



Forensic Accounting: Signaling Practicing Accountants To Improve Skillset And Forming Regulatory Body For Forensic Accountants In India

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ABSTRACT

Forensic accounting is hardly a new field, but in recent years the increased number of frauds and the helplessness of the authorities to combat them have brought the Forensic Accounting in the limelight. Forensic accounting is the specialty practice area of accounting that describes engagements which result from real or anticipated litigation. Forensic accounting is very important tool to detect, investigate and prevent the frauds. In order to detect and prevent financial frauds and white collar crimes forensic accounting is making use of various tools. Forensic accountants are currently in great demand, with the public need for honesty, fairness and transparency in reporting increasing exponentially. These forensic accountants need accounting, finance, law, investigative and research skills to identify, interpret, communicate and prevent fraud. As more and more companies look for forensic accountants and professional organizations offer certifications in the area, it is becoming evident that the forensic accountant has a skill set that is very different from an auditor or a financial accountant. In India unfortunately it is being used as an investigative tool, rather than a preventive tool. If forensic auditing is made mandatory in various sectors, many of the scams can be restricted. It has been suggested that appointment of forensic accountants should be made mandatory in public sectors and large scale companies for the sustainable development of the economy.

KEYWORDS : Forensic Accounting, Scams, Investigative Skills, Forensic Accounting Tools.

Introduction:

Forensic Accounting is a simply analysis of evidences. Forensic accounting is the specialty practice area of accounting that describes engagements, which result from real or anticipated litigation. The word forensic accounting can be divided into two parts –

Forensic means relating to, or used in courts of law or public debate or argument.

Accounting means language that provides information about the financial position of an organization.

According to American Institute of Certified Public Accountants (AICPA): "Forensic accounting is the application of accounting principles, theories and disciplines to facts or hypothesis at issues in a legal dispute and encompasses every branch of accounting knowledge."

To make it simple, the integration of

- Accounting skills
- Auditing skills and
- Investigative skills, creates the specialty known as Forensic accounting

Forensic accounting is used for fraud examination and fraud examination covers fraud allegations from inception to disposition, including obtaining evidence, interviewing, writing reports, and testifying.

In the current scenario the emphasis is on the forensic accounting as the public deals with financial collapses, increased white collar crime and growing occurrences of occupational fraud.

Forensic accounting provides investigative functions and litigation support services to understand the depth and width of the financial scams happening in any economy.

India's image on tackling corruption has not improved with Transparency International's Corruption Perception Index (CPI) placing it at 94th rank out of 176 nations.

Frauds, in the different sectors like bank, insurance, stock market, cyber world etc., need a sharp scientific tool, for investigation and settlement of disputes.

The term 'fraud' essentially "involves using deception to dishonestly make a personal gain for oneself and/or create a loss for another." Although the legal definitions of fraud may vary from country to country, most are based around these general themes. Examples of fraud commonly include activities, such as, theft, corruption, conspiracy,

embezzlement, money-laundering, bribery and extortion.

Objective of the study:

- Highlighting the problems so as to develop future prospects of Forensic Accounting and its importance in India.
- To determine the extent to which financial and economic crimes have impacted on the Indian economy and the effectiveness of forensic accounting functions.
- To understand the historical perspective of forensic accounting in India.

Historical Perspectives of Forensic Accounting in India:

Recent cases of frauds and financial scams in India require more professionalism in accounting and finance. Investigative audit has always been there, it is only the techniques involved that has been changing in line with sophistication of the financial fraud involved (Krancher, 2006).

Maurice E. Peloubet who coined the term Forensic Accountant in 1946 essay "Forensic Accounting: Its Place in Today's Economy." Archaeological findings reveal that, during 3300-3500 BC, accountants of their day in Egypt, were involved in the prevention and detection of fraud. During 1800" close relationship developed between accountancy and legal profession. Many amendments to financial statement disclosure can be attributed to frauds in corporate. In 1930 s America Eliot Ness was credited to bring down gangster Al Capone, but his case was based on the investigative work done by Elmer Irey, an accountant with the Internal Revenue Service that ensured Capone's conviction for tax evasion. He was probably America's first high-profile forensic accountant. But in Indian context history of investigative accounting goes back to ancient times of Mauryan Times. Kautilya was the first person to mention the famous forty ways of embezzlement in his famous Kautilya arthashastra.

