
Forensic Accounting a Multidimensional Approach to Investigating Frauds and Scams

Dr. CA. Kishore S Peshori

Associate Professor, Department of Accountancy, Smt. Chandibai Himathmal College, Ulhasnagar

ABSTRACT:

Over the past two decades the rate of white-collar crime has increased. The ending of the bull run of 1990s saw a string of high blown accounting scandals to the tune of billions of dollars. The bankruptcies of high profile companies, which were shareholders, jewel not so long ago left investors pauper. Even as investigations are on into the happenings at Enron, WorldCom, Lehman Bros and our own Satyam, investors and regulators alike are eager to learn how exactly did this maze was created . Solving such a crime requires a different set of skills. It requires a fair knowledge of accounting concepts, analytical skills and investigative abilities. This culminated into development of new vista of accounting – FORENSIC ACCOUNTING. The Paper tries to introduce the reader the meaning of Forensic Accounting. It further highlights the growing importance of forensic Accounting. The paper also tries to provide framework for Forensic Accounting and the methodology in which forensic accounting is conducted. The paper also talks about relevance and legislative support for forensic accounting in India. This paper is conceptual in nature and information is collected from secondary data. The rise of financial scams in India especially in governmental sector requires that forensic auditing should be made mandatory as the current statutory audit are not in the state of in depth audit which is required to detect the financial scandals which have become a real threat against the development agenda for developing and emerging nations like India.

Keywords: *Forensic Accounting, Frauds, Financial Scams, Investigative functions.*

INTRODUCTION

Economic and Accounting scams have become order of the day. Daily in newspaper there are reports of credit card thefts, scams and accounting irregularities. According to KPMG Fraud Survey white-collar crime in corporate India has witnessed a ‘substantial increase’ over the last two years. The incidence of fraud had increased by 10% from 2010 to the same survey in 2012. It has adverse impact on international investors and entrepreneurial spirit in India. An estimate by CK Prahalad, a management expert at the University of Michigan, puts the cost of corruption to the Indian economy at up to 2.5trillion rupees a year. According to the latest report by Transparency International, a UK-based anti-corruption organization, India ranks 84 out of 180 countries in terms of corruption. Forensic Accounting is the area which can help the Indian Government to solve this problem.

Now let us understand what the Forensic means:

1. According to Webster's Dictionary means "belonging to use in or suitable to courts of judicature or to public discussion and debate".
2. According to Google Forensic means "used or applied in the investigation and establishment of facts or evidence in a court of law".
3. According to Dictionary .com Forensic means "pertaining to, connected with, or used in courts of law or public discussion and debate".

Thus we see that forensic meant evidence applied in courts of law. Let us examine what forensic accounting means:

1. Branch of accounting that uses investigative skills to determine the accuracy of a company's financial statements in a legal dispute. The word forensic means "suitable for a court of law. "Thus, forensic accountants are used in fraud investigations, breach of contract disputes, and other disagreements that require court action. Forensic accountants are often retained by one or both parties in such dispute to bolster their cases." Free Dictionary

2. Forensic accounting is also called as investigative accounting. It involves application of accounting concepts and techniques to legal problems. It tries to investigate and fixed accountability for the financial Fraud and WHITE-COLLAR CRIMES such as Embezzlement. Thus they try to provide evidence in the court of law and act as litigation support to lawyers and law enforcement agencies investigating financial wrongdoing.

3. **Forensic accounting** is the specialty practice area of accounting that describes engagements that result from actual or anticipated disputes or litigation. Forensic accountants often have to give expert evidence at the judicial trial. Many of the larger accounting firms such as Big4's have specialist forensic accounting departments. There may be further sub-specialisations: some forensic accountants may, for example, some specialise in insurance claims, personal injury claims, fraud, construction, or royalty audits.

