

# Forensic Accounting and its Relevance in Indian Context

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**Abstract:** Due to the growing complexities of business environment and the growing number of Business related investigations, Forensic accounting professionals are in a great demand now a days as they are increasingly asked to assist in the investigation of financial and business related issues of fraud cases. The purpose of this paper is to identify the meaning and need of forensic accounting. The paper holds importance as there is very little awareness of the topic in Indian Context and this research will lead to awareness regarding the importance of forensic accounting.

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## Introduction

Forensic Accounting was coined in 1940 by Maurice Paulobet. Forensic accounting is the application of a specialized knowledge and specific skills to stumble upon evidence of economic transactions. The job demands reporting, where the accountability of the fraud is established and the report is considered as evidence in the court of law or in the administrative proceeding. It is an area of accounting that requires the accountant to perform their work to a standard that is suitable to be used in a court of law. Forensic accounting provides an accounting analysis that is suitable to the court which will form the basis of discussion, debate and ultimately dispute resolution. Forensic accounting work in most major accounting firms and are needed for investigating mergers and acquisitions and in tax investigations, economic crime investigations, all kinds of civil litigation support, specialized audits and even in terrorist investigations. Forensic accounting procedures lower the risks of frauds. Researches have proven that proactive forensic data analysis using computer based sophisticated analytical tests can detect fraud that may remain unnoticed for years. Ernst and Young's worldwide fraud survey, which states that only 20% of organizations employed forensic accountants although the satisfaction level for the services 88% was the highest.

Forensic accounting includes coverage in two areas: **Investigative accounting and Litigation support.**

Litigation support provides assistance of an accounting nature in a matter involving existing or pending litigation. It deals primarily with issues related to the quantification of economic damages. A typical litigation support assignment would be calculating the economic loss resulting from a breach of contract. The area of litigation support requires the accountant to become trained to be an expert witness. Investigative accounting is often associated with investigations of criminal matters. A typical investigative accounting assignment would be an investigation of employee theft. Other examples include securities fraud, insurance fraud, kickbacks and proceeds of crime investigations. It is working like a detective and looking for fraud. Financial forensic engagements may fall into several categories. For example: Economic damages calculations, whether suffered through tort or breach of contract; Post-acquisition disputes such as earnouts or breaches of warranties; Bankruptcy, insolvency, and reorganization; Securities fraud; Business valuation; and Computer forensics/e-discovery.

## What does a forensic accountant do?

A forensic accountant is often retained to analyze, interpret, summarize and present complex financial and business related issues in a manner which is both understandable and properly supported. Forensic accountants can be engaged in public practice or employed by insurance companies, banks, police forces, government agencies and other organizations. A forensic accountant is often involved in investigating and analyzing financial evidence, developing computerized applications to assist in the analysis and presentation of financial evidence, communicating their findings in the form of reports, exhibits and collections of documents and assisting in legal proceedings, including testifying in court as an expert witness and preparing visual aids to support trial evidence. In order to perform these services a forensic accountant must be familiar with legal concepts and procedures. In addition a forensic accountant must be able to identify substance over form when dealing with an issue. The forensic accountant needs to be able to take a more proactive, skeptical approach to examine the books of company. He must be open to consider all alternatives, scrutinize the fine details and at the same time see the big picture. In addition, he must be able to listen effectively and communicate clearly and concisely in a timely manner. Forensic Accountants work throughout the business world, in

public accounting, corporation and in all branches of government. They have both the quantitative skills in researching numbers to uncover fraud and qualitative skills to determine the weakness of internal control systems. The forensic accountant has a mindset that more interested in exposing fraud compared to financial auditors. Forensic accountants have the expertise in untangling complicated accounting maneuvers that misrepresent financial statements. The types of crimes forensic accountants investigate are classified as "crimes against property." They investigate crimes such as fraud and give expert testimony in court trials. They also perform work related to civil disputes. Forensic accountants are also known as fraud investigators, investigative accountants, forensic auditors or fraud auditors.

