



A Comprehensive Study of Forensic Accounting in Context to current scenario of India

Dr. Piyush N. Marthak

Assistant Professor, Department Of Commerce, Dr. Subhash Mahila Arts, Commerce and Home Science College, Junagadh (Gujarat) (Affiliated to Bhakt Kavi Narsinh Mehta University, Junagadh)

M: 099988 61218 E-mail: piyushmarthak@gmail.com

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.*

KEY WORDS: *Forensic Accounting, Forensic Audit, Fraud, Investigative Techniques.*

❖ 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.

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.

❖ CONCEPTION OF FORENSIC ACCOUNTING:

This is a new era of technology and information. Corporate fraud and scandal in the nature of white collar crimes. It is new threat for the society and government. The occurrence of magnitude of fraud needs to be analyzed in terms of two significant aspects:

1. Opportunity to commit fraud – fraudsters always looks for a favorable risk reward ratio.
2. Central outcome of fraud – financial loss to individuals, to the organization and to the society.

Every day in the media common man see the different news about this type of unethical practices. It is a global problem for society. In India there is a new challenge to control it. India is facing same problem in Corporate Sector. So, the nature of white collar crimes has evolved in the urban

areas with the concentration of the industry and commercial activities in the urban areas.

The changing socio-economic scenario of the society coupled with the increase of wealth and prosperity has furnished opportunities for such crimes, Theft by employees, embezzlement of cash, kickbacks, misstatements, omission of disclosures, advancing.

The time of revenue recognition, recording fictitious assets, delaying recognition of expenses, keeping debts off the balance sheet – all constitute white collar crime in the work place.

So, the researcher has more interest in the Forensic Accounting research. It is an emerging sector of accounting aspect of current scenario. There is a wide scope for the auditor to investigate so many hidden things from the corporate sector. This is ultimately useful for so many agencies for finding the financial fraud and malpractices. Digital transactions and E Commerce usage is more beneficiary for our country. Statutory financial auditing refers to the process of evaluating compliance of financial information with regulatory standards, usually for public companies, by an external and independent entity.

A forensic accountant investigates a wide range of different activities related to fraud that can take place within corporate, healthcare, real estate, mass marketing, hedge funds, and securities trading fields. These professionals may also investigate other crimes such as contract disagreements, money laundering, bribery, and embezzlement. While the duties of forensic accountants mainly lead them to investigate and analyze, they may also be called upon to serve as expert witnesses in court.

❖ DEFINITION OF FORENSIC ACCOUNTING:

According to AICPA (1993): “Forensic accounting is the application of accounting principles, theories, and discipline to facts or hypotheses at issues in a legal dispute and encompasses every branch of accounting knowledge.”

“Forensic Accounting provides an accounting analysis that is suitable to the court which will form the basis for discussion, debate and ultimately dispute resolution” Zysman A.(2009).

As per Webster Dictionary, Forensic Accounting “Belonging to, used in or suitable to courts of judicature or to public discussion and debate”.

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

❖ HISTORICAL AND MODERN OUTLOOK 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 first time used the term Forensic Accountant in 1946 in his essay "Forensic Accounting: Its Place in Today's Economy." Archaeological studies disclose that, during 3300-3500 BC, accountants of Egypt, were involved in the prevention and detection of fraud. During 18th century close relationship developed between accountancy and legal profession. Many amendments to financial statement disclosure can be attributed to frauds in the corporate.

In 1930s an American Eliot Ness was credited to bring down gangster Al Capone, but his case was based on the investigative work done by Elmer Irely, 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.

In India, Kautilya was the first person to mention the famous forty ways of misappropriation in his famous book Kautilya Arthashastra. In India Chartered Accountants are called upon to take up such investigative assignments.

Wide use of Forensic Accounting developed in India after Enron case, Rajat Gupta case and Satyam Case. Very few Chartered Accountant firms have fraud examination as a separate practice. Chartered accountancy firms like Sharad Joshi, S.K. Jain (Xerox Fraud case) are

providing this type of services. However, this this area is by and large dominated by the big four consultancy firms such as Deloitte, KPMG, Price water House Coopers and Ernst and Young.

In India the formation of Serious Fraud Investigation Office is the landmark creation for the Forensic Accountants. Companies Act 2013 paved the way for a special approach to prevent economic fraud and preserving national wealth in the lines of American law and British Bribery Act. For proper risk management, reputational risk was to be managed. The occasion of fraud and irregularities and lapses in compliance culture necessitated proper investigation thereof as well as a strong preventive environment. Thus forensic accounting was called for to detect planning of the fraud, execution of the fraud, consequences of the fraud and book the culprits without much time lag. (Basu, 2014)

❖ FORENSIC ACCOUNTING IMPLEMENTATION IN INDIA:

Given the nature and types of fraud in India, the Reserve Bank of India (RBI) has compulsorily made forensic accounting audit mandatory for all banks within the country. The establishment of Serious Fraud Investigation Office (SFIO) in India has become the turning point for forensic accountants in the country.