OBJECTIVES OF STUDY:

There has been a significant increase in frauds and financial scams in India. It requires more professionalism and newer techniques in audit. Investigative audit is one of the technique which helps to detect financial fraud (Krancher, 2006). There is also need felt that statutory audit should include some element of forensic enquiry (Enyi, 2009). The purpose of this paper is:

- 1) To understand the History of Forensic Accounting in India.
- 2) To understand the importance of Forensic Accounting and its impact in modern India.
- 3) To understand the Global Frauds.
- 4) To understand the Indian Frauds
- 5) To understand the framework of Forensic Audit.
- 6) To prepare an audit programme of Forensic Audit.

7) To understand the problems of Forensic Audit

The present paper is of conceptual nature and is based on information from secondary data.

The word ‘accounting’ used here includes ‘audit’ as commonly perceived in India since auditors world over are commonly referred to as part of accounting work. The paper refers to accounting and auditing in a common context.

HISTORY OF FORENSIC ACCOUNTING IN INDIA:

Sherlock Holmes was probably the most famous practitioner being the Forensic Chemist. Archaeological findings reveal that, during 3300-3500 BC, Egyptians accountants were involved in prevention and detection of fraud. It was in early 19th century that close relationship developed between accounting and legal profession. One can highlight the bringing down of Al Capone was based on investigative work done by Elmer Irey, an IRS accountant that ensure conviction for tax evasion as the first major work of 20th century. Further one can see reference of this term by Maurice E Peloubet in 1946 essay “Forensic Accounting : Its place in Today’s Economy”.

In India it was the Kautilya who was the first economist who openly recognized the need of the forensic accountants. He mentioned forty ways of embezzlement centuries ago in his famous. Kautilya Arthashastra. Till today this area is dominated by Big four consultancy firms. It is very recently that some chartered accountants like Vijay Kewalramani and Rajkumar Aduki have taken up fraud examination has a separate practice .To give a credit to such firms one can quote of the world famous Xerox fraud case investigated by a Delhi based firm S K Jain.

IMPORTANCE OF FORENSIC ACCOUNTING AND ITS IMPACT IN MODERN INDIA:

Forensic accounting is the specialty area of the accountancy profession which describes engagements that result from actual or anticipated disputes or litigation. „Forensic“ means „suitable for use in a court of law“ and it is to that standard and potential outcome that forensic accountants generally have to work (Crumbley et al. 2005). It is often said, Accountants look at the numbers but Forensic accountants look behind the numbers (Okoye 2009). Forensic accountants are trained to look beyond the numbers and deal with the business realities of the situation. Analysis, interpretation, summarization and presentation of complex financial and business related issues are prominent features of the profession (Bhasin 2007).

The services provided by Forensic Accountants are as follows

- Business valuations
- Divorce proceedings and matrimonial disputes
- Personal injury and fatal accident claims
- Professional negligence

- Insurance claims evaluations
- Arbitration
- Partnership and corporation disputes
- Shareholder disputes (minority shareholders claiming
- Civil and criminal actions concerning fraud and financial irregularities – cross examination, formulate questions
- Fraud and white-collar crime investigations

In India the formation of Serious Fraud Investigation Office is the landmark creation for the Forensic Accountants. The increase in number of cyber crimes and failure of regulators to track the security scams, series of co-operative banks bursting - all are pinpointing the need of forensic accounting, irrespective of whether we understand the need or not.

In the Indian context due to growing number of frauds Forensic Accountants are the most required .After the Satyam scam, forensic auditors are much in demand as many companies want to understand what could be the initial warning signals of a Satyam kind of fraud in other Indian companies. In the case of Satyam, even the government’s Serious Fraud Investigation Office (SFIO) has sought the help of forensic accountants to get to the root of the financial fraud at Satyam.

Global Frauds

Although fraud and corrupt practices are globally present, however, the rate at which public office holder in developing economies perpetrate financial malpractice is dangerously alarming. Leaders of third world nations, especially, embezzles public fund not minding whatsoever consequences their activities may have on the citizens of the country and their image in the international community, when their nefarious act become known to the world (Adefila, kasum and Olaniyi, 2006). A brief disclosure of loss suffered due to frauds and scandals by high-profile leaders are shown in Table I.

