
Forensic Accounting

(In the Growing Financial Scenario)

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'The Council of the **Institute of Chartered Accountants of India**, recognizing the need for **Forensic Accounting and Fraud Detection**, in the emerging economic scenario, has decided to launch the Certificate Course on Forensic Accounting and Fraud Detection using IT and CAATs.'

Over the past few years, the corporate world has witnessed many ups and downs. The stock markets have crashed, and the corporate sector has been plagued by huge business scandals. In most of these corporate /business scandals and failures, accounting fraud has been the main culprit. The way accounting is practiced or the interpretations that may give different prescriptions in similar situations are some dark areas that may open some scope for the corrupted accountants. Forensic Accounting and Fraud Detection specialization is in increasing demand considering increasing incidents of cyber crimes and frauds detection. It is the practice of utilizing accounting, auditing, CAATs/ Data Mining Tools, and investigative skills to detect fraud/ mistakes. The paper is essentially a conceptual one the basic foundation of which comes from various secondary sources and websites. The paper also discusses various aspects of forensic accounting.

Forensic Accounting is an integration of accounting, auditing and investigative skills. The term 'forensic accounting' was invented by Maurice E. Peloubet, in whose words "financial statements have some but not all the characteristics of forensic Accounting." According to oxford dictionary, the term forensic mean of or used in 'law court'. Thus, Forensic accounting as a special practice area provides accounting analysis that is suitable to the court and which form the basis for discussion, debate and ultimately dispute resolution. Forensic accounting looks beyond numbers and the focus is on looking at the business reality of the situation.

Definition of 'Forensic Accounting'

Forensic Accounting utilizes accounting, auditing, and investigative skills to conduct an examination into a company's financial statements. Thus, providing an accounting analysis, that is suitable for court. **Investopedia explains 'Forensic Accounting'** Forensic accountants are trained to look beyond the numbers and deal with the business

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reality of a situation. They are frequently used in fraud cases. Forensic accounting, forensic accountancy or financial forensics is the specialty practice area of accountancy that 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. Forensic accountants, also referred to as forensic auditors or investigative auditors, often have to give expert evidence at the eventual trial.

All of the larger accounting firms, as well as many medium-sized and boutique 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, and fraud, construction, or royalty audits.

Financial forensic engagements may fall into several categories. For examples: Economic damages calculations, whether suffered through tort or breach of contract, Post-acquisition disputes such as earn outs or breaches of warranties, Bankruptcy, insolvency, and reorganization Securities fraud; Business valuation; and Computer forensics/e-discovery.

Forensic accountants often assist in professional negligence claims where they are assessing and commenting on the work of other professionals. Forensic accountants are also engaged in marital and family law of analyzing lifestyle for spousal support purposes, determining income available for child support and equitable distribution.

Engagements relating to criminal matters typically arise in the aftermath of fraud. They frequently involve the assessment of accounting systems and accounts presentation—in essence assessing if the numbers reflect reality.

Areas covered by forensic Accounting

- Certain engagement related to civil disputes viz. disagreements related to company acquisitions like business valuation, calculating and quantifying losses and economic damages through breach contracts etc.
- Shareholders and partnership disputes involving detailed analysis of numerous years accounting records to quantify the issues in dispute.
- Cybercrimes like credit card frauds, ATM card frauds, cyber blackmail, cyber pestering, phishing i.e. sending unsolicited e-mails & collection of sensitive information by simple techniques.

- Forensic accounting also deals with areas of professional negligence claims, involving assessment and reporting on work of other professionals. This involves investigating whether breach of 'generally agreed accounting and/or auditing principles' has occurred.
- Engagement involving criminal matters, involving assessment of accounting systems and accounts presentation, where forensic accountants are hired by the law enforcement agencies.
- Business investigations involving fund tracing, asset identifications and recovery, forensic intelligence gathering and due diligence reviews.
- Employee fraud investigations involving procedures to determine existence, nature and extent of fraud and may involve identification of the clauses etc
- Business Economic losses viz. contract disputes trademark and patent infringements, losses arising from breach of non-compete clauses etc.
- Cases involving medical insurance claims, medical malpractices resulting in economic losses.
- Mediation arbitration in alternative dispute resolution mechanisms due to familiarity of forensic accountants with legal issues and procedures, helping individuals and businesses resolve disputes with minimum disruption and loss of time.