The indications of the growing demand for the field are:

- The growing list of online criminal offences
- Breakdown of regulators to trace and detect cyber-security frauds
- The long chain of co-operative banks going bust

❖ OBJECTIVES OF FORENSIC ACCOUNTING

- A forensic accountant can help improve and ensure the integrity of the financial reporting system.
- Forensic accounting helps in detecting financial frauds and thefts.
- To use the forensic accountant's conclusions to facilitate a settlement, claim, or jury award by reducing the financial component is an area of continuing debate.
- To restore the downgraded public confidence.
- To formulate and establish comprehensive corporate governance policy and the statutory audit function.
- To create a positive work environment

and help strengthen auditors' independence.

❖ NEED OF FORENSIC ACCOUNTING:

- People and corporates are increasingly going for court action to resolve their problems,
- Trade transactions are increasing and getting more complex,
- People and corporates are having more problems with government,
- Employees involving with fraud is increasing and it is getting harder to unveil and prevent them,
- There have been increasing fraud with financial tables of companies and this led to increasing harm to society,
- It has come out that there has been increasing number and amounts of unsuccessful companies,
- Lawyers and courts need more support from specialists in the different areas of fraud,
- There has been increasing fraud in the virtual environment and the necessity of experts to fight against these scams.

❖ BENEFICIARIES OF FORENSIC ACCOUNTING

The parties who will be benefitted directly through Forensic Accounting Services are

- People and companies in business life,
- Banks,
- Attorneys at Law,
- Security forces,
- Insurance companies,
- Government offices,
- Courts
- Society at large

❖ SCOPE OF FORENSIC ACCOUNTING IN INDIA

There is a great scope for forensic accounting in India due to an increase in white collar crimes and frauds, scandals in public as well as private sectors. Forensic accounting covers two broad areas of practice. These are litigation support and investigative accounting.

- Forensic accountant detects fraud by analyzing the financial matters, financial statements, financial reporting systems, management information systems, company's method of operations, business structure, accounting principles and by following internal and external auditing procedures.

- Forensic accounting helps to collect evidences and investigates the strategies, litigation procedures to interpret the results
- Forensic accounting designs and performs statutory audit procedures for risk reduction of the business
- Forensic accountant or auditor acts as an advisor to the audit committee
- Forensic accountant helps in the research activities of the investment analyst, economic Offences Wings also required during the Due Diligence in case of Mergers and Acquisition.
- Detection of frauds committed by employees
- Detection of white collar crimes and taking civil and criminal actions.
- Noncompliance of the auditing practices and ethical code of the profession.
- Resolving the matter to dispute.
- Settlement of the challenging Insurance claims.
- It includes Contract Disputes, construction claims, product liability claims, infringement of patents trademarks and any other breach of contract.

❖ **SIGNIFICANCE OF FORENSIC ACCOUNTING:**

Forensic accounting represents the only realistic approach to gaining a deeper understanding of what's going on behind the scenes in a financial capacity. As such, for any business with an interest in minimizing losses and maximizing revenues, it is an invaluable specialism.

The major significance of forensic accounting includes:

- Minimized losses.
- Maximizing revenues.
- Improved operational efficiency.
- More effective and efficient solutions.
- Reduced exploitation risk.
- Financial operational standards.
- Future exploitation is significantly reduced.
- Avoidance of legal problems.
- Improved brand reputation and authority.

❖ **FORENSIC ACCOUNTING AS PREVENTION**

As respects a suitable reaction to misrepresentation which has been distinguished, each foundation requires an incorporated corporate methodology. An irreverent business environment defiles genuine representatives. The economy can't

manage the cost of business to wind up a facilitator for wrongdoing and unscrupulousness, simply in light of the fact that it has ended up helpful not to convey guilty parties to equity. In building up a fitting misrepresentation reaction arrangement, it is crucial that a foundation considers the accompanying strides:

- What are the association's real hazard ranges and what is its arrangement position on culprits of misrepresentation?
- To whom is the duty regarding dealing with the reaction apportioned?
- What is the level of extortion mindfulness inside an association?
- Are controls powerful?
- Are clients or exchanging accomplices mindful of the organization's strategy on Misrepresentation?
- Do representatives comprehend the organization's state of mind to misrepresentation and Contemptibility?
- Can representatives report misrepresentation secretly?
- Are enrolment hones perfect with a legit workforce?
- Do disciplinary procedures apportion equity fairly and all the more vitally, are the seen to do as such?