As pointed out by Black (2010), "Financial statement fraud was a contributing factor to the recent financial crisis and it threatened the efficiency, liquidity and safety of both debt and capital markets." Furthermore, it has very significantly increased 'uncertainty' and 'volatility' in financial markets, shaking 'investor' confidence worldwide. It also reduces the credibility of financial information that investors use in their investment decisions (Rezaee and Kedia, 2012).

When taking into account the loss of investor confidence, as well as, reputational damage and potential fines and criminal actions, it is clear why financial misstatements should be every manager's worst fraud-related nightmare (E&Y, 2009). From time-to-time, corporations and regulatory bodies have tried to analyze and correct any existing defects, if any, in their reporting systems. In addition, discussion on the relevance of "forensic accounting" in detecting accounting scandals has emerged in recent years. All these cases imply that the

corporations have failed to supply accurate information to their investors, and to provide appropriate disclosures of any transactions that would impact their financial position and operating results.

The Institute of Chartered Accountants of India (ICAI) has taken the challenge of training some Chartered Accountants to become Certified Forensic Accountants (CFAs). It is providing a "Certificate Course on Forensic Accounting and Fraud Detection using IT and CAATs," with 100 hours spread over 6 weekends. This challenge is yet to be embraced by most of the Indian Universities providing higher education.

While forensic accounting developed as early as 1995 in USA, it put its first step in India just few years back. In India, forensic accounting has risen to prominence because of increased financial frauds popularly known as white collar crimes. The shortage of respect and perception in India's law enforcement agencies plus the price at which white collar crimes have enhanced, has prompted the improvement of forensic accounting in India. Forensic accounting though a new field in Indian accounting world has tremendous potential as a new practice area for Indian CAs. Indian CAs with their extensive theoretical education and practical experience can create forensic accounting and auditing as their niche area.

Chartered Accountancy firms which provide the Forensic Accounting services are as follows:

- Sharad Joshi Chartered Accountants who investigated the Delhi based Xerox fraud case.
- Deloitte
- Ernst and Young
- Price Water House Coopers
- KPMG

In order to curb the increasing financial fraud cases, scams Government of India has established three four agencies that combat frauds as follows:

1. SFIO (Serious Fraud Investigation Office)

It is formed by Government of India under Ministry of Corporate Affairs which looks after the Frauds in the areas of Income tax, FEMA, RBI etc.

2. CBI (Central Bureau of Investigation)

It has its specialized wing to deal with the financial frauds called as "economic offenses wing".

3. CVC (Central Vigilance Commission)

It takes care of the occupational frauds such as corruption. It has developed the "Forensic Cell" which takes care of the Banking Frauds governed by RBI and financial frauds are covered by SEBI.

Scope of Forensic Accountants:

The services rendered by the forensic accountants are given below:

i. Fraud detection where employees commit Fraud:

Detection of frauds committed by employees

ii. Criminal Investigation:

Detection of white collar crimes and taking civil and criminal actions.

iii. Matters related with professional negligence:

Non compliance of the auditing practices and ethical code of the profession.

iv. Arbitration service:

Resolving the matter to dispute.

v. Settlement of insurance claims:

Settlement of the challenging claims.

vi. Dispute settlement:

It includes Contract Disputes, construction claims, product liability claims, infringement of patents trademarks and any other breach of contract.

