

A STUDY ON FORENSIC ACCOUNTING AND ITS USABILITY

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Abstract:

Forensic accounting is not a new field, but in recent years, banks, insurance companies and even police agencies have increased the use of these experts. Forensic accounting in India has come to limelight only recently due to rapid increase in Frauds and white-collar crimes. A large global accounting firm believes the market is sufficiently large to support an independent unit devoted strictly to 'Forensic Accounting'. This study examines the various techniques of Forensic Accounting that can be used to detect the frauds and the other areas where it can be used. George A. Manning in "Financial Investigation and Forensic Accounting" defines it as a science of gathering and presenting financial information in a form that will be accepted by a court of jurisprudence against perpetrators of economic crimes. It is an integration of accounting, auditing, and investigative skills to detect or prevent accounting fraud like stock market fraud or bank fraud or cyber fraud, corporate frauds. The paper talks about the uses of forensic accounting in various fields along with the techniques used. The concept is now used universally with a promising future ahead.

Introduction:

Forensic Accounting utilizes accounting, auditing, and investigative skills to conduct an examination into a company's financial statements. It is providing an accounting analysis that is suitable for court. In other words Forensic accountants are trained to look beyond the numbers and deal with the business reality of a situation. They are frequently used in fraud cases.

Forensic accountants are experienced auditors, accountants, and investigators of legal and financial documents that are hired to look into possible suspicions of fraudulent activity within a company; or are hired by a company who may just want to prevent fraudulent activities from occurring. They also provide services in areas such as accounting, antitrust, damages, analysis, valuation, and general consulting. Forensic accountants have also been used in divorces, bankruptcy, insurance claims, personal injury claims, fraudulent claims, construction, royalty audits, and tracking terrorism by investigating financial records.

There is a big difference between an auditor and a forensic accountant. It is said that "Auditor should be watchdog and not be the bloodhound". It's a good quote that every auditor should know. This quote makes the definition of Forensic accountants even simpler. 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 (if they can assume so then there is no need for their appointment) 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.

In India, Forensic Accounting did not get recognition even after alarming increase in the complex financial crimes. There is a lack of adequately trained professionals to investigate and report on the complex financial crimes. The task of Forensic Accountants is handled by Chartered Accountants who are different from traditional practice of auditing as required under

the Companies Act, 1956. Forensic accountants are called upon by the agencies enforced by Income Tax Act or the companies or private individuals to assist in investigating the financial crime or scam. However, growing financial fraud cases, recent stock market scams, failure of non-financial banking companies, phenomena of vanishing companies, plantation companies and failure of the regulatory mechanism to curb it has forced the Government of India to form Serious Fraud Investigation Office (SFIO) under Ministry of Corporate Affairs which can be regarded the first step of Government of India to recognize the importance and advance the profession of forensic accountants. Experts from financial sector, capital market, accountancy, forensic audit, taxation, law, information technology, company law, customs and investigation have been taken from various organizations like banks, Securities & Exchange Board of India, Comptroller and Auditor.

Objectives of research

The objective of research is as below:

- a) To identify different forensic accounting techniques applicable to detect the frauds and financial scams in India.
- b) To assess the usability of forensic accounting in different financial scam in India.

Research methodology:

This paper is based on secondary data. Different books, articles, websites are referred to gather the information related to forensic accounting. A descriptive research method is followed for the current research. Forensic accounting covers a wide range of operations of which fraud examination is a small part where it is most prevalent.

Area where forensic accounting is used:

There are different areas where forensic accounting can be used like-

- a) Fraud and scam detection
- b) Professional negligence
- c) Criminal Investigation

- d) Settlement of insurance claim and
- e) Dispute settlement

Types of frauds

- a) **Securities frauds:** Although not corruption scams these have affected many people there is no way that the investor community forget the under tune Rs. 4000 crore Harshad Mehta scam and over Rs. 1000 Crore Ketan Parekh scams which ended the shareholder wealth in form of big market
- b) **Insurance frauds:** Insurance frauds are on the rise and a number of life insurance companies are reporting a sharp increase in cases of fraud and misrepresentation of facts with respect to selling of the product. That's not all. The number of unauthorized agents purporting to represent companies has also risen exponentially. For instance, during the first half of 2013, nearly 50% of customer complaints received by PNB MetLife India were linked to fraud by unauthorized agents.
- c) **Cyber fraud:** The report, which is one of the largest global studies investigating the impact of cyber crime on consumers, is based on responses from 13,022 adults across 24 countries, including 1,000 from India. Today's cyber criminals are using more sophisticated attacks such as ransom ware and spear-phishing, which yield them more money per attack than ever before. With 66 per cent of Indian consumers using their personal mobile device for work and play, this creates entirely new security risks for enterprises as cyber criminals have the potential to access even more valuable information
- d) **Corporate frauds:** The government vowed to strengthen laws to prevent corporate fraud after Satyam Computer, the country's fourth-largest software company, shocked investors by revealing profits had been falsely inflated for years. Chairman Ramalinga Raju resigned after revealing India's biggest corporate scandal in memory, sending the company's shares plunging nearly 80 per cent. There different ways of financial frauds like –
 - Embezzlement of the money during its collection but before it is recorded in accounts

- Stealing the cheques of business
- Tampering the bank records and taking monetary advantage
- Gaining advantage through forgery of documents
- Making payments which should not be made or previously made
- Creating fictitious debts and having payments done in favor of oneself
- Giving discount improperly or without authority
- Creating ghost suppliers and having payments made in their favor
- Inventory and scrap theft
- Office supplies and fixed asset theft
- Creating fictitious expenses and obtaining disbursements
- Padding expense items
- Benefiting from placing redundant order
- Creating ghost employees and embezzling their wages/salaries
- Accepting bribes from the customers and suppliers of the business with various reasons
- Using credit cards of the business for personal objectives
- Benefiting from overstated personal expenditures
- Manipulating the overtime periods and obtaining extra payment
- Benefiting from padded travel expenses
- Selling business assets under the market value

e) **Bank frauds:** In India bank frauds are becoming common. There are different department where the frauds can happen like loan department, transactions, overdraft. Bank fraud is a big problem in world.

