
Forensic Accounting: A Tool for Detecting and Preventing Frauds

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ABSTRACT

Forensic accounting plays a key role in discovering the financial frauds and white-collar crimes. However, forensic accounting covers a wide range of operations of which fraud examination is a small part where it is most prevalent. The failure of the major corporate governance mechanism to reduce financial frauds and the increasing sophisticated financial frauds has imposed serious threat to investors, government and general public. In the context of India forensic accounting is the most required in the trend of the growing frauds. Even the government's serious fraud investigation office (SFIO) has sought the help of forensic accountant to get to the root of the financial fraud. After the Satyam scam, forensic examiners are much in demand as many companies want to recognize what could be the early warning signals of a Satyam kind of fraud in other Indian companies. The general objective of this study is to assess whether forensic accounting and fraud management help in the effective reduction and control of fraudulent practices in India.

Key words: - *Forensic Accounting, Forensic Accountant, Corporate governance.*

INTRODUCTION

Forensic accounting is a rapidly growing field of accounting that describes the engagement that results from actual or anticipated dispute or litigations. (Okoye and Gbegi, 2013) concur that "Forensic" means "suitable for use in a court of law", and it is to that standard that forensic accountants generally work. Forensic accounting is an investigative style of accounting used to determine whether an individual or an organization has engaged in any illegal financial activities. Forensic accounting is an investigative style of accounting used to determine whether an individual or an organization has engaged in any illegal financial activities. The need for forensic accounting is due to failure of audit systems in the business firms as the organizational internal audit and the other regulatory procedures failed to trace the errors in the managerial system .market fraud or bank fraud or cyber fraud; forensic accounting has become an indispensable tool for investigation. India being ranked as the 88th most corrupt nation, the needs for forensic accountants become all the more profound.

Madanlal Bhasin(2007) finds in his article "Forensic Accounting And Auditing – perspectives and prospects" that the services of forensic accountants are in great demand in the areas which include criminal investigation; settlement of outgoing partner; settlement of insurance claims; detection of employee fraud and case relating to professional negligence. The author quotes from William Messier: "a forensic audit's purpose is the detection or deterrence of a wide variety of fraudulent activities."

According to Osisioma (2013), forensic accounting clearly demands a change in scope, method and operational style for accountants. In financial audits, accountants are alert to signs or evidence of errors and irregularities of a material nature. Small errors are of less concern to financial auditors. Conversely, forensic accountants are very much concerned about small errors and irregularities, particularly if they seem to be related to the modus operandi of corrupt employees and fraudsters. Criminals usually cannot bury all their tracks; small errors and irregularities may therefore be the tip of a fraudulent iceberg. Hence, the forensic auditor is expected to look out for evidence of control procedure exceptions, accounting classification anomalies and oddities in financial trends. According to Jafaru (2011), forensic and investigative accounting should be seen as the application of financial skills and investigative mindset conducted within the context of the rules of evidence to resolve unresolved issues

In the article “forensic accounting in Indian banks”, T. R. Shastri observes that while incidence of frauds, detection of frauds and the investigations before and after have been there in India for decades, there is no standardized approach to these investigations. The profession of forensic accountancy has not been recognized as such either in banks or in the financial services industry. The author provides a live example of forensic accounting in banks in India to illustrate how a forensic report formed the basis for handling a case of fraud in a private sector bank. ."

1. WHY THERE IS NEED OF A FORENSIC ACCOUNTANT?

Why bring in a forensic accountant and his team when the organization's internal auditor and management team can handle the situation which can range from a simple employee fraud to a more complex situation involving management itself? The answer would be obvious when management itself is involved and the fallout to the discovery of the fraud leads to low employee morale, adverse public opinion and perception of the company's image and organizational disorderliness generally. Engaging an external party can have distinct advantages from conducting an internal investigation.