Head of Government	Designation	Period	Estimates of Funds allegedly embezzled
Mobutu Sese Seko	President of Zaire(Congo Dr)	1965-97	US \$ 5 Billion
Mohammed Suharto	President of Indonesia	1967-98	US \$ 15-35 Billion
Jean–Claude Duvalier	President of Haiti	1971-86	US \$ 300-800 Million
Ferdinand Marcos	President of Philippines	1972-86	US \$ 5-10 Billion
Siobodan Milosevic	President of Serbia Yugoslavia	1989-2000	US \$ 1Billion
Sanni Abacha	President of Nigeria	---	US \$ 2-5Billion
Alberto Fujimnori	President of Peru	1990-2000	US \$ 600 Million
Pavio Lazarenko	Prime Minister of Ukarine	1996-97	US \$ 114-200 Million
Arnoldo Aleman	Presidet of Nicaragua	1997-2002	US \$ 100 Million
Joseph Estrada	President of Philippines	1998-2001	US \$ 78-80 Million

Source : Transperency International (2004)

Magnitude of losses suffered by frauds and malpractices: A survey of various reports

• **Kroll’s Global Fraud Report (2014):** Recently in July and August 2013, a worldwide survey on fraud and its effect on business has been commissioned by Kroll and conducted by the Economist Intelligence Unit. In this survey more than 901 senior executives worldwide from a broad range of industries and functions were polled. 24% were based in North America, 25% in Europe, 23% in Asia Pacific, 14% from Latin America, and 14% in the Middle East and Africa. The survey covered more than 10 industries. The details of findings are enumerated in **Table II**

Table II : Percentage of Companies affected by listed frauds (Figures are in Percentage)

Types of Frauds	2013	2012	2011
Theft of Physical Assets	28	24	25
Information Theft	22	21	23
Management Conflict of interest	20	14	21
Vendor, Supplier or Procurement fraud	19	12	20
Internal financial fraud	16	12	19
Corruption and bribery	14	11	19
Regulatory or Compliance breach	16	11	11
IP theft	11	8	10
Market Collusion	8	3	9
Misappropriation of Company frauds	8	-	-
Money laundering	3	1	4

Source: Kroll Global Fraud Report, Key Facts and Figures , Annual Edition:2012/2013 and 2013/2014

Indian Frauds:

The Ernst and Young’s “India Fraud Indicator Report” (2012): The report stated that during 2011-12, total losses suffered in India was INR 66 billion. Data compiled by the Reserve Bank of India (RBI) disclosed that money lost by banks duet to frauds and scams had doubled in the past 4 years. Losses incurred by banks due to fraud increased by 88% in 2010-11 to exceed INR 37.9 billion (more than INR 20.10 billion in 2009-10). PwC’s “The 4th Biennial Global Economic Crime Survey: India” (2007) Report: According to this report the total cost of fraud in India and world is in **Table III**.

Table III : The Cost of Fraud in India, Asia and Pacific and Global

Item of loss	India	Asia and Pacific	Global
1 Direct Loss (Average in US \$) +	15,35,217	14,38,526	24,20,700
2 Management Cost (Average in US \$) +	10,29,184	4,16,393	5,50,355
3 Damage to reputation or brand (%of Cases) +	92	89	88
4 Decline in Staff Morale (%of Cases) +	88	92	88
5 Damage to External Business relations (%of Cases) +	84	87	84
6 Strained relations with regulator (%of Cases)	75	83	80

Total Cost of fraud (1+2)	25,64,401	18,54,919	29,71,1055
----------------------------------	------------------	------------------	-------------------

Source :PwC: The 4th Biennial Global Economic Crime Survey : India (2007)

India, an emerging country, has also noticed umpteen numbers of scams and fiascos. Following are some bird's eye view of such scams and malpractices or accounting irregularities on

