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Forensic Accounting In India

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Abstract

Increasing use of technology in almost every sector of business is recklessly giving rise to multifaceted and complicated frauds. This, thereby, increases the challenges to regulators and business heads to circumvent frauds and threats. In the wake of swelling number of such frauds and threats following modern technology, forensic accounting helps corporate prevent frauds and also execute their objectives in an organized, meticulous approach to improve the potency of risk management, control and governance practices. Forensic accounting is the application of financial accounting and inquisitive dexterity to a standard acceptable by court to regulate problems in disputes in the spirit of civil and criminal indictment. Although most international firms support this accounting as an independent unit, but unfortunately Indian corporate sector is still using this as investigative tool rather than a preventive one. This paper highlights the role of forensic accounting in fraud examination and also the steps taken by the Government of India to implement this by instituting amendments in laws and making it a vital part of the legislative system of India. The paper suggests that application of forensic accounting in corporate sector in India is of prime importance for the sustainable development of the Indian economy.

Keywords: Forensic accounting , Fraud , Investigation, Corporate, Financial information.

Introduction

Forensic accountant attempts to detect the deceitful transactions from the records of organization. Separation of ownership from management has demanded regular checking of corporate governance mechanisms to protect the wealth of stakeholders. Frequent corporate frauds have dampened the trust of the investors and users of financial information in the authenticity of financial reporting structure (Chakrabarti,2014).Further, high incidence of corporate frauds has malign influence on the Indian corporate image which, in turn, discourages entrepreneurial spirit among young professionals and deters foreign investment in India (Moid,2016).This fosters the need of Forensic Accounting(FA). Integration of accounting, auditing and investigative skills yields the specialty of a rapidly growing area of FA which focuses closely on detecting or preventing accounting fraud and white-collar criminal activities(Crumbley,2005).FA as a convergence of different skills investigates the financial reports for protecting the interest of stakeholders in general(Chaturvedi,2015).Thus, FA as a multidisciplinary branch of knowledge affords excellent assurance in fraud detection and resolution (Prakash,2013). In India frauds being increased extremely, the need for FA becomes more profound. FA is still progressing in India due to increasing size of corporations and the growth of complication of financial frauds (Bhasin,2017).

Significance for the Study

Poor corporate governance, frauds and other wrong doings have placed importance on forensic accountants to prepare themselves with the skills and techniques for identifying, distinguishing as well as keeping the proof of all kinds of financial corruption. Accounting practices have improved significantly, still recent complicated frauds have outstretched to such level as they remain unidentified.

Moreover, failure of statutory audit to prevent corporate financial scandals has posed burdens on the professional forensic accountants and the legal practitioners to find a better way of disclosing fraud in business world.

Materials & Methods

The study is descriptive in nature. Descriptive research has been preferred for developing a better profundity of knowledge. Information required for the study has been collected from secondary sources viz. website, books, journals, reports, etc. The inherent limitation of the study is that as the study is based on published data and information, and this secondary source may be lacking in authenticity, the result inferred there from may not be completely dependable. The study takes into consideration the perspective of FA and its implementation in India.

FA- Perspective

FA sometimes called investigative accounting exercises specialized knowledge and skills to identify ghost transactions. FA involves the application of accounting and auditing, financial and investigative skills to unsettled issues within the context of the rules of evidence (Arokiasamy and Cristal-Lee,2009;Ozkul and Pamukc,2012). FA as a discipline should have sound knowledge and understanding of business reality and the working of the legal system. FA with the help of multidisciplinary knowledge analyzes, investigates, inquires and examines matters in civil law, criminal law and jurisprudence to obtain the truth for exerting expert opinion (Zia,2010). FA explains accounting data acceptable to court and, thus, forms the basis for discussion, debate and ultimately resolution (Zysman,A.,2009). In India, Chartered Accountants(CA) perform investigation tasks. Serious Fraud Investigation Office(SFIO) is a benchmark for the forensic accountants in India. Developing cyber-crimes, failure of regulators to track the security scams, etc. recognize the exigency of FA.

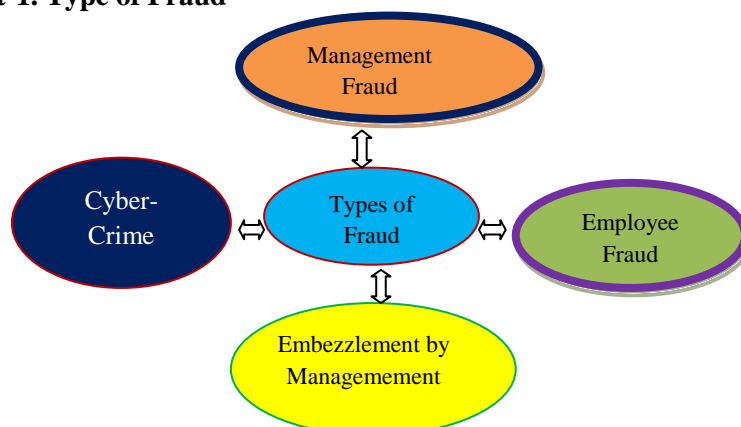
Practice of FA

Arnoff, Norman B. and Sue, Jacobs C. (2001) outlined the following functions of forensic accountants : i)Fraud detection; ii) Criminal investigation; iii) Outgoing partner's settlement; iv) Cases concerning professional negligence; v)Arbitration service; vi)Settlement about vehicle accident; vii) Insurance claim settlement; viii) Dispute settlement; ix) Matrimonial dispute cases, etc. A forensic accountant should also be familiarized with corporate financial management and administration. Crawford(2010) and Zia(2010) indicated in their study that the professionalism required for forensic accountants should have persistence and firmness, knowledge aptitudes in criminology, computer abilities, confidence, curiosity, creativity, discretion, prudence, secrecy and honesty.