Problem Identification:

1) With sluggish economy and struggling stock market there has been an increase in % of frauds in following manner:

- a) Money Laundering 12%
- b) Occupation Frauds 49%
- c) Cyber Fraud 2%
- d) Bank Fraud 30%
- e) Stock Market Fraud 8%
- f) BPO Fraud 3%

- 2) Due to digitalization of the records it is difficult to maintain accounting and audit trail.
- 3) Due to complex and traditional Judicial and political System it is difficult to seek the information.
- 4) No specific guidelines are prepared for adoption of Forensic Accounting.
- 5) Internal Control System is influenced by the management which results in fraudulent financial statements.
- 6) According to Kessler International Study;
 - a) 39% companies are in need of adoption of Forensic Accounting
 - b) 18% companies are not assisted.
 - c) 15% companies are not aware of the Forensic Accounting
- 7) Model should be prepared for continuous audit based on the probability of fraud detection based on the perceptions of fraudsters seeking perceived opportunity to commit fraud.
- 8) As per Sarbanes Oxley Act, Internal Financial Control Report should be prepared.

Skills Set for the Forensic Accountant:

Various studies have sought out the skills which a Forensic Accountant should have to be effective and remain present to the relevant frauds.

In a related research that surveyed Forensic Accounting Practitioners, Accounting practitioners and attorneys, the following skills were identified although perceptions differed among groups as to the different rankings of the skill sets (Davis, Ramona & Ogliby 2009)

- Deductive Analysis
- Critical Thinking
- Unstructured problem solving
- Investigative flexibility
- Analytical proficiency
- Oral communication
- Written Communication
- Specific legal knowledge and
- Composure (DiGabriele, 2007)
- Persistence and doggedness
- Knowledge skills in criminology
- Computer skills
- Confidence
- Curiosity
- Creativity
- Discretion
- Prudence
- Secrecy
- Honesty
- Personal courage

1.1 Scams in India:

2G Spectrum 2010	Rs.175000 Crore	Irregularities in License. Issued on first cum first basis. No auction
Common Wealth Games 2010	Rs. 10000 Crore	Misuse of funds. Public funds raised for infrastructure (construction)
Satyam Scam 2009	Rs. 8000 Crore	Falsified Revenues
Indian Coal Allocation 2012	Rs. 186000 Crore	No auction in allotment of Blocks.Falsified data to losses framed to CAG
VVIP Chopper Deal 2013	Rs. 362 Crore	Acceptance of Bribe Rs. 36 billion and jurisdiction discipline.

VP NHRM 2008	Rs. 10000 Crore	Siphoned funds kept for Rural Immersion
Ketan Parekh 2008	Rs. 1500 Crore	Stock Exchange
Harshad Mehta 1992	Rs. 4000 Crore	Stock Exchange
Fodder Scam 2012	Rs. 950 Crore	Embezzlement by falsification in Expense reports.

Tools and Techniques used for the purpose of Forensic Accounting:

Ø Theory of Relative Size Factor (RSF): The relative size factor test is an effective test for detecting errors. This test highlights all the possible fluctuation. It measures the ratio of largest number to the second largest number in the given set. Higher the difference indicates higher chances of occurrence of fraud and error. The given formula decides the ratio.

$$\text{Relative Size Factor} = \frac{\text{Largest Record in a Subset}}{\text{Second Largest Record in a Subset}}$$

Ø Computer Assisted Auditing Tools (CAATs): Computer-assisted audit techniques (CAATs) is an automated tool to perform audit process.

CAAT are used by the auditors to perform various auditing procedures such as:

- Testing details of transactions and balances,
- Identifying inconsistencies or significant fluctuations,
- Testing general as well as application control of computer systems.
- Sampling programs to extract data for audit testing, and
- Redoing calculations performed by accounting systems

Ø Benford’s Law: It is a mathematical tool, and is one of the various ways to determine whether variable under study is a case of unintentional errors (mistakes) or fraud. 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, i.e. Benford’s percentage numbers for first digit and observed percentage of first digit for a particular level of confidence. If the data confirms to the percentage of Benford’s law, it means that the data is Benford’s set, i.e. there is 68% (almost 2/3rd) chance of no error or fraud. The first digit may not always be the only relevant field. Benford’s Law gives the expected patterns of the digits in the numbers in tabulated data. Benford has given separate sets for 2nd, 3rd, ... and for last digit as well.