Technique of forensic accounting

a) **Theory of relative size factor (RSF):** RSF is measured as the ratio of the largest number to the second largest number of the given set. It shows all unusual fluctuations, which may be

routed from fraud or genuine error. In practice there exist certain limits for each entity such as vendors, customers, and employees. If there is any stray instance of that is way beyond the normal range, then there is a need to investigate further into it. It helps in better detection of anomalies or outliers. In records that fall outside the prescribed range are suspected of errors or fraud.

- b) Ratio Analysis:** Most effective fraud detection technique is the calculation of data analysis ratios for key numeric fields. Like financial ratios that give indications of the financial health of a company, data analysis ratios report on the fraud health by identifying possible symptoms of fraud.
- c) Data mining techniques:** Data mining techniques are sets of assisted techniques designed to automatically mine large volumes of data for new, hidden or unexpected informations or patterns. Data mining techniques are categorized in three ways: Discovery, Predictive modeling and Deviation and Link analysis. It discovers the usual knowledge or patterns in data, without a predefined idea or hypothesis about what the pattern may be, i.e. without any prior knowledge of fraud.
- d) Computer Assisted Auditing Tools(CAATs):** CAAT helps auditors to perform various auditing procedures such as: (a) Testing details of transactions and balances, (b) identifying inconsistencies or significant fluctuations, (c) Testing general as well as application control of computer systems. (d) Sampling programs to extract data for audit testing, and (e) Redoing calculations performed by accounting systems. CAATs are computer programs that the auditor use as part of the audit procedures to process data of audit significance contained in a client's information systems, without depending on him.
- e) Benford's Law:** Benford's Law is a mathematical tool, and is one of the various ways to determine whether variable under study is a case of (mistakes) or fraud. The steps of Benford's law are very simple. Once the variable or field of financial importance is decided, the left most digit of variable under study extracted and summarized for entire population. The summarization is done by classifying the first digit field and calculating its observed count percentage then Benford's set is applied. A parametric test called the Z-test is carried out to measure the significance of variance between the two populations.

Procedure of detection of frauds by Forensic Accounting:

Each forensic accounting assignment is unique. Accordingly, the actual approach adopted and the procedures performed will be specific to it. However, in general, many Forensic Accounting assignments will include the steps detailed below.

- a) **Meeting with client:** First of all client meeting is very compulsory to judge the trustworthiness of financial records. It is helpful to meet the client to obtain an understanding of the important facts, players and issues at hand.
- b) **Checking the Conflicts:** A conflict check should be carried out as soon as the relevant parties are established.
- c) **Initial investigation:** Initial investigation prior to the development of a detailed plan of action is very helpful. This will allow subsequent planning to be based upon a more complete understanding of the issues which can be raised in future.
- d) **Deciding Action plan:** This plan will take into account the knowledge gained by meeting with the client and carrying out the initial investigation and will set out the objectives to be achieved and the methodology to be utilized to accomplish them.
- e) **Collecting relevant evidence:** Depending on the nature of the case this may involve locating documents, economic information, assets, a person or company, another expert or proof of the occurrence of an event.
- f) **Analysis the performance:** The actual analysis performed will be dependent on the nature of the assignment and may involve:
 - Economic damage calculation
 - Huge transaction summarization
 - Using proper discounting rate for assets present value calculation
 - Performing sensitivity analysis
 - Using of computers and computer accounting software
 - Utilization of charts, graphs for analysis
- g) **Report preparation:** Often a report will be prepared which may include sections on the nature of the assignment, scope of the investigation, approach utilized, limitations of scope and findings

and/or opinions. The report will include schedules and graphics necessary to properly support and explain the findings.

Financial scams in india:

- a) 2G Spectrum scams
- b) Commonwealth Games scams
- c) Satyam scams
- d) The fodder scams
- e) The Howala scandal
- f) Harshadmetha
- g) Ketan Parekh Stock Market Scam.

Conclusion:

Forensic accounting in India has come to limelight only recently due to rapid increase in Frauds and crimes caused by white color people. The diverse range of cases where forensic accountants are called to give expert financial advice reveals the extent to which forensic accounting has become a necessary requirement in many legal cases. Forensic Accountants can act for either the Plaintiff or the Defendant in their litigation process and can advise clients on all aspects of their claims from initial investigation to negotiations to final settlement.

Forensic accounting not only helps to decrease the rate of frauds and scams but also helps to settle many financial disputes. Due to different techniques of forensic accounting it is easy to locate the frauds and scams. In India there is much evidence of financial scams, insurance settlement disputes, and big scams. But due to the forensic accounting it is easy to detect these scams and prevents the economic development from such frauds.

References

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