better able to make decisions that will improve delivery, quality, and work speed since they have a thorough awareness of the organization's objectives. Because they can see the wider picture and precisely estimate how their efforts will contribute, the team concentrates on adding value rather than merely producing outcomes (Internal, 2024). A part of giving information about a company's financial health is auditing accounting. The company's operational performance can undoubtedly be enhanced by the financial report audit's findings. Auditors are authorized to examine and confirm the accuracy of all financial reports as part of their job duties. In the event of a tax audit, the objective is to guarantee that the business does not transgress any tax laws or accounting rules. They must be able to fulfill the independence and competency standards as auditors. In order to protect the confidentiality of firm information and preserve the professionalism of the profession, there is also an auditor's

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FRAUD AUDIT AND FORENSIC ACCOUNTING THEORY AND CONCEPTS

CHAPTER 3: ACCOUNTING PRINCIPLES AND FRAUD

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CHAPTER 3
ACCOUNTING PRINCIPLES AND FRAUD

A. INTRODUCTION

In the global financial ecosystem, accounting principles serve as the fundamental guidelines that promote transparency, accountability, and consistency in financial reporting. These principles, which are globally standardized through frameworks such as the Generally Accepted Accounting Principles (GAAP) or International Financial Reporting Standards (IFRS), are critical to ensuring that financial statements are reliable and comparable across different organizations and industries. By adhering to these principles, businesses can present an accurate reflection of their financial health, allowing investors, creditors, and regulators to make well-informed decisions.

However, even with established accounting standards, fraud continues to undermine the integrity of financial reporting. Fraud—defined as any intentional act of deceit to manipulate financial data for personal or corporate gain—can occur when individuals or organizations deliberately deviate from accounting principles. Common forms of fraud include falsifying financial statements, inflating revenue, understating expenses, or misrepresenting asset values. Such manipulations can lead to significant consequences, not just for the organizations involved, but for entire economies.

The relationship between accounting principles and fraud is particularly relevant in emerging economies like Indonesia, where rapid economic growth has led to increasing complexity in business transactions. Indonesia's economy, one of the largest in Southeast Asia, has experienced significant expansion in sectors such as finance, technology, and manufacturing. As businesses scale, the need for robust financial reporting becomes paramount. Yet, with growth comes the risk of financial mismanagement, especially in environments where regulatory oversight may lag behind the pace of corporate expansion.

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CHAPTER 4: FINANCIAL STATEMENT FRAUD AND FRAUD SCHEMES

Dr. Judith Tagal Gallena Sinaga, MBA., BSAc.

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CHAPTER 4
FINANCIAL STATEMENT FRAUD AND FRAUD SCHEMES

A. INTRODUCTION

Fraud has been the problem that cannot be fully eradicated. There are several giant corporations that suffered loss and even collapsed due to fraudulent act by individuals who behave unethically in running the business. Financial statements must be prepared and presented in conformity with accounting standards. To have legitimate financial reporting, organizations of all sizes must follow the rules and regulations that have been created. Financial reporting fraud is a serious social and economic problem (Kaminski et al., 2004). There are omissions, faults, or errors that are easily addressed; nevertheless, if they are done purposely and have a major impact on the financial statement, they are considered fraud. Businesses that engage in unethical behavior without worrying about facing legal consequences have a terrible impact on the community's economy and people. For businesses of all sizes, in all geographic locations, and in almost every industry, fraud is still a serious threat. Fraud is the term for when someone working for an organization purposefully and intentionally manipulate, falsify, or distort financial facts. This comprises activities meant to fool authorities, investors, and auditors in order to gain advantages for oneself or the firm (Khamainy, A.H., Amalia, M.M., Cakranegara, P.A. & Indrawati, 2022).

The Department of Justice in the United States has initiated a criminal investigation into General Electric's accounting, which has been audited by KPMG for more than 109 years (Shubber, K. & Edgecliffe-Johnson, 2020). On the civil side, PwC was successfully sued by the Federal Deposit Insurance Corporation ('FDIC') for failing to uncover $2.3 billion in fraud at Colonial Bank, an Alabama bank that failed following the 2008 financial crisis. This year, the trial court granted PwC $625.3 million in damages

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FRAUD AUDIT AND FORENSIC ACCOUNTING THEORY AND CONCEPTS

CHAPTER 5: PREVENTION, DETECTION, AND RESPONSE TO FRAUD

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CHAPTER 5
PREVENTION, DETECTION, AND RESPONSE TO FRAUD

A. INTRODUCTION

Fraud remains an important and interesting issue, especially as the number of cases increases in modern society. The Association of Certified Fraud Examiners classifies fraud into three types: financial statement fraud, asset misappropriation, and bribery. One of the most common types of fraud in the government division is related to corruption. The word corruption comes from the Latin term corruption or corrupter, which means rotten, damaged, to undermine, to distort, or to bribe.

