

Forensic Accounting: A Future Way of Accounting

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Abstract – In India, the scams of thousands of crores are increasing rapidly. Due to the increasing frauds, there is a loss of trust in the reliability of the financial information uses by the user or makers of the economic decisions. To investigate the reason behind this a detailed investigation is very important. This made a great demand for a forensic accounting in India. Merely an audit is not enough for detecting the frauds. Forensic Accounting is the combination of the auditing, accounting and investigation skills. Initially, the forensic accountant is worked only for the government agencies to uncover or detect the underlying frauds. In this exploratory research paper discusses the concept and scope of the forensic accounting and the techniques used by the forensic accountant to uncover the frauds or white collar crimes. Also, discuss the recent notable scams in India.

Keyword: Forensic Accounting, White collar crimes, Frauds, Data Mining Technique and Relative size factor.

I. CONCEPT OF FORENSIC ACCOUNTING

Maurice E. Peloubet, a partner in an accounting firm in New York, was the first person who used term, „forensic accounting“ he wrote about the utilization of the accounting in the court procedures as a major aspect of the declaration.

The term „forensic“ defined by the Webster’s Dictionary is, “Belonging to, used in or suitable to courts of judicature or to public discussion and debate.” The term accounting means, “A systematic recording of financial transactions and summarizing it for analyzing, verifying and recording the results. Forensic accounting is another step after auditing for checking the frauds if exist. Forensic accounting starts from where the audit ends. The report of the forensic accounting is reliable and acceptable in the courtroom. Mainly, its use for the legal purposes. It is a very useful tool for

investing and preventing the frauds. According to AICPA, “Forensic accounting is the application of accounting principles, theories, and discipline to facts or hypothesis at issues in a legal dispute and includes every branch of accounting knowledge”. As per Crumbley et al. (2009) forensic accounting is an act to identify, record, extract, settle, sort, report and finally to verify financial data related to past or other kinds of accounting activities to settle current or expected legal disputes or to use such type of past data to evaluate potential financial data for settling legal disputes. According to Mehta and Mathur (2007) describe forensic accounting as a financial detective with a quite sharp and evaluating of mind, having the spirit of the financial bloodhound, it’s a kind of extraordinary observer with a sixth sense who has the ability to find truth beyond number and enables reconstruction of past accounting transactions. According to Bhasin (2007), forensic accounting evaluates loss caused

due to auditor's avoidance. Its objective is to find fact regarding any embezzlement if has taken place, in what amount and then to define whether criminal proceedings are needed to be held hence it collect evidence for such proceedings and calculates assets value in a divorce call. He identifies that the goal of the forensic accounting is to find any fraud if has taken place and its effect introduced into the accounting domain.

Another name of forensic accounting is Investigative accounting is the use of expert knowledge and specific skills for analyzing the authenticity of the materialistic transactions. Mainly it uses for detecting frauds which includes fraud allegations. The major components of forensic accounting are as follows:

- (a) In case of a court case, investigative skills of the forensic accountant are used in two ways, he can be called upon to give his expert opinion based on his investigation and may require possible courtroom testimony.
- (b) Forensic accountant's investigative skills are required for collecting, analyzing, and evaluating financial evidence, as well as the ability to construe and communicate findings.

The forensic accountant appointed by the banks, corporations, government agencies, law firms, and other organizations to analyze, interpret and summarize the issues related to financial transactions. The techniques of forensic accounting are quite similar to audit techniques but the purpose of forensic accounting is different from the purpose of an audit.

II. SCOPE OF FORENSIC ACCOUNTING

The scopes of forensic accountants in various fields are given below:

- (a) **Detection of fraud committed by employees:** When the employees involved in false practices and if, he found to have committed fraud, and

then the forensic accountant tries to find out the unrevealed truth and also tries to reveal any advantage taken by the employee from the funds defalcated.

- (b) **Criminal Investigation:** For the purpose of civil and criminal actions, forensic accountants are involved in detecting fraud and white collar crimes.
- (c) **Matters related to professional negligence:** Professional negligence cases are taken up by the forensic accountants. The matters related to Non-conformation to Generally Accepted Accounting Principles (GAAP) or non-compliance to auditing practices or ethical codes of any profession is identified by forensic accountants. Forensic Accountants measures the loss arise due to such professional negligence.
- (d) **Arbitration service:** Forensic accountants are trained in the area of settlement of disputes and mediation services. They also resolve the mattes related to partnership and corporation disputes.
- (e) **Settlement of insurance claims:** Forensic accountant helps in handling the various types of insurance claims such as loss of property due to different risks, substantial loss policy, property loss due to different risks, other types of insurance claims Also, the claim settlement as worked out by the insurance companies to challenge that policyholders need the help of the forensic accountant.
- (f) **Dispute settlement:** Forensic accountants also help in resolving the cases related to contract disputes, construction claims, product liability claims, and infringement of patent and trademarks, liability arising from breach of contracts etc.

III. TYPES OF FRAUDS IN FORENSIC ACCOUNTING

Corruption: There are three types of corruption fraud: conflicts of interest, bribery, and extortion.

