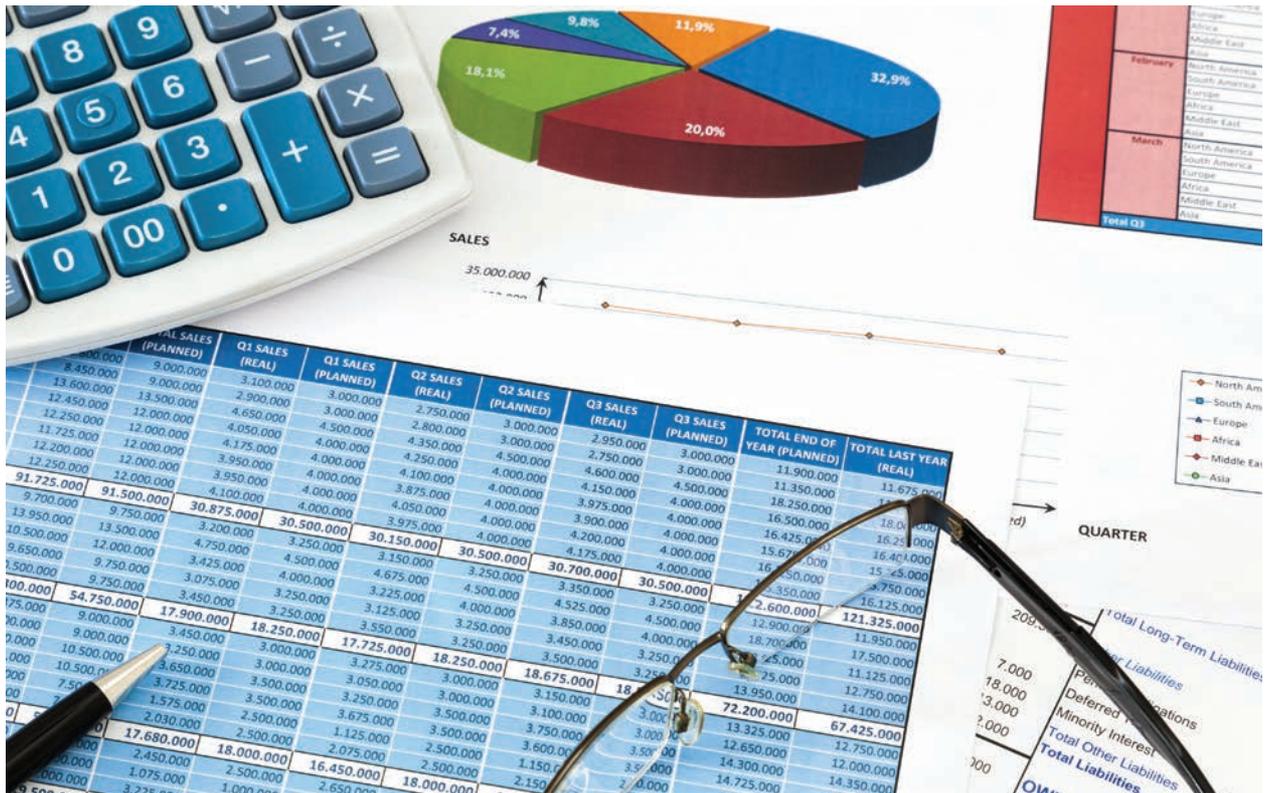


## Importance of Shadow Profiling in Forensic Assignments—A Simplified Approach



*The term forensic provides a scientific and legal perspective to the evaluation of facts, and gathering and preservation of evidence, which is admissible in a court of law and/ or facilitates deciphering criminal intent in a given situation. Then, forensic accounting can be said to involve profiling the legalities in accounting or financial transactional trails from the perspective of gathering objective evidence and substantiating facts. Investigation procedures aim to bring out the truth while validating facts involving profiling of the sequence of events with a purpose to ascertain the intent, through screening the business decisions, accounting practices, disclosures and financial reporting in the light of company's policies, procedures, standards, internal process manuals, contractual arrangements, financial transactions, statutory filings, authorisations, transactional trails and end results. Shadow profiling is a continuous process that enables to recreate scenarios and develop strategies in progression to the next level of investigation. Author in this article presents an informative perspective on shadow profiling in forensic assignments. Read on...*



**CA. R. Srivatsan**

(The author is a member of the Institute, who may be contacted at [vatsan.rayam@gmail.com](mailto:vatsan.rayam@gmail.com).)