Fraud is a dishonest or deceptive act intended to obtain an illegal advantage or cause injury to another person. In the financial and business context, fraud typically involves the manipulation, falsification, or theft of information that is used to steal money or company assets, obtain an unfair advantage, or cause loss to another person.

Fraud often involves the use of manipulation, lies or breach of trust to achieve a fraudulent purpose or cause harm to others. It can result in significant financial loss, reputational damage or legal consequences for those responsible. Detecting, preventing and addressing fraudulent activity is therefore a key aspect of ethical business practices and financial sustainability.

B. FRAUD

Literally, fraud is a term derived from English meaning deception or fraud. This action may include intentionally falsifying financial statements for the purpose of defrauding related parties. Fraud can also be defined as any illegal or dishonest act committed by a party, either internal or external to a business, for personal gain. Fraud is not only unethical but also causes significant damage to a business, both tangible and intangible.

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FRAUD AUDIT AND FORENSIC ACCOUNTING THEORY AND CONCEPTS

CHAPTER 6: CORRUPTION

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CHAPTER 6
CORRUPTION

A. INTRODUCTION

Corruption is a pervasive and insidious issue that impacts societies globally. It undermines public trust and hinders social, economic, and overall growth. Corruption manifests in several forms and infiltrates both governmental and commercial sectors. These forms encompass embezzlement, bribery, nepotism, and political favoritism.

Corruption creates numerous adverse effects, such as suppressing innovation, distorting market dynamics, and sustaining inequality. Corruption in the public sector erodes the rule of law, diminishes democratic institutions, and reallocates resources from essential services such as healthcare, education, and infrastructure. In the business sector, corruption causes inequitable competition, erodes market integrity, and deters foreign investment, presenting a dark picture of a reality where moral decay substitutes ethical government.

As the incidence of corruption around the world continues to rise, it is imperative that concerted efforts be made to address this complex problem. The implementation of substantial reforms, the enhancement of accountability systems, and the cultivation of a culture of transparency and honesty are all processes that require collaboration between governments, civil society organizations, and international institutions. In order to ensure accountability for those who commit acts of corruption, leaders at all levels are required to advocate for ethical leadership, uphold the values of good governance, and sustain the values of good governance.

In the following chapter, we discuss the various aspects of corruption, including its definition, theories, legal penalties, and measures to eradicate it within the context of Indonesia. The objective is to shed light on this serious problem and inspire people to take action in the direction of a future free of corruption by presenting perspectives that provoke thinking, presenting engaging case studies, and doing analytical analysis.

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FRAUD AUDIT AND FORENSIC ACCOUNTING THEORY AND CONCEPTS

CHAPTER 7: FRAUD RISK ASSESSMENT

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CHAPTER 7
FRAUD RISK ASSESSMENT

A. INTRODUCTION

Fraud has emerged as one of the most harmful economics disruptions faced by international companies. This practice has raised the concerns of many parties due to its negative impact on the society as well as business environment. These concerns arise due to the negative economic impact suffered by companies as well as investor alike (Van Driel, 2019).

PwC report shows how fraud deeply affects firm's financial performance where cybercrime, customer fraud, and asset misappropriation, corruption and bribery, accounting/financial statement fraud, and supply chain fraud are the dominant types experienced by the firm.[12] Their findings show that most of the fraudsters come from external parties, followed by internal parties, and the collaboration of the external and internal parties. These perpetrators are using different method causing the emergence of new fraud trends in the recent years.

As financial fraud is becoming a bigger threat to the economy (Huang *et al.*, 2017), there is an emergency to prevent this from becoming a financial disaster that challenge business environment sustainability in the future. A current survey conducted A survey revealed that 69% of global executives and risk professionals anticipate a rise in financial crime risks over the next year, primarily due to cybersecurity threats and data breaches, along with financial strains on organizations. [3]Consequently, corporations face significant reputational and financial impact due to these financial crime threat.