Table IV

Scams and frauds	Year	Losses Suffered (Rs)	Scams and Frauds	Year	Losses Suffered (Rs)
Harshad Mehta Securities Market Scam	1991	5,000 Crore	Madhu Cora Scam	2009	4,000 crore
Fodders Scam (Chara Ghotala)	1992	950 Crore	Commonwealth Game Scam	2010	2,342 crore
C. R. Bhansali Scam	1995	1,200 Crore	Adarsh Housing Society Scam	2010	--
Ketan Parekh Securities Market Scam	2001	1,250 Crore	Sahara India Pariwar Investor Fraud Scam	2010	25,000 crore
The UTI Scam	2001	4,800 Crore	Coal Block Allocation/Coalgate Scam	2012	1,856 Billion
Uttar Pradesh Food Grains Scams	2003	35,000 Crore	Karnataka Wakf Board Land Scam	2012	20,000 crore
Satyam Scam	2008	10,000 Crore	Uttar Pardesh NHRM Scam	2012	10,000 crore
The 2G Spectrum Distribution Scam	2008	1,75,000 Crore	Saradha Group Financial Scandal	2013	200-300 Billion

Source: Capital/Via Global Research Ltd, Indian Stream Research Journal and others

Framework of Forensic Audit.

Since each and every fraud and financial irregularity is unique, accordingly the approaches to be adopted to unveil each of them will be specific to it. Association of Chartered Certified Accountants(ACCA) has provided guidelines to perform such audit in general. However such guidelines are applicable in general. Forensic investigator has to develop some specific unique procedures to detect the frauds and malpractices. Therefore instead of adopting prototype procedures as are followed in case of financial audit assignment, forensic investigator should adopt situation oriented procedures. The procedures are discussed below:

Meeting with the client and accepting the engagement

In order to understand important facts, players and issues etc., the investigator must meet the client. It is to be considered initially that whether his firm has the necessary skills and experience to accept the work. Such audits are highly specialized and the work requires detailed knowledge of fraud investigation techniques and the legal framework.

Performing conflict check

Additional consideration is whether or not the investigation is being requested by the audit client. In order to achieve objectivity, a conflict of interest check should be carried out as soon as the relevant parties are established. Fees may also be negotiated at this stage depending on specific nature of accounting and auditing work and the likely involvement of the experts in team.

Performing initial investigation

It is generally desired to perform an initial action plan prior to developing a detailed plan. Such initial action plan will help to formulate subsequent planning to be based upon more complete and comprehensive understanding of the situation.

Planning the audit or formation of robust action plan

This is to be developed based on the meeting with the client and carrying out the initial investigation scanner on the subjects to be investigated. This action plan will set out the objectives to be achieved and the methodologies to be adopted. The investigation team must carefully take into consideration the objectives to be achieved and plan their work accordingly. The objectives of such assignments include:

- Identifying the types and nature of the frauds or irregularities that have been operating.
- The estimated time period of their occurrence.
- How the fraud was concealed, the techniques and methods adopted for their concealment.
- Identifying the fraudster(s) involved.
- Assessment of the financial losses and quantification of them.
- Gathering the evidences to support the court's proceeding.
- Providing advice so that re-occurrence of the fraud can be prevented.

Gathering relevant evidence

It involves obtaining relevant documents, economic information, tracing different assets/ persons/ unaccounted records, meeting with other experts, statutory and internal auditors of the client. The evidences gathered should be sufficient to ultimately identify and prove the fraudster(s) and the mechanism adopted for such frauds.

Analysis of evidences and other supporting information

The actual analysis to be performed will solely depend upon the nature of the assignment. This may include:

- Summarisation of a large number of transactions.
- Performing robust procedures to trace unidentified assets.

-
- Calculating the economic damages and if required, the loss of goodwill.