### What Does the Term Forensic Imply?

The term *forensic* provides a scientific and legal perspective to evaluate facts, gathering and preserving evidence that is admissible in a court of law and/or facilitates deciphering criminal intent in a given situation. The term *forensic* when aligned to any field of specialisation, namely ballistic or medicine

or pathology, or even accounting gets a scientific and legal interpretation in analysing the evidential trail and sequence of events. Examples that could be cited include Forensic Ballistics, where the bullet is traced to the shooter or the weapon. Similarly, in case of Forensic pathology, the post mortem procedure involves examining a dead body for toxic trails that could aid gathering of indisputable evidence.

The term Forensic Accounting in simple terms can be said to involve profiling the legalities in accounting or financial transactional trails from the point of view of gathering objective evidence and substantiating facts. This could include an investigation procedure where the accounting transactions, reporting and disclosures are subjected to a screening procedure to isolate aberrations that could impact the true and fair presentation of the accounting results. The procedure involves interpretation of the deviations based on empirical facts and evidence gathered as against the standard norms, policies and procedures and regulatory requirements. These deviations would need to be brought under the lens for further scrutiny of the motive, rationale in committing the deviation and distinguish mistake from misrepresentations.

### What is Shadow Profiling?

Investigation procedures have the prime objective of surfacing the truth and validating facts. These further involve profiling of the sequence of events with a purpose to ascertain the intent, motive by studying the evidential leads. This is generally achieved through screening the business decisions, accounting practices, disclosures and financial reporting in the light of company's ethos & pathos, policies, procedures, standards, internal process manuals, contractual arrangements, financial transactions, statutory filings, authorisations, transactional trails and end results. The independent validations through confirmations, background checks, due diligence checks further add credibility to the investigation processes. In simple terms, shadow profiling is a screening or filtering process of accomplished tasks, information and people with reference to a subject matter of investigation.

The shadow profiling is an enabler in recreating scenarios and developing strategies in progression to the next level of investigation. The shadow profiling is a continuous process and at the preliminary study phase, involves analysing the financial statements, ratios and benchmarking with general statistical trend of information under regular and irregular

conditions. This is supplemented by reference to the memorandum records and operating MIS, an essential cross check to validate the financial figures in gathering evidential trails. The gathered evidential information would need to be evaluated for admissibility in court and would stand test of scrutiny as an aid to litigation support in any potential legal dispute.

### Profiling of Data and Information

The concept of tracing and tracking is often practiced in evaluating a transaction and also to evaluate the results of data analytics and processed information from the perspective of whether this can stand a court trial. The sequencing of the events akin to a time and motion study and deciphering the aberrations is a method that facilitates progression of investigations. This is further extended to a multitude of transactions, cross-functional reviews, cross entity-reviews, cross industry reviews, across businesses duly supported by relational database management system.

### Financial Reporting and Disclosures

The Companies Act, 2013 has stipulated certain norms on fraud reporting to the Ministry of Corporate Affairs and some extra judicial powers through the establishment of the Serious Fraud Investigation Office. This factor coupled with the progressive steps in the form of strengthened IT enabled Services, labour law reforms, revamping of banking system, the opening of insurance sector and technological advancement in terms of telecom, satellite, mobile banking and digital economy provides an excellent set of trails to detect wrongful activities. The regulators such as SEBI, IRDA, NHB and RBI too have guidelines to report on frauds

**The Companies Act, 2013 has stipulated certain norms on fraud reporting to the Ministry of Corporate Affairs and some extra judicial powers through the establishment of the Serious Fraud Investigation Office. This factor coupled with the progressive steps in the form of strengthened IT enabled Services, labour law reforms, revamping of banking system, the opening of insurance sector and technological advancement in terms of telecom, satellite, mobile banking and digital economy provides an excellent set of trails to detect wrongful activities**

and investigations in progress. This may require a synchronisation of the penal provisions of the Companies Act, 2013 with other related regulations namely Indian Evidence Act, 1872 as also read with the Criminal Procedure Code, 1973 and the Civil Procedure Code (1908).