- (i) In a conflict of interest fraud, is when someone tries to get personal financial and disclosed profit that ultimately affects the position of the company.
- (ii) Bribery means to take money or something else to influence a situation.
- (iii) Extortion is the opposite of bribery and it means for securing a particular outcome, money is demanded.
- (a) **Asset misappropriation:** Frauds arise due to the assets misappropriation is the most common frauds. The common feature is the theft of cash or other assets from the company like theft of cash, fraudulent disbursements, frauds related to inventory or any other assets.
- (b) **Financial Statement Fraud:** This is also known as fraudulent financial reporting and it causes a material misstatement in the financial statements. It includes intentional error and omissions in the transaction, misrepresentation in balances or disclosures in the financial statements or the misapplication of financial reporting standards or falsification of accounting records.

IV. TECHNIQUES OF FORENSIC ACCOUNTING

- (a) **Benford's Law:** It is a mathematical tool, and it is used to test whether the errors (mistakes) done intentionally or not. On detecting any such phenomenon, under study detailed

inspection is carried on various variables.

- (b) **Theory of Relative Size Factor (RSF):** It shows all unusual fluctuations, which may arise from fraud or genuine errors. RSF is measured as the ratio of the largest number to the second largest number of the given set. In practice there exist certain limits (e.g. financial) for each entity such as vendor, customer, employee, etc. These limits may be defined or analyzed from the available data-if not defined. If there is any stray instance of that is way beyond the normal range, then there is a need to examine further into it.
- (c) **Computer Assisted Auditing Tools (CAATs):** CAATs programs used in the audit procedures to process significant auditing data contained in the information system of the client. CAAT helps in performing various auditing procedures like (a) Checking details of transactions and balances, (b) locate unusual or significant fluctuations, (c) For audit testing, it helps in extract data through sampling programs, and (e) Redoing calculations performed by accounting systems.
- (d) **Data Mining Techniques:** It is a set of statistical 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, Predictive modeling and Deviation and Link analysis. It ascertains the usual patterns in data, without having any prior knowledge of frauds. It shows various similarities, trends, and variations in the form of uncertain reason. In analytical model, actual value, and expected values are compared to find the frauds, if any.

(e) **Ratio Analysis:** It is another useful technique for fraud detection. In this, various ratios are analyzed. Like profitability ratios that indicate the profitability index of a company, Ratio analysis help in detecting fraud by identifying possible symptoms of fraud. Three important ratios are –

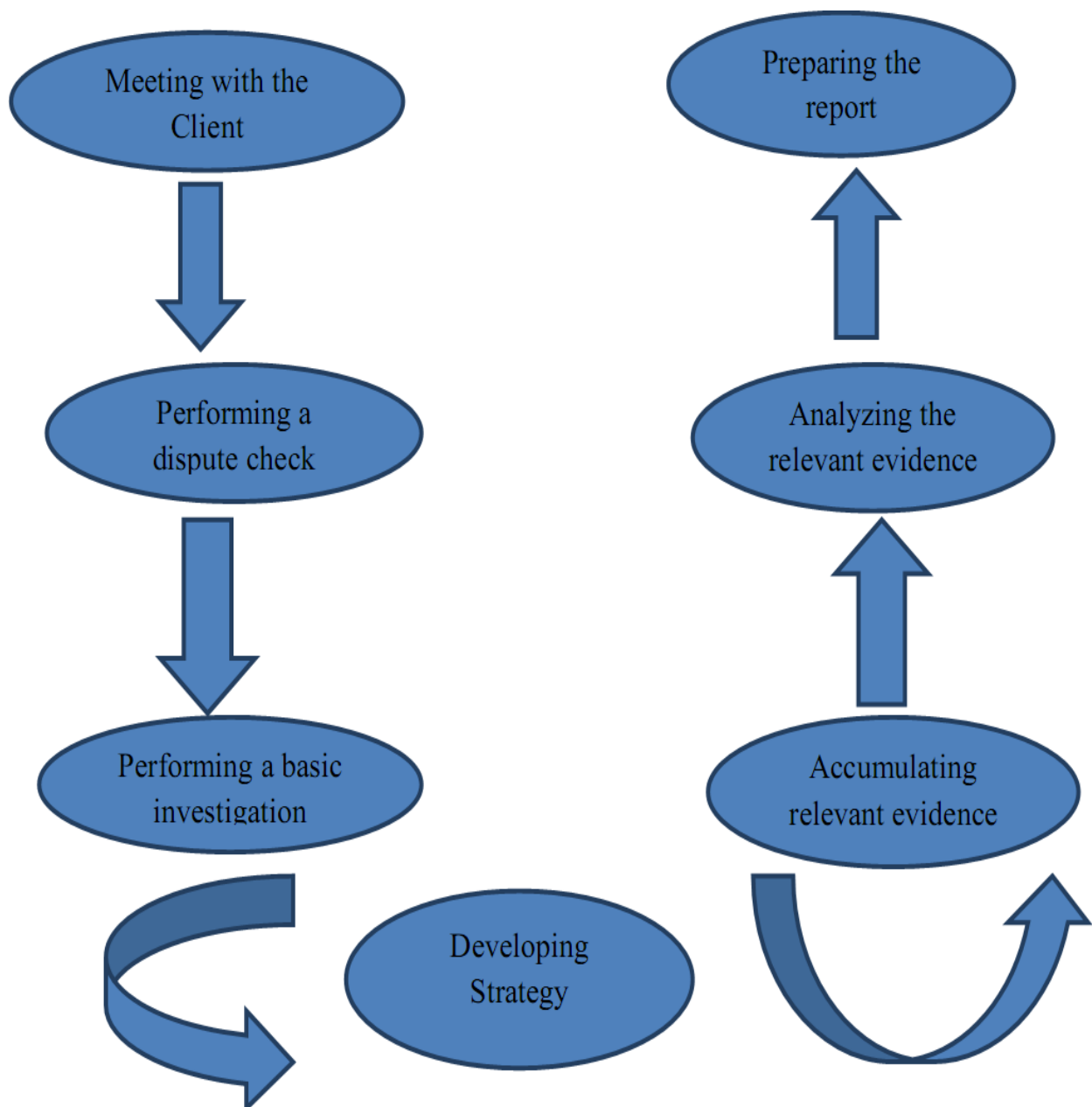
- (i) The ratio of the maximum value to the minimum value (max/min);
- (ii) The ratio of the maximum value to the second maximum value (max/max); and