#### **What types of assignments does a Forensic Accountant perform?**

Forensic Accountants become involved in a wide range of investigations, spanning many different industries. The practical and in-depth analysis that a Forensic Accountant will bring to a case helps uncover trends that bring to light the relevant issues. The various areas in which a Forensic Accountant will often become involved are:

1. **Criminal Investigations:** Forensic investigations often relate to criminal investigations on behalf of police forces. For example, a Forensic Accountant may be retained by the R.C.M.P., the O.P.P., as well as by regional or local police forces and organizations such as the Law Society. A Forensic Accountant's report is prepared with the objective of presenting evidence in a professional and concise manner.
2. **Shareholders' and Partnership Disputes:** These assignments often involve a detailed analysis of numerous years accounting records to quantify the issues in dispute. For example, a common issue that often arises is the compensation and benefits received by each of the disputing shareholders or partners.
3. **Personal Injury Claims / Motor Vehicle Accidents:** A Forensic Accountant is often asked to quantify the economic losses resulting from a motor vehicle accident. A Forensic Accountant needs to be familiar with the legislation in place which pertains to motor vehicle accidents. Cases of medical malpractice and wrongful dismissal often involve similar issues in calculating the resulting economic damages.
4. **Business Interruption / Other Types of Insurance Claims:** Insurance policies differ significantly as to their terms and conditions. Accordingly, these assignments involve a detailed review of the policy to investigate coverage issues and the appropriate method of calculating the loss. A Forensic Accountant is often asked to assist from either an insured or insurer's perspective in the settlement of a case. Examples of these types of assignments include; business interruptions, property losses and employee dishonesty (fidelity) claims.
5. **Business/Employee Fraud Investigations:** Business investigations can involve funds tracing, asset identification and recovery, forensic intelligence gathering and due diligence reviews. Employee fraud investigations often involve procedures to determine the existence, nature and extent of fraud and may concern the identification of a perpetrator. These investigations often entail interviews of personnel who had access to the funds and a detailed review of the documentary evidence.
6. **Matrimonial Disputes:** Matrimonial disputes from a Forensic Accounting point-of-view often involve the tracing, locating and evaluation of assets. The assets to be evaluated and valued may be businesses, property or other assets.
7. **Business Economic Losses:** Examples of assignments involving business economic losses include; contract disputes, construction claims, expropriations, product liability claims, trademark and patent infringements and losses stemming from a breach of a non-competition agreement.
8. **Professional Negligence:** These investigations are often approached from two different but complimentary perspectives, these being Technical (has a breach of Generally Accepted Accounting Principles or Generally Accepted Auditing Standards or other standards of practice occurred) and (Loss Quantification). If the professional in question is an accountant then a Forensic Accountant could be involved with both perspectives. If the matter involves some other profession a Forensic Accountant will normally be retained to perform only loss quantification.
9. **Mediation and Arbitration:** Because of their familiarity and comfort with legal issues and procedures some Forensic Accountants have sought out special training and become involved in alternative dispute resolution (ADR).

#### **Implications of Frauds in India**

A study called "Early Warning Signals of Corporate Frauds" conducted by the Pune- based India forensic Consultancy Services (ICS) revealed that atleast 1200 companies out of 4867 companies listed on the Bombay Stock Exchange as on March 31,2007, including 25-30 companies in the benchmark Sensex and Nifty indices, have massaged their

financial statements. The manufacturing sector, which contributes about 28 percent of India's gross domestic product, is the one most ridden with fraud mainly due to the peculiar nature of the business and the procedural complexities inherent in this sector. Real estate and public sector undertakings came second. The motive for committing accounting statement frauds was to exceed expectations of stock market analysis. Other reasons for the fraud include credit-hungry firms manipulating application data in order to qualify for credit. May be this is due to the human greed to earn a lot within the shortest period. To increase the share price by creative accounting of the financial statements to attract the investors is also main factor for the rise in fraud. Foreign Institutional Investors are now asking brokerage houses to run forensic accounting checks on the numbers reported by major companies in India many of which may be practicing creative accounting to window-dress their books.

Due to heavy loss of reputation and wealth, India has taken several steps towards combating these frauds. A foundation named- Forensic Research Foundation was created which provides support for investigation of fraud. They publish a bi-monthly journal which relates to forensic and economic crimes. Another international organization named KPNG has set up investigation detection center in India. Networks Limited, a Delhi based organization is trying to innovate ways and means to detect financial irregularities and crimes in India. Serious Investigation Fraud Offices (SIFO) has been established in India for the same reason i.e. detection and prevention of economic irregularities and crimes. In the year 2009, Reserve Bank of India has issued the circular which fixed the responsibility of fighting the frauds on the Chairman and CEO's of the banks. This circular further stated that banks need to understand the forensic audit techniques. RBI further mentions that fraud investigation requires competence in 'forensic audit' and also technical / transactional expertise. In this regard, banks may take immediate steps to identify staff with proper aptitude and provide necessary training to them in forensic audit so that only such skilled staff is deployed for investigation of large value frauds.