In Corporate entities, despite a robust internal audit system, the focus is not always on detection of fraud but on strengthening the GRC system (Governance Risk Control System). Under these circumstances, any inadvertent erroneous reporting of fraud by Statutory Auditors to the Ministry of Corporate Affairs would eventually surface due to robust financial intelligence gathering mechanism of the Government and more so in recent years due to factors including access to insurance, banking sector, enforcement directorate, filings under FEMA regulations, Income tax department etc. Thus, there are multiple avenues to ascertain incidents of fraud through these channels for the regulator. In contrast, corporate entities, seldom have a Fraud Intelligence Unit unlike the banking and Insurance industry where the same is mandated by regulations. Hence, the corporate entities will need to gear up in a proactive manner to ensure robust financial research and intelligence gathering mechanism as a safeguard against improper disclosures.

## External and Internal Business Intelligence

The seamless integration of information across regulatory bodies is yet to be wired or networked across the Indian Territory and therefore court proceedings, filing of affidavits, first information report (FIR), police complaints, Income tax proceedings are prone to manual intervention. There are ambiguities in interpretations of evidential trails that impacts the timely completion of the process of investigation. The systemic breaks in information and lack of synchronised effort poses a major impediment in timely conclusion of the investigation process leading to impediments in settlement of fidelity insurance claims with insurance companies. Under these circumstances, the source of information, interpretation and due synchronisation with the sequence of events, are essential in driving conclusive results.

The anti-money laundering measures are another area that would need to be strengthened in terms of being watchful of the source of funds of business associates, vendors and fixed deposit holders. The money does not have colour and

**The corporate entities will need to gear up in a proactive manner to ensure robust financial research and intelligence gathering mechanism as a safeguard against improper disclosures**



indirect link to a money laundering activity with these investments can impact the 'brand reputation' of the corporate entities. Hence a shadow profiling of the investments and financials of the business associates and a robust financial intelligence alert mechanism is desirable.

For example, the collection of fixed deposits by companies is an important source for fund generation. The fixed deposit collections at a granular level are not under the direct purview of the regulators except for the mandatory filing of returns under the governing statutes. In these circumstances, proper accounting, differentiation of advances collected, refunds on account of non-adherence to KYC norms would need to be monitored diligently. Cross validation/ confirmation of Fixed Deposits in investor records and KYC checks is recommended in profiling the credibility of investment retained by deposit holders. The profiling of the fixed deposits retained by high net worth individuals and a declaration on source of funds, could be sound hygiene measure for corporate sector.

## News Analysis in Public Domain – An Eye Opener for Fraud Diagnostic Reviews

To quote from an article in The Economic Times dated 20<sup>th</sup> October 2015, *Contract Labour: The Maruti Way*, the unprecedented mob attack at the Manesar plant of Maruti Suzuki India Limited (MSIL) on July 18, 2012, which claimed the life of

a senior HR manager, was a strong signal of the excessive use and (mis)management of contract labour. In this article there was a mention about unequal treatment between permanent and contract labour for doing almost similar jobs, prevalent in almost all manufacturing establishments in India. The incident as referred in the article caused a major financial loss of ₹500 to ₹600 Crore to the company. More than the financial impact, there was a huge reputation loss for a company known worldwide for its employee relationships and best human resource practices. This was a major setback for the company as it affected its market share as well as relationship with the employees. Unquote.

Taking a cue from this story published in public domain, Corporates could review and inspect their internal control procedures as a proactive measure in the form of periodic fraud diagnostic assessments by independent functionaries. This should be extended to validate the payroll records, contractual payments, declarations to statutory bodies, parity in information across entities within the group (especially for consolidated accounts) and consistency in information filed with various agencies. The interpretation of applicable statutes and statutory filings would need to be scrutinised through cross validation checks between a 'contractor' entity and a 'contractee' entity. The parity in job profiles by whatever name or designation, wage structure and manpower strength would need to be evaluated in an independent manner. Care should be taken to decipher the penal offenses and procedural aberrations. Abundant caution is necessary in classification of various violations into cognizable and non-cognizable offenses. The consequences in terms of offences impacting civil or criminal procedures would need to be assessed. There is a need to ensure that a violation at the grassroots level does not impact the senior functionaries and vice versa.