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[1] https://www.pwc.com/gx/en/forensics/gecsm-2022/PwC-Global-Economic-Crime-and-Fraud-Survey-2022.pdf

[2] https://www.pwc.com/gx/en/services/forensics/gecs/2024-global-economic-crime-survey.pdf?WT.mc_id=GMO-TRS-NA-FY24-RISK-LCWWSR-T56-CI-XLOS-SUR-GMOTRU000137-EN-CASURV-T1

[3] https://www.kroll.com/en/insights/publications/fraud-and-financial-crime-report

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FRAUD AUDIT AND FORENSIC ACCOUNTING THEORY AND CONCEPTS

CHAPTER 8: COMPUTER CRIME

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CHAPTER 8
COMPUTER CRIME

A. INTRODUCTION

Cybercrime is generally understood to be any illegal activity committed by people through the use of computers or computer networks. Cybercriminals use a wide range of patterns and techniques to perpetrate crimes in the online community. But there are also a lot of patterns and actions you can take to stop these kinds of things from happening. Tech-enabled kidnapping, bullying, and pornography are a few instances of cybercrime. In actuality, studies show that there are between 10 and 15 instances of cybercrime worldwide per second.

In the modern world, knowing how to safeguard corporate data from cyberattacks is essential. Cyberattacks can harm systems and data in a variety of ways. The best defenses against cyber risks for company data are prevention and vigilance. Attempts to harm, pilfer, or obtain unauthorized access to computer systems, networks, or data are referred to as cyberattacks or cybercrimes.

Cybercriminals and hackers, also referred to as attackers, take advantage of security flaws in order to steal data, corrupt data, or take down entire networks. They may seek to steal identities, seize control of systems, or harm people's reputations, among other things.

As the dependency on digital technology grows, cyber-attacks have emerged as a significant threat to individuals, organizations, and governments globally. Understanding how to safeguard company data from these threats is essential. Cyber-attacks pose a major risk, potentially leading to substantial harm to individuals, businesses, and government entities. With the rapid evolution of technology, the frequency of these attacks has increased. The risks associated with cyber-attacks include personal data theft, business information breaches, and the propagation of malware capable of disrupting operational systems.

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FRAUD AUDIT AND FORENSIC ACCOUNTING THEORY AND CONCEPTS

CHAPTER 9: CYBER FORENSIC

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CHAPTER 9
CYBER FORENSIC

A. INTRODUCTION

Fraud is a deceptive act that harms both individuals and companies. There are many types of fraud, and it can occur anywhere. In an ever-evolving digital era, technology has opened doors for companies to enhance their operational efficiency. However, along with technological advancements come new challenges regarding data security and reliability. One of the efforts to address these challenges is through forensic audit practices within organizations.

Fraud detection has now become a focus for many stakeholders, especially the government. Considering the direct impact of these measures, we hope to minimize the number of fraud cases in the future. Indonesia is one of the countries with a relatively high level of fraud, particularly corruption. In fact, in 2020, Indonesia Corruption Monitoring (ICW) reported 217 corruption cases in Indonesia amounting to IDR 8.04 trillion in 2019.

There are many methods you can use to detect fraud. However, various stakeholders are trying to identify the most effective ways to detect fraud. A study proved that there is a highly effective way to detect fraud, namely through forensic testing. Some studies found that forensic audits not only effectively and efficiently detect fraud cases but also prevent and reduce fraud cases very effectively and efficiently. Additionally, it is also stated that they recommend using forensic audits as a highly effective method for detecting fraud. There are several reasons to consider this screening as an effective fraud detection method.

Of course, other factors also influence the fraud detection process through forensics. There are factors that can enhance the fraud detection process, including using big data directly to detect fraud or as a tool to measure the effectiveness of other fraud detection methods, such as email reports and forensic testing.

ASSIGNMENT AND EVALUTIONS

1. Why people can easily do the cyber forensic?
2. How is important cyber forensic to the company?
3. What are the roles of cyber forensic in company?
4. Does every company need cyber forensic?
5. Does cyber forensic relate with progress of AI?

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FRAUD AUDIT AND FORENSIC ACCOUNTING THEORY AND CONCEPTS

CHAPTER 10: GATHERING DOCUMENT AND EVIDENCE

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CHAPTER 10
GATHERING DOCUMENT AND EVIDENCE

A. INTRODUCTION

In the field of auditing, ensuring the accuracy and validity of data, findings, or conclusions is of utmost importance. Auditors must perform various tests to achieve this goal. This article will explore the different testing techniques auditors use to verify the validity and accuracy of data, and it will include specific examples to support the explanations.

Audit procedures encompass all information that supports the figures or other details presented in financial statements, which auditors use as a basis to form their opinions. The audit document procedures must be conducted using the correct techniques.

