

Forensic Accounting: Some New Aspects



Numerous financial frauds in the past and the beginning of the century, as well as the global financial crisis and recent scams, demanded an advanced mechanism for fraud prevention. In this scenario to cover the limitations of the existing accounting system a branch of accounting called forensic accounting came into limelight. The need for forensic accounting has been recognised worldwide and most of the developed countries are using this system very effectively and efficiently in order to fight against the white collar crimes. Unfortunately in our country the system of forensic accounting is largely unexplored and not only common people, even academicians and auditors are unaware about such an effective tool that we can use against the growing frauds and scams which are the foremost issue that India is facing at present. Chartered Accountants are the pioneers in the area of Auditing in India and they can contribute significantly to protect and prevent accounting frauds. Nowadays, criminals and fraudsters are using the latest technology and they are changing it constantly, so the new generation accountants should be updated and technically, they should be one step ahead of the criminals by upgrading themselves with the latest tools and techniques to detect financial criminology. ICAI identified this need early and has taken initiative by launching a Certificate Course on Forensic Accounting and Fraud Prevention using IT and CAAT. This paper is an attempt to show the role of Forensic Accounting in Fraud Prevention. Read on to know more....

Introduction

According to occupational fraud and abuse (Global fraud study, 2014) Reports to Nations, issued by Association of Certified Fraud Examiners (ACFE), by the time you finish reading this sentence, the



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world would have lost 1.8 million dollars to fraud. Financial frauds and corruptions become a severe problem all around the world. Fraud varies from an employee reporting extra hour in duty timesheet to a minister using his power to influence someone to get any deals or contracts worth crores in favour of him. Every single amount in the account has its legal use, so misuse of any money will affect the organisation badly on where it should actually be used. The effect of this can be seen on an organisation or a nation as a whole. It is so endemic that fraud and corruption are gradually becoming a normal way of life. In most

cases scams, corruptions and financial crimes have been committed by those who are in the higher authority, who is entrusted with the responsibility of taking care of funds. If we take a look at the scams that took place in India for the last few years and the amount involved in it, it seems shocking and unbelievable. Here are a few of them :

SCAM	AMOUNT
Coal Gate Scam	186,000 crore
2G Spectrum Scam	175,000 crore
Commonwealth Games	35,000 crore
Satyam Scandal	8,000 crore
Harshad Mehta	4,000 crore
Saradha Group Scandal	40,000 crore
Ketan Parekh	1,500 crore
C. R. Bhansali	1,200 crore
Fodder Scam	450 crore

Table 1: Statistics of Scams in India

These corporate frauds, white collar crimes and corruptions have raised serious questions over the reliability of Auditing, Financial Reporting, and Accounting Standards, it undermined investor confidence in accounting records. Traditional Accounting and Auditing Techniques failed to stop this financial criminology. In most cases, frauds are committed by the top executives with high intelligence and expertise knowledge. So it is difficult for auditors to detect and prevent these frauds with their traditional techniques. In this scenario, to cover the limitations of existing accounting system, a branch of accounting called Forensic Accounting came into limelight. Forensic Accounting is a merger of Forensic Science and Accounting. The integration of Accounting, Auditing and Investigative Skills creates an accounting analysis that is suitable for court, called Forensic Accounting. Forensic Accounting is a largely unexplored area in India. Forensic Accountants are being engaged in public practice and are being employed by Insurance Companies, Banks, Police Forces, Govt. Agencies, so the opportunities for Forensic Accountants is growing fast.

What is Forensic Accounting?

Forensic Accounting is believed to be one of the oldest professions on earth. In ancient Egypt, auditor acted as “Eye and Ears” of the king. Today, it is the art and science of doing financial auditing and investigation. George A. Manning (1999) reported in his book, “Forensic Accounting is a science of gathering and

presenting financial information in a form that will be accepted by the court of jurisprudence against perpetrators of economic crimes”. According to AICPA, “Forensic Accounting is the application of the accounting principles, theories and discipline to facts or hypothesis at issues in legal dispute and includes every branch of accounting knowledge”. Mehta and Mathur (2007) described the concept of Forensic Accounting, and according to him “Forensic Accounting involves a financial detective with an apprehensive mind, a financial bloodhound, someone with a ‘sixth sense’ that enables reconstruction of past accounting transaction and an individual who looks beyond the number”. Crumbley in the year 2009 defines the concept of Forensic Accounting, “as the action of identifying, recording, settling, extracting, sorting, reporting and verifying past financial data or other accounting activities for settling current and prospective legal disputes or using such past financial data for projecting potential financial data to settle legal disputes”. From the above, we understand that Forensic Accounting consists of two major components and the same are shown below:

1. Forensic Accountant need the skill to collect, analyse, evaluate financial data to interpret and to report it.
2. In court proceedings, he can be called for expert opinion and also for courtroom testimony if needed.

History of Forensic Accounting

The newspaper in Glasgow, Scotland reported first about the concept of Forensic Accounting in 1824. The Roman empire gave importance to forensic accounting through royal court of justice to control and audit financial matters. Worldwide, pioneer of Forensic Accounting is believed as Sherlock Holmes, the artificial character created by Sir Arthur Conan Doyle. There was a strong linkage between accounting and law in the first official Chartered Accountancy Profession of the 19th century at Scotland. In 1980

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the demand for Forensic Accountant increased due to the great recession. During 1988 in Texas, the Association of Certified Fraud Examiners (ACFE) was found, and later in 1992 the American College of forensic examiners was established. While Forensic Accounting put its first step in India only a few years back, it developed as early as 1995 in the USA (Ghosh 2011). Later in the 1990s, a sudden increase in the white collar crimes and the September 11 attack on twin tower in America hiked the demand for forensic accountants. Forensic Accountants played a notable role in bringing life back to New York after losing all their accounting records. Interest in forensic accountants spread through the UK and the USA early in the 20th century. Forensic Accounting got more role of original accountant as a result of growing importance of record keeping and other financial services. Forensic Accounting in developing countries like India is a niche field but with the current economic downturn, there is a high demand for forensic accounting services worldwide.

In India 'Kautilya' in his book 'Arthashastra' mentioned the famous 40 ways of embezzlement. Similarly, as one of the nine gems of King Akbar (Bhasin 2007) Birbal explained different fraud examination methods. Forensic Accounting in India got more relevance after scams like Satyam scam, Harshad Mehta and other white collar crimes created a situation where companies and government felt like they need to have someone who is specialised to detect and prevent fraudulent practices. On the basis of the report made by the 'Naresh Chandra Committee' in the year 2003, the Government of India formed Serious Fraud Investigation Office (SFIO) at New Delhi. Later, SEBI created a forensic accounting cell to improve the quality of financial information and ensure its reliability. RBI also made it compulsory to have forensic accounting audit for banks. According to Business Standard Newspaper Reports (25.4.2014); forensic accounting profession is growing in India. As a result of that growth in 2015-2016 academic year, BML Munjal University

introduced MBA in forensic accounting course. All these show a bright future for forensic accounting in India. In India Forensic Accounting is still considered as a fraud detection tool. At present, the role of the forensic accountant is carried by Chartered Accountants along with their traditional accounting and auditing duties as per the Companies Act or Income-tax Act. Upgrading Chartered Accountants with forensic accounting skills and techniques seems to be a good option as they have good basic knowledge in auditing and fraud detection. But so far, apart from ICAI, no interest had been taken by any bodies for such an action even after the country is suffering from scams, fraud and corruption.

Traditional Accounting vs Forensic Accounting

Some of the very common differences between Traditional Accounting and Forensic Accounting are:

1. Traditional Accounting is limited to preparing and tallying the accounts whereas Forensic Accounting goes beyond just numbers and ensures its validity.
2. Forensic Accounting is more investigative in nature which can be attained only through massive experience.
3. Traditional Accounting looks whether accounts are made on the basis of GAAS, GAAP etc. whereas Forensic Accountant uses physical evidence, testimonial evidence, documents etc. for identifying the suspects and culprits.
4. Forensic Accountant can use any type of information like documentary paper, computer video or audio if needed to interpret and present it.
5. Forensic Accountant may be asked to serve as an expert witness for a law suit or criminal case in court.
6. Forensic Accountant needs to possess the experience and skills in their field i.e. Private investigation and accounting for being a great forensic accountant, whereas no such requirement is there in traditional accounting.