The parity of terminologies between Shops and Establishments Act (as applicable in various states of India) and under various labour laws, the Factories Act, 1948 have varied interpretation in terms of defining establishment, manpower strength for each of the establishment. Payment of appropriate license fee by the contractors, proper wage record etc. The remittance of statutory dues and related filing of returns for provident fund and pension benefits though being the responsibility of the Contractor may under certain

circumstances impact the serviced company as a principle employer. The shadow profiling of extent of employees not reporting to duty for substantial period without a leave application provides a good data to ascertain presence of ghost employees, whether their KYC papers are valid or whether there are other reasons that they are not traceable. Often these remain unattended in the payroll system for substantial periods of time. Similarly unclaimed salaries are an area that can provide sufficient leads on veracity of employee records. While profiling the master payroll record, death cases, absconding cases, resignations and retrenchment proceedings would require different profiling methods in line with prescribed regulatory norms.

Often the designation, roles, activity, tasks for regular permanent employees may overlap with the role of contractual employees, though termed differently in personnel department records. This results in ambiguity in terms of work content, tasks and nature of employment and should not appear to be masking the intent in deployment of such labour in the eyes of the regulatory authority. Hence, the nomenclature in terms of definition of the Job profile is subject to interpretation and may tend to circumvent the objective of labour regulations. Abundant caution is needed in ensuring that 'cost reduction' being the business objective does not override principles of 'natural justice'. Such ambiguities in interpretation may impact the disclosure norms.

Another factor is the Union Management relations and the concept of ONE RANK ONE PENSION could be cited as a classic example, in terms of interpretation of the parity between the 'contractual labour' and 'regular permanent employees'. The extent of companies those have not provided for retirement benefits or those have classified the financial figures as non-funded retirement benefits would need to ensure

---

**Often the designation, roles, activity, tasks for regular permanent employees may overlap with the role of contractual employees, though termed differently in personnel department records. This results in ambiguity in terms of work content, tasks and nature of employment and should not appear to be masking the intent in deployment of such labour in the eyes of the regulatory authority**

---

**In extreme cases, the evidential trail may not get identified or detectable in the short dry runs. Under these circumstances, alternative thinking and exaggerations or bloating the problem out of proportion is suggested in terms of bringing the focus on investigation, to establish whether a wrong has been committed**

appropriate exemption from designated authority as per statutes. In this context, abundant caution also needs to be exercised in submission of data for actuarial valuation for retirement benefits for appropriate disclosure in books of account.

The outsourcing of jobs is a factor often interpreted to be out of bounds of the Contract labour Operations. The influx of consultancy and other types of service providers have probably resulted in an extensive ambiguity on applicability of labour laws. The same concept can be extended to operating of the E-Business Startups and universally applied to Global Consulting firms.

It is important to take note of these statutory filings, challenges in interpretation of statutes and representations in financial statements. The shadow profiling akin to a reality check aids in establishing the veracity of the existence of these activities or perhaps trace fictitious consultancy expenses booked in the system. In addition, the digitisation of the records and functional 'silos' in the system provide ample avenues to mask these dealings. Corporate entities may need to ensure that proper listing of contracts as distinguished between (a) contract labour (b) Consultancy arrangement (c) Outsourcing arrangements (d) Related Party Transactions and ensure that these not expensed out directly in the system without routing through a dedicated control ledger account.

### Profiling Banking Habits and Money Trail

Most monetary trails against wrongdoing are tracked to bank accounts that are opened by the alleged offender either in his personal capacity or routed through several entities. The biggest brand erosion is when employees/business associates operate proprietary firms misusing the logo and emblems of Branded Corporates. These are surrogate methods of misrepresentation of brands and diverting business or siphoning off dues of

corporate entities to their personal account. The shadow profiling of such activities would require a web search of such entities in the public domain under various similar sounding names. Thereafter, establishing a trail of monetary transactions through confirmation from external customers. The alert trigger for stakeholders could be an abrupt decline in business volumes or rising defaulters, disparities in business performance that could be perceived as adversely impacting the corporate entities.