The third standard of fieldwork requires auditors to obtain sufficient and appropriate evidence for audit procedures, which serves as the foundation for expressing an opinion on the audited financial statements.

The auditing process is conducted by an auditor, who needs audit evidence to form the basis of a high-quality opinion. Auditing itself is the process of gathering evidence from economic activities to align reports. This evidence can be obtained through various means, such as inspections, observations, and confirmations from the relevant parties regarding the reports previously submitted to the auditor. In essence, audit evidence is one of the most critical aspects of the auditing process, as it relates to the quality of the final report. However, some still underestimate the importance of audit evidence, despite it being a fundamental element in conducting an audit.

Thorough, detailed, and careful documentation is crucial for creating a strong audit trail. Documentation is not just about recording data; it's about constructing a narrative that reflects the essence of the audit process. This involves a variety of materials, ranging from policy documents and system logs to user manuals and transaction records. We

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FRAUD AUDIT AND FORENSIC ACCOUNTING THEORY AND CONCEPTS

CHAPTER 11: FRAUD AND PERAN EXTERNAL AUDITOR

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CHAPTER 11
FRAUD AND PERAN EXTERNAL AUDITOR

A. INTRODUCTION

Businesses all throughout the world deal with the challenge of fraud. Stakeholders' confidence in the accuracy and impartiality of financial reports has been severely damaged by multiple accounting scandals. In order to guarantee accurate financial reporting, management, the board of commissioners, the audit committee, external auditors, and internal auditors are essential. Public accountants must continue to be seen as credible by all facets of society while rendering their services. Therefore, in order to maintain the caliber of their public accounting services in compliance with the professional standards of public accountants, public accountants must maintain and improve their technical skills. Users must be reassured by the financial statement audit that public accountants use technical competence, integrity, independence, and objectivity in the audit and the identification of material misstatements in the financial statements. This is done in order to identify inaccuracies and conduct additional research, as well as to stop unlawful reports from being issued.

Planning and carrying out the audit is the auditor's responsibility in order to ensure that there are no major misstatements in the financial statements, whether as a result of fraud or error. Assessing the financial statements' fairness with regard to serious misstatements in compliance with auditing standards and the accountants' code of ethics is undoubtedly the goal of that duty. The auditor is not exhibiting enough independence and is not avoiding different conflicts of interest if there are infractions or departures from professional ethics as specified by auditing standards and the accountant's code of ethics (Rizky Restu Amalia, 2017)

Fraud frequently happens during the preparation of a financial report. Fraud is defined as a deliberate mistake in the review or omission of disclosures in financial statements. Using an audit system to combat fraud

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FRAUD AUDIT AND FORENSIC ACCOUNTING THEORY AND CONCEPTS

CHAPTER 12: FRAUD AND THE ROLE OF INTERNAL AUDITOR

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CHAPTER 12
FRAUD AND THE ROLE OF INTERNAL AUDITOR

A. INTRODUCTION

Fraud frequently happens during the preparation of a financial report. Fraud is defined as a deliberate mistake in the review or omission of disclosures in financial statements. Using an audit system to combat fraud in the financial reporting process is currently a critical job and obligation of an auditor.

Auditors must reveal the findings of their examinations in an open, transparent, and unambiguous manner, indicating that they have taken fraud into account and outlining the methods used for the examination. An auditor must also be prepared to serve as an internal controller, utilizing an audit system bolstered by the auditor's knowledge and abilities to monitor and resolve fraud that occurs within a corporation in the recording of financial reports.

Corporate fraud can take many different forms, such as the theft of firm assets, financial report manipulation, and abuse of power. Alongside changes in the economic and social landscape and the growing complexity of technology and industry, there is an increased risk of fraud. For example, increased competition in business may force people to use dishonest tactics in order to obtain an advantage, or the pressure to achieve high performance goals may cause someone to falsify financial reports. Therefore, it is imperative that businesses put in place adequate and efficient internal control systems in order to stop and identify fraud. Through risk assessments, internal audit plays a critical role in guaranteeing the efficacy of the internal control system. Theft of company assets, manipulation of financial reports, and abuse of authority are just a few examples of the various ways that corporate fraud manifests itself. There is a greater chance of fraud in addition to shifts in the social and economic landscape and the increasing complexity of industry and

3. What are the different between internal and external auditor
4. What are internal auditor’s responsibilities?
5. Should every companies have internal auditor?