2. ROLE OF FORENSIC ACCOUNTANT

As an investigator a professional forensic accountant can be seen as those who are specialist in fraud detection, and particularly in documenting exactly the kind of evidence required for successful criminal prosecution; able to work in complex regulatory and litigation environments; and with reasonable accuracy, can reconstruct missing, destroyed, or deceptive accounting records. Meanwhile, as an economist, they are particularly effective at economic loss, damage and social harm estimates; familiar with the assumptions, algorithm, and calculations in econometric models and opportunity cost scenarios; can measure and quantify such things as loss of goodwill and reputation. finally, as an appraiser, forensic accountants should be able to reliably express informed opinion on matter of business value, based on generally accepted theory; effective at evaluating the historical and projected degrees of risk and return of any going concern as well as any and all financial transactions involving assets, property taxes, and equities (Bologna and Lindquist, 1995).

Moreover, Bologna and Lindquist (1995) assert that the characteristic that differentiates fraud auditors and professional forensic accountants from regular auditors is the persistence and doggedness to which a suspicion is followed upon. Professional forensic accountants may be ordered in by a regulatory agency after receiving notice from an employee whistle blower, or press coverage may make it know that the company has a scandalous eco or history (Bologna and Lindquist 1995). There are no professional standards for when regular auditors should become whistleblowers, and unfortunately, the involvement of a forensic accountant is almost always reactive. There is a need for more proactive monitoring of the signs of financial crime.

3. FORENSIC ACCOUNTANTS - THE BLOODHOUNDS OF BOOK-KEEPING

Forensic accounting requires the most important quality a person can possess: The ability to think. There is no book that tells you how to do a forensic investigation. It is about solving a puzzle. It takes creativity. All of the larger accounting firms, as well as many medium-size firms have specialist forensic accounting departments. Within these groups, there may be further sub-specializations: some forensic accountants may, for example, just specialize in insurance claims, personal injury claims, fraud construction, or royalty audits. Forensic accountants are involved in recovering proceeds of crime and in relation to arrogation proceedings concerning actual or assumed proceeds of crime or money laundering. In the United Kingdom, relevant legislation is contained in the proceeds of crime act 2002. In India there is a separate breed of forensic accountants called certified forensic accounting professionals. Some forensic accountants are also certified fraud examiners, certified public accountants, or chartered accountants. Forensic accountants utilize an understanding of business information and financial reporting systems, accounting and auditing standards and procedures, evidence gathering and investigative techniques, and litigation processes and procedures to perform their work. Forensic accountants are also increasingly playing more proactive risk reduction roles by designing and performing extended procedures as part of the statutory audit, acting as advisers to audit committees, fraud deterrence engagements, and assisting in investment analyst research. The forensic accountant is a bloodhound of bookkeeping. These bloodhounds sniff out fraud and criminal transactions in bank, corporate entity or from any other organization's financial records. They hound for the conclusive evidences. External auditors find out the deliberate misstatements only but the forensic accountants find out the misstatements deliberately. External auditors look at the numbers but the forensic auditors look beyond the numbers. Forensic accountant takes a more proactive, skeptical approach in examining the books of accounting. they make no assumption of management integrity show less concerns for the arithmetical accuracy have nothing to do with the accounting or assurance standards but are keen in exposing any possibility of fraud.

4. ADVANTAGES OF FORENSIC ACCOUNTING

1) Fraud Identification and Prevention: - fraud is quite common in big organizations where the number of daily financial transactions is huge. In such an environment, an employee can easily undertake fraudulent activities without being caught. Forensic accounting helps in analyzing whether the company's accounting policies are followed or not, any deviation

observed in the books of accounts can help in identifying fraud, and necessary measures can be taken to prevent it in the future.

2) Formulation of Economic Policies - various cases of fraud that becomes evident after forensic analysis act as a reference for the government to formulate improved economic policies that would be able to curb such fraudulent activities in the future. By doing so, the government can strengthen the economy and prevent such illegal activities in the country.