Terminologies used pertaining to forensic accounting

1. Forensic investigation:

This refers to using specialized investigative skills to undertake inquiry in such a manner that outcome shall have application in court of law. Forensic investigation may be grounded in areas like accounting, medicine or engineering.

2. Forensic Audit:

This refers to investigation of a fraud or presumptive fraud with a view to gathering evidence that could be presented in courts of law. It is essentially a blend of propriety, investigative, regularity and financial audits. The Objective is to ascertain whether true business value has been reflected in the financial statement and during the course of examination to find whether any fraud has taken place.

Detection techniques used in forensic accounting

Critical point auditing (CPA): In CPA, symptoms of fraud are filtered out from regular transactions where they may be concealed.

Scrutiny for CPA purpose may involve: use of

1. Trend analysis
2. Checking unusual debits/credits in the accounts

3. Discrepancies in receivable /payable /inventory balances evidenced from financial records corresponding subsidiary records.

4. False credits to boost sales with corresponding debits to non-existent/dummy personal accounts.

Forensic accountant

Forensic accountants may be involved in recovering proceeds of crime and in relation to confiscation 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. In other countries, some forensic accountants are also Certified Fraud Examiners, Certified Public Accountants with AICPA's Certified in Financial Forensics (CFF) Credentials, Chartered Accountants (CA), Certified Management Accountants (CMA) or Chartered Certified Accountants.

Financial frauds have from time immemorial affected all establishments as no one is immune to frauds, but they often go undetected due to inadequacies in the system. Recent happenings in most parts of world has exposed the growing greed of human being and art of camouflaging of accounting facts through deception by indulging in fraud and manipulation, depending upon the position that one holds. Alarming increase of financial fraud, inability of internal audit and limitation of statutory audit to sniff out the financial fraud has given rise to new profession known as Forensic Accountant.

Forensic accountants utilize an understanding of economic theories, business information, financial reporting systems, accounting and auditing standards and procedures, data management & electronic discovery, data analysis techniques for fraud detection, 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.

Forensic Accounting has a focus on prevention and detection of financial frauds and conduct of investigation to undertake and assist in litigation support to book the wrong doers. The Forensic Accountant besides the in-depth professional knowledge of Accounting, Finance, Audit, Law, Intellectual Property, Computerization, Ethics and Criminology coupled with the Skill and Knack to Investigate, has a Sixth-Sense and Photogenic Memory to evaluate and examine the accounting transactions to link Data, Knowledge, and Insight together to detect financial fraud and prevent potential wrongdoings. In Nutshell Forensic Accounting looks at the accounting in a wider prospective rather than in different segments such as data entry, record keeping,

preparation, and finalization of accounts. Forensic accounting is not limited to the correctness of accounts; it encompasses accounting, investigative accounting, investigative audit, and litigation support.

Forensic Audit is an expanded version of Investigative Audit in search of and in prevention of financial fraud by finding the inadequacies and shortcomings in the existing system and by blocking the loopholes, to prevent the wrongdoers to take any advantage of the inadequacies and loopholes in the system. Forensic Audit starts with an understanding of complete commercial activity and involves the following:

- Evaluate the transactions in a manner they are recorded & should have been recorded
- Investigate the inconsistencies prevalent from the origin till the finalization of transaction
- Examine the linking of each transaction till its finalization
- Establishing the inconsistencies, missing links

"While Forensic Accountants ("FAs") usually do not provide opinions, the work performed and reports issued will often provide answers to the how, where, what, why and who. The FAs have and are continuing to evolve in terms of utilizing technology to assist in engagements to identify anomalies and inconsistencies. It is important to remember that it is not the Forensic Accountants that determine fraud, but instead the court."

David Malamed, Forensic Accountant, Toronto Ontario

CONCLUSION

Nowadays Forensic Accounting through a new field in Indian accounting world has wonderful potential as a new practice area for Indian CAs given the increasing use of e-commerce application, cyber frauds and increasingly complex transaction in both domestic as well as cross-border businesses. Indian CAs with their extensive theoretical education and practical experience can create forensic accounting and auditing as their niche area.

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