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Forensic Accounting Education in India

In India, Forensic Accounting is still a newborn baby. In countries like the USA different varieties of courses, researches and journals are there separately for forensic accounting itself whereas in India it is still on the initial stage. There are companies like KPMG which offers forensic audit and other services

for companies. Apart from that, these are some Institutes that offer Forensic Accounting Courses in India:

- ICAI (The Institute of Chartered Accountants of India): Introduced a Certificate Course on Forensic Accounting and Fraud Prevention using IT and CAAT due to the importance of Forensic Accounting and Fraud Prevention, in the emerging economic scenario.
- India Forensic: Offers Courses like Certified Bank Forensic Accounting (CBFA), Certified Anti-Money Laundering Expert (CAME), Certified Forensic Accounting Professional (CFAP) etc.
- IFS (International Forensic Sciences) Education Department : Launched courses like Short term Certificate Course in Forensic Accounting and Fraud Examiner, Advanced Diploma Course Certification in Forensic and Fraud Examiner, PG Diploma in Forensic Accounting and Fraud Examiner, Professional Specialised Certification in Forensic Accounting and Fraud Examiner, Universal Certification in Forensic Accounting and Fraud Examiner etc.
- Gujarat Forensic Sciences University: Offering MBA Finance with specialisation in Forensic Accounting and also P. G. Diploma in Forensic Accounting.
- BML Munjal University: The first university to identify the demand for experts in forensic accounting and corporate fraud and they introduced an MBA in finance with a specialisation in Forensic Accounting and Corporate Fraud.

Role of Forensic Accounting

The services rendered by Forensic Accountants are as follows:

1. *Fraud detection*: The primary duty of the forensic accountant is to detect the frauds in books committed by any employees and investigating deeply to exhibit a true picture of books of accounts.
2. *Criminal investigation*: It is the duty of the forensic accountant to report for civil and criminal actions against the organisation or any employee involved in any kind of manipulation or fraud.
3. *Reporting professional negligence*: If forensic accountant found professional negligence like non-confirmation GAAS (Generally Accepted

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Accounting Standard) or non-compliance with the profession or ethical codes of any profession they need to measure and report the loss.

4. *Arbitration service*: Forensic accountants are trained in the area of alternative dispute resolution so they can render arbitration and mediation service for the business organisation.
5. *Insurance claim settlement*: Both policyholder and insurance company seek the help of a forensic accountant. The Insurance Company uses forensic accounting for accurate assessment of the claim to be settled. Policyholders use forensic accounting to question the claim sanctioned by the Insurance Company.
6. *Settlement of dispute*: Since forensic accountants are experts in dispute resolution, firms use forensic accounting to solve cases related to contract dispute, construction claims, product liability claims, patent and trademark etc.

Techniques of Forensic Accounting

Forensic accountants use so many techniques including traditional accounting and auditing tools like ratio, cash flow etc. They also use so many other ways like computer audit and other techniques. Some of the techniques used by forensic accountants to examine frauds are given below:

1. *Benford's Law*

It is a mathematical tool used to analyse the financial data and identify the frauds. It finds whether the amounts shown in the books are manipulated or not. It assumes that the database normally follows a strange rule called Benford's law. This rule allows to predict number of times each number 1 to 9 will appear in the first non zero digit in the database. We can say the numbers have been manipulated if data seems different from the prediction of Benford's law.