3) Making Sound Investment Decisions: - forensic accounting helps in analyzing the financial standing and weaknesses of a business, it provides a path for investors to make thoughtful investment decisions. A company dealing with fraud is definitely not a good option for investment. Therefore, the reports of forensic accountants act as a guide for potential investors of a company. Many organizations also apply for loans from various financial institutions. By performing an analysis, such institutions can take a decision on whether they would like to fund a company or not.

4) Rewarding Career Opportunity: - forensic accounting is extremely rewarding, as it not only involves regular accounting activities, but also involves identification, analysis, and reporting of the findings during an audit. The acceptance of reports generated by a forensic accountant by the court of law, gives them an upper hand as compared to other accountants.

5. DISADVANTAGES OF FORENSIC ACCOUNTING

1) Confidentiality issue: - since the scrutiny of a company's financial records is done by an external forensic accountant, the chances of leakage of confidential matter are always there. It is true that their code of ethics clearly mentions that forensic accountants and other members involved in the scrutiny must not engage in disclosing confidential data to outsiders, but the possibility of disclosure cannot be nullified.

2) increases chances of threats and negative publicity :- If the analysis of a company's financial statements points out the involvement of a particular person in fraudulent activities, there is a significant chance that the person will try to threaten the company to safeguard himself from the trial. Also, any trial that confirms a fraud happening in the company comes under public eye and gains negative publicity, which directly affects the reputation and investor relations of the company.

3) Costly Process: - Forensic accounting can be an expensive affair because the procedures which accountants use involve high-end accounting software. If study results have to be presented in a trial, the overall expenditure goes up even further. This can be a matter of concern for the organization.

4) Limited Use of Services:-federal regulations limit the use of services from a single accounting firm. Suppose a company has tied up with one firm for auditing, it cannot ask the firm to provide other services. Therefore, a company has to reach out to several firms for carrying out its accounting tasks.

Despite the disadvantages associated with forensic accounting, it is, and will continue to be an important part in the world of business. This is because it helps organizations and individuals to figure out whether their financial accounts are accurate or fabricated to hide illegal activities going on within the organization.

6. CURRENT AFFAIRS

The finance ministry has ordered a Forensic Audit Of Dena Bank and Oriental Bank of Commerce after some of their Mumbai-based branches allegedly misappropriated funds worth Rs. 437 crore, Mobilized through fixed deposits. Professional services firm KPMG in India has been given the mandate to undertake forensic investigations. In the case of Dena Bank, the misappropriation was to the tune of Rs. 257 crore and related to funds mobilized from seven corporate. In Oriental Bank's case, it related to misappropriation of funds amounting to Rs. 180 crore, reportedly belonging to the Jawaharlal Nehru Port Trust. The central bureau of investigation is already looking into the alleged fraud. The incident in oriental bank of commerce dated to February 2014 and the bank had swung into action early in March itself to nip the fixed deposit scam in the bud, said Bansal. Of the initial amount of Rs. 180 crore, as much as Rs. 110 crore was immediately recovered and handed over to the original remitter, he added. To prevent scams in financial sector, RBI has also asked banks to include forensic auditing practices.

7. CONCLUSION

Forensic accounting is the application of a specialized knowledge and specific skills. The major concern of the country is to prevent white collar crimes which affect the very fabric of the society. Forensic accounting has come up as an effective tool for preventing this menace .The practice and development of forensic accounting are relatively very much lower in developing countries like India than those in developed countries. On account of global competition, the accounting profession must convince the marketplace that it has the "best-equipped" professionals to perform such services .Forensic services require 'specialized' training as well as real-life 'practical' corporate experience. As a matter of fact, there is no effective tool to measure, detect and prevent fraud and corruption in India; so, forensic accounting now appears as a one of the strategic and dynamic tool for the management of all types of corruption. It is still in a nascent stage and requires technological reinforcement on a continuous basis and global cooperation. It will develop as a specialized profession of accountancy and its importance to law enforcing agencies and also regulators will increase day by day forensic accounting engagement: how it is conducted 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.

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