In India serious fraud office and IRDA have special focus on the frauds however there is no specialized education provided by any of the universities in the country for Forensic accounting. There are few agencies in India, which are dedicated to the mission of combating frauds. SIFO looks into violations of Income tax, FEMA, RBI Act, etc. CBI (Economic Office wing) deals with big financial frauds, and Central Vigilance Commission deals with corruption. These are major government agencies that combat frauds of different types. TCS has also come out with software to combat money laundering and Subex Systems have designed software to combat telecom frauds. The ministry of Company affairs (MCA), first enlarged the scope of work of statutory auditors by issuing a 22 point questionnaire called the MAOCARO Order, 1975. This made internal audit compulsory and the statutory auditor was bound to comment on the efficacy and extent of internal controls and review the internal audit. Such internal audit is not mandatory internationally.

Securities and Exchange Board of India (SEBI) and the Department of Corporate Affairs (DCA) thereafter made it mandatory to have audit committees where independent directors were in a majority and whose chairman had led to be an independent director; they would be Obligated to review and implement internal controls, Observe accounting standards, Review and approve accounts, Review financial management, Appoint internal auditors and recommend statutory auditors. Institute of Chartered Accountants of India (ICAI) issued 32 accounting standards, 34 auditing standards, 6 internal audit standards and several external quality control standards. It has moved for harmonization of standards with the International Federation of Accountants (IFAC). Legal jurisprudence with reference to auditors has evolved substantially in Europe, the US, Australia and India increasingly recognizes the social responsibility of the auditor. However almost every precedent recognizes that an auditor is expected to exercise a high degree of reasonable care and skill and he is not expected to be a bloodhound unless there are circumstances to arouse his suspicion and the law has now evolved to ensure that he is liable for damages for not faithfully discharging his duties not only to the contracting party but to everyone who in the normal course would use the audited accounts.

In the current scenario, career in forensic accounting has emerged as a lucrative option in India. Several institutions are offering training and education to become a good forensic accountant. The Institute of Chartered Accountants of India is among the few, which conduct certificate course on forensic accounting and fraud detection. The Institute of Chartered Financial Analysts of India University Tripura also offers postgraduate diploma program in forensic accounting.

### **Courses on Frauds in India**

There are three courses on frauds in India. India forensic is the only formal body that provides formal education about accounting in India. India forensic is however not affiliated to any of the Universities.

**Certified Forensic Accounting Program - (CFAP)** is the course dedicated to Corporate Frauds in India. It speaks about the classification of the Corporate Frauds and the ways to investigate the frauds in various different sectors.



**Certified Bank Forensic Accounting – (CBFA)** is the course dedicated to Bank Frauds in India.

**Certified Anti-Money Laundering Expert – (CAME)** is dedicated course on Anti-Money Laundering. It also focuses on the various aspects that good software should detect in its AML solution. Basic concepts are also explained in the same course. To qualify as a forensic accountant, one must possess the appropriate license or qualification as recognized by the jurisdiction in which the lawsuit or dispute is taking place. Forensic accounting is one of the highly paid jobs in India. A beginner can earn salary between Rupees 25,000-30,000 per month, while an experienced person can earn a lot more than that, probably in six figures.

### **Conclusions**

Because forensic accounting is relatively a new area of study, a series of working definitions and sharing of corporate experiences should be undertaken and encouraged to ensure a common understanding. Indeed, there is great future in forensic accounting as a separate “niche” consulting. On account of global competition, the accounting profession must convince the marketplace that it has the best equipped professionals to perform such services. In the backdrop of increasing levels of frauds, the demand for forensic accountants is bound to substantially increase in the future. So, it is beyond doubt that the role of forensic accountant is an immediate requirement in Indian Scenario to prevent the further loss due to the hidden frauds in corporate world, public accounting and awareness of government in future. Hence, proper attention is required by the regulators, Government and the educational Institutes to support Forensic accounting.

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