**Some of the techniques used by Forensic Accountant are enumerated as under:
(framework)**

a. Benford's Law

It is a statistical tool to determine whether the data under study shows any pattern signifying suspicious movement. Benford suggested the probabilities for the occurrence of each digit at various places in the number whereby if the data is manipulated; the said digit would not appear at the same place. Benford's Law does not detect the frauds but only indicates the probable area of fraud.

b. Theory of Relative Size Factor (RSF)

RSF is measured as the ratio of the largest number to the second largest number in the given set of data. It highlights all unusual fluctuations, which may be routed from fraud to genuine errors. Thus, if the second largest number is way beyond the highest number in the data, there is need to investigate further into it.

c. Ratio Analysis

Probably the biggest strength of the forensic accountant is the ratio analysis and the use of the answers for detection of areas of fraud. Numerous ratios are used by various analysts including financial ratios, data analysis ratios and utility ratios. However, the use of data analysis ratios are prominently used by forensic accountant is identifying possible symptoms of fraud.

Some of the ratios commonly used are –

i. Gross Margin Index

Any ratio less than 1:1 indicates deterioration and needs to be looked into in detail.

ii. Asset Quality Index

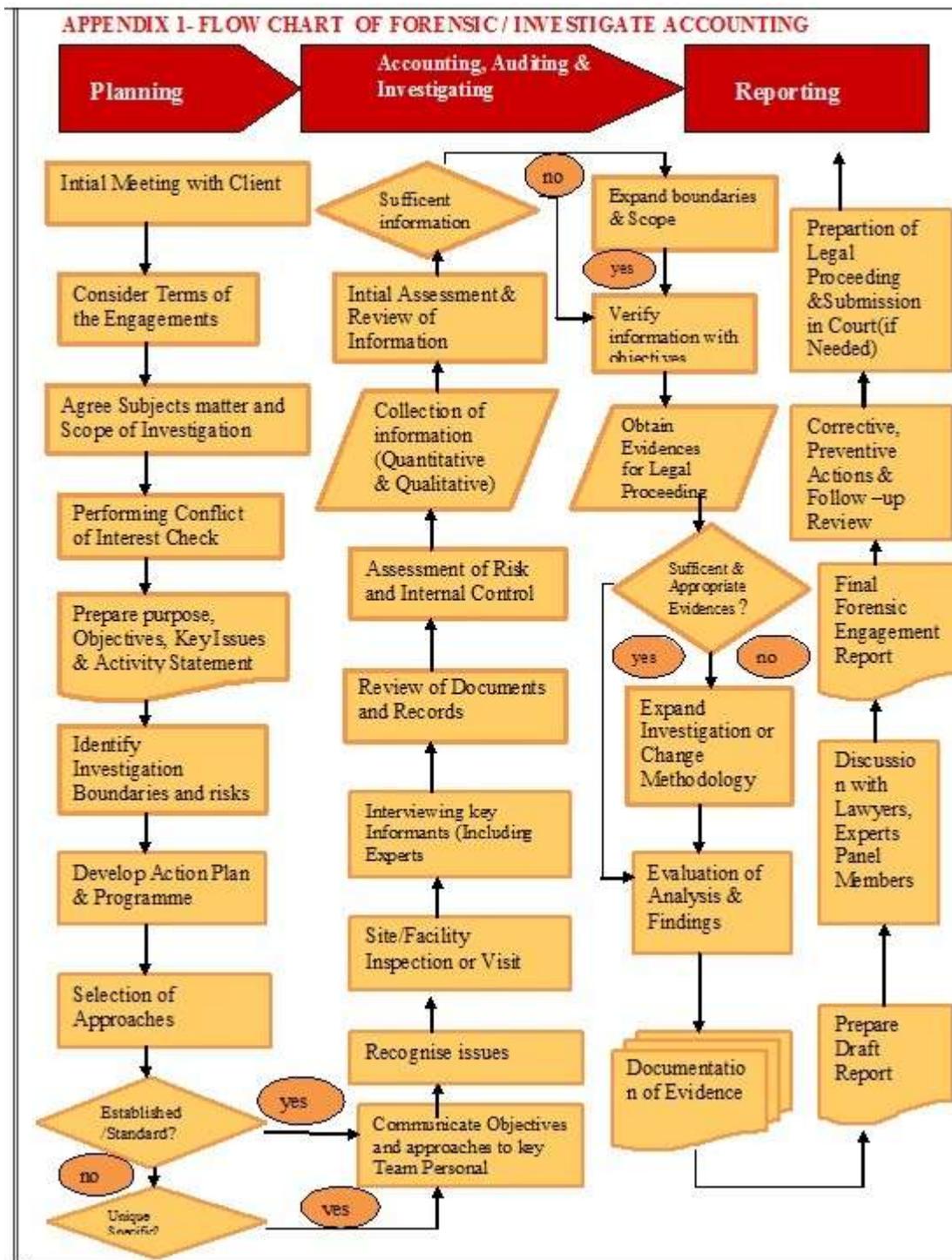
A ratio of non-current assets exclusive of property, plant and equipment to total assets in any given year is computed and any change beyond 1:1 indicates further study for possible error or fraud.