(iii) The ratio of the current year to the previous year.

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

VI. STEPS OF FORENSIC ACCOUNTING

Every case is unique, and the specific circumstances decide the steps in an assignment. However, there are certain common steps that in every case follow.



V. NOTABLE SCAMS IN INDIA

- (a) **Punjab National Bank (2017-18):** This scam was happened in Brady house branch in Mumbai. In this case, Punjab National Bank gave Letter of Undertaking to the foreign banks. Due to this Punjab National Bank is now liable for making the payment of Rs. 11,600 crore. This scam is linked to Nirav Modi of Firestar Diamonds against whom a Complaint has been filed with the CBI. A new employee in the bank first noticed this fraudulent transaction. Under the scanner of investigation agencies, three Jewellers, i.e. Gitanjali Gems Ltd and its subsidiaries, Gili and Nakshatra are also under the investigation.
- (b) **Saradha Group Financial Scandal (2013):** This financial scam caused by the failure of a Ponzi scheme run by Saradha Group, an association of over 200 private companies. In this, it was believed that this was collective investment schemes popularly but incorrectly referred to as chit funds. In this scam (Odisha and West Bengal), Kunal Ghosh is in jail since November, 2013 for interrogations. Also arrested Ramchandra Hansda, Pravat Tripathy, Subarna Naik, Hitesh Kumar Bagarti, Srinjay Bose and MLA Madan Mitra.
- (c) **Abhishek Verma Arms Deal Scandal (2012):** Abhishek Verma who is globally known as „Lord of War“ and his wife former Miss Universe Romania Anca Verma’s global weapons companies SIG SAUER and GANTON hacked the emails and documents available on the US-based servers of the arms dealer. These leaked documents were received by Indian politicians Arvind Kejriwal and Prashant Bhushan which was released these documents in the press as a prove and on the basis of this prove Abhishek and his wife Anca arrested against multiple cases of defense sector and money legalizing amounted to Rs. 80,000 crores.
- (d) **Indian Coal Allocation Scam (2012):** Due to coal blocks not auctioned but allocated, the Comptroller and Auditor General of India estimated the losses amounted to 1,85,591 due to which Supreme Courts cancels all 214 coal blocks allocations since 1993. After that government again started e-auction of the coal blocks.
- (e) **Uttar Pradesh NHRM Scam (2012):** This is corruption scandal in the Indian state of Uttar Pradesh. Various persons including Chief Medical Officers were murdered. In this NHRM funds amounted to Rs. 10,000 crores were misused by Mayawati Government. Babu Singh Kushwah and IAS Pradeep Shukla are in imprisonment for involving in this scandal.
- (f) **Common Wealth Games Scam (2010):** This scam is related to commonwealth games. In this, estimates cost 70,000 crores out of which only half of the amount spent on the Indian Sports persons. Commonwealth games related projects, The Central Vigilance Commission involved in this corruption. In this scam has found differences in proposals like payment to anonymous persons, willful delays in execution of contracts, overstated price and mishandle in the purchase of equipment through tendering and misuse of funds.

VII. CONCLUSION

As now-a-days, there are showed that there are frauds in the banking sector or in any other sector there is a demand for skilled professionals that can identify, uncover and avoid structural weaknesses by controlling three main areas i.e. corporate governance, maintain internal control and financial statements. In India, there are losses of thousands of crores only because of frauds. It can be prevented by making forensic accountant mandatory in the financial sector and corporate sector. As in India, the forensic accountant is being used as an investigative tool not as a preventive tool. According to the recent study, SEBI has decided to create a forensic

accountant cell to prevent the financial frauds and also, to improve the quality of financial statement disclosures. Also, RBI has made the forensic accounting audit compulsory for banks in India. These all show a healthy prospect for the forensic accounting profession in India.

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