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FRAUD AUDIT AND FORENSIC ACCOUNTING THEORY AND CONCEPTS

CHAPTER 13: CORPORATE INTELLIGENCE IN THE PROCESS FRAUD AUDIT AND FORENSIC ACCOUNTING

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CHAPTER 13
CORPORATE INTELLIGENCE IN THE PROCESS *FRAUD* AUDIT AND *FORENSIC ACCOUNTING*

A. INTRODUCTION

Corporate intelligence plays a crucial role in the processes of Fraud Audit and Forensic Accounting. By gathering and analyzing relevant information about company operations, financial transactions, and other important information, corporate intelligence helps uncover potential fraudulent activities and provides valuable insights for investigative purposes. (Yu, S., & Rha, J. 2021). In this section, we will explore the importance of Corporate Intelligence in detecting and preventing fraud, as well as its role in supporting Forensic Accounting investigations. Corporate intelligence not only helps in identifying warning signs (Red Flags) and suspicious activities within the company, but also assists in developing strategies to prevent future fraud. By conducting thorough background checks and due diligence on employees, vendors, and business partners, forensic accountants can proactively mitigate risks and protect the financial well-being of the organization. (Craja, P., Kim, A., & Lessmann, S. 2020). In addition, corporate intelligence can provide important evidence and documentation needed in legal proceedings, which ultimately supports the successful resolution of fraud cases.

However, relying entirely on Corporate Intelligence can create a culture of distrust within the organization, leading to a decline in employee morale and satisfaction. It is important to find a balance between preventing fraud and maintaining a positive work environment. Although Corporate Intelligence can be a valuable tool in combating fraud, it should not be the primary focus as it can alienate employees and damage relationships in the workplace. Building trust and creating a

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FRAUD AUDIT AND FORENSIC ACCOUNTING THEORY AND CONCEPTS

CHAPTER 14: MONEY LAUNDERING

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CHAPTER 14
MONEY LAUNDERING

A. INTRODUCTION

Money laundering is a form of financial crime involving suspicious transactions. This unethical practice has long been a common issue that both governments and society strive to address. The damage caused is significant, impacting various sectors. In response, Indonesia has established the Financial Transaction Reports and Analysis Center / Pusat Pelaporan dan Analisa Transaksi Keuangan (PPATK), a financial body responsible for preventing and combating money laundering activities

Money laundering involves concealing funds or assets obtained through illegal means, making them appear as if they were acquired legally. The main goal of this activity is personal enrichment. Perpetrators often funnel the illicit money through legitimate businesses and financial institutions to hide its illegal origin. Criminal activities, including money laundering, occur across many sectors in Indonesia. Like other crimes, money laundering is seen as a harmful act that not only damages the government but also affects society. While corruption has long been a prominent issue in Indonesia, money laundering has also gained attention in recent years as a damaging, underground criminal enterprise

Money laundering, often referred to as the process of "cleaning" money, involves receiving funds from illegal or illicit activities. This practice is carried out to conceal the true source of the money, making it seem as if the funds were obtained through legal means. The term "money laundering" has been known since the 1920s in the United States, where funds from illegal activities such as extortion, gambling, and prostitution were used to purchase legitimate businesses.

One method of laundering money involves secretly placing illegal funds into the legitimate financial system by investing in lawful companies. Other ways to launder money include using shell companies, fake

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This book delves into the critical intersection of auditing, accounting, and legal investigations, emphasizing the importance of identifying and mitigating fraud within organizations. This work explores the theoretical foundations of fraud auditing and forensic accounting, providing a comprehensive overview of the methodologies and tools used by professionals in the field.

The book begins by outlining the various types of fraud, including financial statement fraud, asset misappropriation, and corruption, along with the psychological and organizational factors that contribute to fraudulent behaviour. It highlights the significance of ethical practices in accounting and the role of auditors in safeguarding corporate integrity. Central to the text is the discussion of forensic accounting techniques, which blend accounting knowledge with investigative skills. Readers are introduced to key concepts such as data analysis, evidence collection, and the application of legal principles in fraud cases. The importance of maintaining a sceptical mindset and understanding the motives behind fraud are also emphasized.

Furthermore, the book addresses the evolving landscape of fraud in the digital age, considering how technological advancements, such as data mining and artificial intelligence, can enhance fraud detection and prevention strategies. Case studies and real-world examples illustrate the practical application of theoretical concepts, equipping readers with the skills necessary to conduct effective fraud audits.

In conclusion, this book serves as a vital resource for students, professionals, and organizations aiming to enhance their understanding of fraud prevention and detection. By blending theory with practical insights, it offers a roadmap for navigating the complexities of fraud in contemporary financial environments.

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