iii. Day's sales in receivable ratio

Current year sales in receivables and prior period's sales in receivables are compared and any unusual fluctuation would greatly suggest an area for further analysis.

Apart from above, there are numerous techniques used which involve collecting information through grapevine, interviewing the senior knowledgeable employees, verification of background of each employee, physical and electronic surveillance, surprise visits and undercover operations which also lead to detection of fraud with sufficient evidence.

Audit Programme of Forensic Audit



CONCLUSION:

So far forensic accounting in India is being used as an investigative tool, rather than a preventive tool. If forensic auditing is made compulsory in financial and corporate sector many of the scams involving thousands of crores can be avoided. With the above objectives in mind, some of the initiatives taken by regulatory bodies show a positive sign in preventing scams. SEBI and RBI has initiated steps to prevent frauds by using forensic audit. SEBI has decided to “create a forensic accounting cell to improve the financial information quality disclosures and to help in detection of financial irregularities so as to serve as an effective early warning mechanism. RBI has also asked banks to include forensic auditing practices to prevent scams in financial sector

REFERENCES

- i Ansari K M. (2005) "Corruption and Forensic Accounting" Ohio CPA Journal; July – September.
- ii Arnold Shields (2009) History of Forensic Accounting <http://www.dolmanbateman.com.au/125/history-of-forensic-accounting/>
- iii Bhasin, Dr. Madan (2007) Forensic accounting: A New Paradigm For Niche Consulting The Chartered Account ICAI
- iv Crumbley DL Heitger LE, Smith GS, (2005),“ Forensic and investigative accounting” CCH Group, Chicago, IL
- v Debroy, Bibek & Bhandary, Laveesh, “Corruption in India”, www.worldfinancialreview.com p=1575
- vi Enyi, Patrick Enyi, “Detecting Causes of Variances In Operational Outputs of Manufacturing Organizations: A Forensic Accounting Investigation Approach”, SSRN-id1144783 “Forensic Accounting -An Investigative Approach of Accounting” SSRN-id1789123
- vii Ghosh Dr. Indrani and Banerjee Dr. Kamal Kishore, (2011) “Forensic Accounting – Another feather in the Hat of Accounting” Chartered Accountant, ICAI
- viii http://en.wikipedia.org/wiki/List_of_scandals_in_India
- ix Lighting the Fraud Examination in India – “Complete resource guide on Fraud Examination in India”, report by India forensic Research foundation www.indiaforensic.com/frauds in India.
- x Nevis Sherloc(July 2012),„White collar crime“ , Deloitte , www.deloitte.com/in
- xi Okoye Prof. Emma and Akenbor Cletus O, (2009)“Forensic accounting in developing Economies- Problems and Prospects”, The University Advance Research Journal, Issue 1, ISSN 1119 – 8125
- xii Rasey, Michelle, „History of Forensic Accounting“ , <http://www.ehow.com/about>

5005763 history-forensic-accounting.html

xiii Singh, Preethi, (2012 “Forensic Accounting Concept in India”, International Journal of Trade and Commerce - IIARTC January-June, Volume 1, No. 1, pp. 100-105

xiv Wadhwa, Lalith & Pal, Dr. Virender, (2012) , “Forensic Accounting & Fraud examination in India” International Journal of Applied Engineering Research, ISSN 0973-4562 Vol.7 No.11

www.ijmas.com