Ø Data Mining Techniques: It is a set of assisted techniques designed to automatically mine large volumes of data for new, hidden or unexpected information or patterns. Data mining techniques are categorized in three ways:

Discovery: It helps in discovering the usual knowledge without predefined hypothesis.

Predictive modeling: In this model patterns are discovered from the database to predict the outcomes.

Deviation and Link analysis: In this model unusual items are detected. Link discovery has emerged recently for detecting a suspicious pattern. It mostly uses deterministic graphical techniques, Bayesian probabilistic casual networks. This method involves “Pattern matching” algorithm to ‘extract’ any rare or suspicious cases.

Ø Ratio Analysis: Data analysis ratios for key numeric fields are also a useful technique used by forensic accountants to detect the frauds. The following three ratios are commonly used to do data ratio analysis to report on the fraud health by identifying possible symptoms of fraud

- The ratio of the highest value to the lowest value (max/min);
- The ratio of the highest value to the second highest value (max/max2); and
- The ratio of the current year to the previous year

Using ratio analysis, a financial expert studies relationships between specified costs and some measure of production, such as units sold, dollars of sales or direct labor hours.

Suggestions:

New legislative body should be made in order to make Forensic Accounting a part of day to day auditing and accounting practices. Roles, Responsibilities, duties and powers of Forensic Accountant should be framed by the regulatory body. Prosecution for fraudsters should be done by keeping in mind the “framework” or “model” applicable to users of fraudulent practices in IT. This model should act as a powerful tool to prevent the occurrence of frauds.

Conferences, seminars and training programs need to be organized to enhance skills and ability of professional Accountants regarding Forensic issues.

There is further scope of research in this field if this subject is integrated into the academic curriculum.

Traditional Judicial System should be abolished which is free from Red Tapism and bureaucracy.

SEBI and RBI should create a “cell for Forensic Accounting” in field of corporate crimes and financial crimes respectively.

Software should be developed to make a test run of all the tools and techniques as stated.

AICPA and other International professional bodies have already adopted Forensic Accounting since 1995 and hence the survey of their practices can be done in order to prepare a model of Forensic Accounting in India.

Participation of mid-sized Chartered Accountancy firms in work of Forensic Accounting should be done with Big Five so as to spread the importance of the same and hence to reduce the chances of occurrence of fraud and error.

1.2 INSTRUMENT DEVELOPMENT FOR FURTHER RESEARCH IN THE AREA OF FORENSIC ACCOUNTING

AUDITOR	AND	UDITORS	ACADEMICIAN
Audit Due Diligence		Adoption of GAAP	Career path for FA
Critical thinking		Duly Preparing the reports	At what level subject should be included
Investigative ability		Follow up of due dates.	Demand of FA in coming years
Identifying Key Issues		Managing Collections and Payments	Whether Computer based FA is necessary?
Legal Compliances		Regular Filing of Mandatory returns and reports	Software Study :
Cross Examination of transactions		Reporting to External Auditors	FA’s:ACL, IDEA, Data Mining, and Digital Evidence Recovery
Reliance on report of Internal Auditor		Testing the details of the transactions and balances	
Communication with Management		Influence of Management in Decision Making	
Adoption of CAAT		Checking trail of transactions	

Conclusion:

To conclude Forensic accounting as a discipline is an interesting area and can be highly useful to both the society and the investigator. However, it is pertinent to note here that only persons of such skills and courage with an attitude to know the secrecy can be successful in the process of forensic investigation. With increase in the use of Computers in accounting and auditing there are more chances of occurrence of the fraud. The model given in the table 1.2 could be rewarding in terms of prevention of frauds and errors in the financial statement. The check list can be prepared as and when the accounting is done by the management and there should be accuracy and

detailed trail of each and every transaction. Investigators act as sniffer dogs but if disclosure is transparent and authentic then the chances of frauds would reduce. Further research can be done to find the integration of the subject outline for the academicians and also "investigative skills" and "model" to the accountants so as to have Forensic Accounting as preventive measure rather than to have it as Investigative tool.

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