2. *Theory of Relative Size Factor (RSF)*
It is the technique of detecting fraud from unusual fluctuations. Here, forensic accountant compares highest two amounts for each subset and calculates RSF for each. If there is any fluctuation beyond normal range, then it will be examined deeply. It helps in better discovery of anomalies or outliers. Suspected errors or frauds will fall outside the prescribed range in the records. In order to locate relationship between these records or fields need to relate to other variables or factors, thus establishing the truth.
3. *Computer Assisted Auditing Tool(CAAT)*
It is a computer program which helps a forensic accountant to investigate his client's information system without depending on him. This technique will help forensic accountant in identifying fluctuations and inconsistency, testing general as well as application control of computer system, sampling programs to extract data for audit testing and redoing of calculation done by accountants.
4. *Data Mining Technique*
It is a set of statistical techniques which discovers the usual knowledge or pattern in data without knowing pattern of data. It mines large volume of data for new, hidden or unexpected information or patterns. Data mining technique can be performed in three ways: Discovery, Predictive Modeling, Deviation and Link Analysis.
5. *Ratio Analysis*
Forensic accounting uses data analysis ratios as a technique for fraud detection. Just like financial ratio indicates financial health, data analysing ratio finds the manipulations by identifying possible symptoms of fraud. Three important ratios are:
 - a. The Ratio of highest value to lowest value (max/min).

- b. The Ratio of highest value to second highest value (max1/max2).
- c. The Ratio of current year to previous year.

Challenges for the implementation of Forensic Accounting in India

Following are the major challenges in the successful implementation of forensic accounting in India:

1. Criminals and fraudsters are using the latest technology and they are changing it constantly, so the forensic accountant should be updated and technically he should be one step ahead of the criminals.
2. As a result of globalisation, it is found that many foreign companies are also involved in these scams and illegal activities, so taking actions against them is difficult for a forensic accountant under Indian jurisdiction.
3. It is found in all recent scams and frauds that business giants and topmost political leaders are also involved. So collecting evidence and reporting it, will be a difficult task for a forensic accountant.
4. Reporting of fraud and taking legal actions against those involved will take time and huge cost, so companies prefer to make settlements outside the court.
5. It is compulsory for all the firms to have internal/external auditor but there is no compulsion for appointment of forensic accountants, so companies are not considering it seriously as they wanted to reduce cost.
6. Awareness regarding forensic accounting is very less amongst people, so accordingly number of forensic accountants with these skills is also very less.
7. As of now, the government did not make any framework or guidelines for the implementation of forensic accounting.

Even though in the light of recent scams and frauds the Government of India was forced to form a Serious Fraud Investigation Office (SFIO) under Ministry of Corporate Affairs, it gives a positive signal towards implementing forensic accounting in India. SFIO is a multidisciplinary organisation combining Financial Sector, Capital Market, Accounting, Forensic Auditing, Taxation, Law, IT etc. from various organisations. Recently, RBI also made it compulsory to have forensic accounting audit for banks.

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Suggestions

There is no argument in bringing down fraud in the books of accounts, but it will take time and effort to put an end to the growing fraud and scam. These are some measures for successful implementation of forensic accounting:

1. A legal framework should be made for creating awareness amongst people regarding the importance of forensic accounting as a fraud detecting tool.
2. Conference, Seminars and Training Programs should be carried out to acquire skill in forensic accounting.
3. Forensic Accountant must be aware of the criminology, psychology, accounting practice, auditing, law etc.
4. It is needed to make compulsory to have a forensic accountant in each company to detect fraud especially in public and large companies.
5. Strong legislation needed to be made against fraudsters and criminals and they should be strictly punished, if found involved in fraudulent practice.
6. Like ICAI and ICMA, a regulatory body needs to be made for controlling and popularising forensic accounting.
7. The inclusion of forensic accounting into academic curriculum is a good way to promote it and more research should be carried out in the area of forensic accounting.
8. Forensic Accounting Techniques have to be popularised amongst all the professional accountants including Chartered Accountants.

Conclusion

Financial Frauds is a serious concern for accounting professional for years. Companies wanting to show high return than their competitors to attract more public investment which ultimately benefits them as bonus and promotion, this will motivate them to manipulate books of accounts. Traditional Accounting has limitations in finding financial frauds as these manipulations are carried by top-level employees with high intelligence, experience and technical skills. So detection and prevention of these frauds are always challenging for accounting professionals. But a forensic accountant can effectively do with their professional knowledge, skill and backup by the law to break into an organisation's system and examine

their records, make discoveries and present the findings as evidence in the law court. So the system of accounting should be given more importance. At last, the Government and Regulatory Authorities should formulate policies and guidelines to promote forensic accounting activities, education and above all, we should keep our trust, integrity, fairness and accountability in our day to day activities.

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