❖ **THE TECHNIQUES OF PREVENTION OF FRAUD (FORENSIC ACCOUNTING):**

The customary bookkeeping and evaluating with the assistance of various bookkeeping devices like proportion procedure, income strategy, a standard measurable device examination of proofs are all a player in legal bookkeeping. In cases including critical measures of information, the present-day legal bookkeeper has innovation accessible to acquire or source information, sort and investigate information and even evaluate and stratify comes about through PC review and different strategies. Smith (2005), Gavish(2007), Dixon (2005), Frost (2004), Cameron (2001) had suggested some of the methods required in Forensic Accounting to inspect the cheats are:

- **Benford's Law:**

Benford's law, also called the Newcomb–Benford law, the law of anomalous numbers, or

the first-digit law, is an observation about the frequency distribution of leading digits in many real-life sets of numerical data. The law states that in many naturally occurring collections of numbers, the leading significant digit is likely to be small. For example, in sets that obey the law, the number 1 appears as the leading significant digit about 30% of the time, while 9 appears as the leading significant digit less than 5% of the time. If the digits were distributed uniformly, they would each occur about 11.1% of the time. Benford's law also makes predictions about the distribution of second digits, third digits, digit combinations, and so on.

• **Theory of Relative Size Factor (RSF):**

It highlights every strange variance, which might be steered from misrepresentation or certified blunders. RSF is measured as the proportion of the biggest number to the second biggest number of the given set. Practically speaking there exist certain cutoff points (e.g. budgetary) for every element, for example, merchant, client, worker, and so on. Waldrup, et. al. (2004)

• **Computer Assisted Auditing Tools (CAATs):**

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. CAAT helps auditors to perform various auditing procedures 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.

- 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

❖ **EMERGENCE OF FORENSIC ACCOUNTING IN INDIA**

As compare to other foreign countries, India is lacking behind in the area of forensic accounting. Forensic Accounting has come to the limelight only recently due to rapid increase in frauds and white-collar crimes. There is huge

• **Data mining techniques:**

It is an arrangement of helped strategies intended to consequently mine substantial volumes of information for new, covered up or unforeseen data or examples. Information mining procedures are arranged in three ways: Discovery, Predictive displaying and Deviation and Link examination. It finds the typical learning or examples in information, without a predefined thought or theory about what the example might be, i.e. with no earlier information of fraud. This technique includes "design coordinating" calculation to "concentrate" any uncommon or suspicious cases. Black (2002); Paletta (2005); Lovett (1955)

• **Ratio Analysis:**

Another useful 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.

❖ **SKILLS REQUIRED 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. According to the study by Davis, Ramona, and Ogliby (2009), Certified Public Accountants (CPA's), Academicians and Attorneys (speaking to clients), Crawford(2010); Kleeyman(2006); Wells(2003); Zia(2010) As reviewed by DiGabriele (2007), A comparative study in Nigeria Okoye&Yohanna(2010) and others.

In a related research that surveyed Forensic Accounting Practitioners, Accounting practitioners and attorneys, the following skills are identified although perceptions differed among groups as to the different rankings of the skill sets;

- Knowledge skills in criminology
- Computer skills
- Confidence
- Curiosity
- Creativity
- Discretion
- Prudence
- Secrecy
- Honesty
- Personal courage

requirement for honesty, fairness and transparency in Indian Corporate reporting. The Institute of Chartered Accountants of India (ICAI) started course on forensic accounting for only its members. It is "Certificate Course on Forensic accounting and Fraud Detection using IT and CAATs". At present, very few academic

institutions are offering courses (full time or part time) on forensic accounting. These days various organizations like India forensic, Institute of Chartered Accountants of India (ICAI), and Association of Chartered Certified Accountants (ACCA) offer courses on forensic auditing in India.

❖ **FUTURE CHALLENGES OF FORENSIC ACCOUNTING IN INDIA**

As it is said that a forensic accountant is a bloodhound of accounting, not a watchdog. However in India, forensic investigators have to face various challenges while working which are discussed below:

- Shortage of forensic investigators: In India, forensic accounting is yet a developing field in fraud detection. Therefore, there is an acute shortage of qualified accountants with adequate technical knowledge.
- Political involvement: In India, most of the fraud cases involve politicians, so it is crucial to find evidences against them.
- Judicial system: The Indian judicial system still follows the age-old British judicial system. Consequently, it is expensive to bring the matter to court and hire expert advocates.
- Due to liberalization and a rapidly growing economy, more and more investors from foreign countries are investing in India, as a result it is difficult to sue financial fraudsters from other countries.
- Technology: Because of continuous adoption of new techniques of Information and Technology by fraudster, it is difficult to Forensic Accountant to cope up with them.

❖ **CONCLUSION:**

The specific objective of this study was to comprehend the concept of forensic accounting in Indian context its emergence and to transcend the significance of the concept from present to future. So far forensic accounting in India is being used as an investigative tool, rather than a preventive tool. If forensic auditing is made mandatory in financial and corporate sector many of the scams involving thousands of crores can be avoided. With the above objectives in mind, some of the initiatives taken by regulatory bodies show a positive sign in preventing scams. SEBI has decided to “create a

forensic accounting cell to improve the quality of the financial information disclosed and to assist in detection of financial irregularities so as to serve as an effective early warning mechanism.” To prevent scams in financial sector, RBI has also asked banks to include forensic auditing practices.

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