Within the entity these are generally parked in inactive, redundant ledger accounts through Journal Adjustment entries or adjusted against unrelated vendor accounts. Externally these are retained in bank accounts as proprietor of an enterprise or in proxy/ surrogate bank accounts to camouflage these financial dealings. To mask the money trail proxy operators through impersonated/surrogate bank accounts are introduced. These dealings generally proliferate 'benami' businesses and contractual arrangements that perhaps would be detrimental to the noble objective of financial inclusion and ethical conduct of business operations. These are generally uncovered through data analytic checks and external validations/ confirmations.

### How does Data Analytics and Simulation Help in Fraud Diagnostic Reviews?

The art of visualisation is often recommended by motivational speakers and in spiritual practices in some parts of the globe. The same concept is of extreme relevance in investigation assignments where any business activity or aberration in processes has to be subjected to the 'visualisation technique' of the end results. This practice is also comparable to the term 'goal seek' in excel templates. These can be summarised as:

- (a) Defining the objective of the assignment and activities/ tasks impacted.
- (b) This is then broken down into sub parts through the use of 'Operations research' techniques in terms of sequencing the activities/tasks.
- (c) The third concept that is of extreme use is lead generation using the 'decision tree concept'. ('What if' and 'so what' questions). This is followed by a scenario planning technique. The scenario planning technique opens multiple windows or avenues to be explored.
- (d) The next step is to apply 'probability' theory of justification of leads. The risk weights are applied to these probabilities and scenarios.

- (e) This is followed by a lead generation of areas to explore. The leads are evaluated over a frequency distribution curve of hits and misses. This narrows down the 'decision points' to the most probable leads that would need to be pursued.
- (f) The primary factors and secondary factors are isolated called conditions for linking actions, tasks, activities, people and end results. Once the primary factors or conditions are identified this leads down a person, action or result of wrongdoing.
- (g) Prejudice and bias in processing of information is to be evened out at this stage. Thereafter, the process of shadow profiling is commenced in terms of establishing whether a wrong has been committed to narrow down on suspicions. At each of these stages materiality is ignored and the focus is on the identification of the first aberration.



the rationale in defining the contract rates, duly benchmarked with prevailing market rates. The difficulty is that facilitation payment in contract fraud is generally routed outside the accounting system.

### Alternative Thinking and Exaggerations

In extreme cases, the evidential trail may not get identified or detectable in the short dry runs. Under these circumstances, alternative thinking and exaggerations or bloating the problem out of proportion is suggested in terms of bringing the focus on investigation, to establish whether a wrong has been committed. For example, where the 'fictitious payment' has complete adherence to the bill passing processes, it is advisable to look for alternative evidence beyond the control of the certifying authority such as stock reconciliations, gate controls, aberrations in regulatory filings, improper classification and disclosure under labour laws. These indirect evidences could be measures to narrow down on the suspicious activities. The structuring of contracts in a manner camouflages the bill passing process resulting in inflated/fictitious billings. These can perhaps be uncovered by breaking the contractual rates in sub elements and evaluating

**In conclusion, the forensic audit does entail extreme uncertainties in gathering of evidences and establishing a wrongdoing. This calls for a multipronged strategy, a disciplined rational approach backed by scenarios, simulation techniques, due diligence checks leading to an objective assessment of whether a wrongful act has been committed**

### Categorisation of Wrongdoing and Standardisation in Investigation Process

Conceptually, forensic audit assignments for ease of understanding can be categorised into (a) Operational frauds those are simple and generally identifiable to the last person where the action of wrongdoing takes place (b) Management frauds are difficult to establish where the authority and responsibility are not clearly defined or business decisions are not backed by empirical study. In these circumstances, the surfacing of the fraudulent activities get deferred over a prolonged period. (c) Fraud on the Company (entity) by external persons is the most difficult to uncover due to legal and other limitations. In these circumstances, a simulated research & data analysis, akin to a dry run of the impacted activities is recommended before reaching any form of conclusion on whether a fraud has been committed in/or against the organisation.

In conclusion, the forensic audit does entail extreme uncertainties in gathering of evidences and establishing a wrongdoing. This calls for a multipronged strategy, a disciplined rational approach backed by scenarios, simulation techniques, due diligence checks leading to an objective assessment of whether a wrongful act has been committed. The concept of shadow profiling involves screening of activities, tasks, results and actions in the light of established policies, procedures, financial reporting and disclosure norms in the true spirit of 'art of visualisation'. ■