Types of fraud

There are four major types of fraud i.e.1)Management fraud;2)Employee fraud;3)Embezzlement by management; and 4)Cybercrime (Kuchta,2001)[**Exhibit-1**].

Exhibit-1. Type of Fraud



Objective of the Study

- ❖ To cognize the role of FA in fraud examination in India;
- ❖ To examine the application of FA in India.

Literature Review

In the wake of surging number of corporate scandals, various authors have deliberated about the scope of FA in India by shedding light on its characteristic and technique along with the role of forensic accountant in fraud examination. Bhasin (2017) in his survey study reported that forensic experts should hold auditing skills, decisive deliberation, methodical proficiency, legal knowledge, amorphous troubleshooting and investigative flexibility. Luke (2013) considered FA as an exercise complementary to statutory audit and assured the robustness of the audit report. Stanbury and Paley-Menzies (2010) stated that FA collects and presents information in a form acceptable by court against perpetrators of economic crime. Okunbor and Obaretin (2010) remarked that FA helps determining issues of facts in business litigation. Dhar and Sarkar (2010) opined tax evasion, bankruptcy and violation of accounting regulation are within the jurisdiction of FA. The America Institute of Certified Public Accountants, 2010 defined FA as services involving the application of specialized knowledge and investigative skills possessed by Certified Public Accountants. Singleton and Singleton (2010) opined that FA necessitates preventing frauds and analyzing antifraud control with non-monetary particulars. Gottschalk (2010) expressed that emphasis of FA is on evidence by the examination of financial documents. Arokiasamy and Cristal, (2009) asserted that forensic accountants detect suspicious transactions by critically examining financial data. Ozkul and Pamukc, (2012) suggested that forensic accountants furnish accounting data to determine the facts required for resolving dispute before lawsuit process takes steps. Huber, (2012) confirmed that scandal, frauds, etc. creating loss of confidence in the minds of the financial statement users have claimed for forensic accountants.

Results

FA in India

Techniques of FA

With the rapid development of IT, fraudsters have also redesigned their techniques. FA rests at the top to prevent the fraudulent practice. Chakrabarti (2014), Moid (2016), Peshori (2015), and Shaheen et al. (2014) mentioned five techniques of FA for detection and prevention of frauds as follows:

i) Benford's Law: Benford's Law shows whether financial disorder springs from unintended mistake or fraudulent activity and suggests to compare the frequency distribution or the count percentage of the digits of the variables under study with the pre-defined standards using Z-test at certain level of confidence. Significant difference between the two demands further investigation. This technique is applied in situation where no other evidence exists to prove or disapprove the fraud or irregularity.

ii) Theory of Relative Size Factor (RSF): RSF is calculated as the ratio of largest figure to the second largest figure in the data set to discover any outliers in the data arising from fraud. An unusually high RSF indicates the non-conformity of the highest number with the other numbers in the set and, thus, calls for further investigation to detect any potential fraud.

iii) Computer Assisted Auditing Tools (CAAT): CAAT assist auditors in performing their tasks while dealing with huge volume of clients data.

iv) Data Mining Techniques (DMT): DMT are categorized into four: (a) Discovery; (b) Predictive modeling; (c) Deviation analysis; and (d) Link analysis. These techniques help extract large volume of data for further analysis.

v) Ratio Analysis: Ratio analysis helps predicting the relationship with any abnormal ratio which, in turn, calls for examination towards detecting potential fraud. FA technique should follow customized and situation-oriented approach for examining financial irregularity as against the statutory auditing techniques (Peshori, 2015).

KPMG, the global professional services giant suggested the following techniques in the light of increasing corporate frauds and economic crimes:

1. Spot the Unusual: Accounting transactions recorded on holiday is a solid dubious for common frauds like misappropriation of funds and bribery. With this, KPMG supports its clients in blocking the inconsistency to avoid such incidents and assists in preparing redesigned financial statements.
2. Fraud Risk Management: KPMG suggests strategies like fraud awareness workshops and training program; fraud risk assessment and vulnerability tool; forensic health check; organization perception survey; predictive data modeling; anti-counterfeiting and competition risk management, etc. to resist fraud and crime.
3. Forensic Technology Lab: Forensic technology lab assists to collect, recover and preserve evidences in digital format in fraud examination and legal prosecution. It also helps detecting manipulation with evidence.
4. Corporate Intelligence: Corporate intelligence includes due diligence checking while entering into business transactions. Due diligence exercises checking on ownership structure, market reputation, past fraud, pending lawsuits, credit-worthiness of the third party, etc.
5. Verification: Verification includes employees background and credentials such as address, education, past employment, pending lawsuits, mental and physical check, criminal record, etc.
6. Documentation Management: E-Discovery tool helps preservation and presentation of vast electronic evidences in the legal proceedings.

FA- Implementation in India

FA, in India, has got its recognition with alarming increase in the complex financial crimes. CA makes distinction themselves from traditional routine as required under the Companies Act or the Income-tax Act to help explore monetary trick. CA or ICWA having post capability in investigation can perform the task of CA-IFA or ICWA-IFA and be lawfully perceived as the Forensic Accounting Experts to handle the cases of monetary violation and submit master declaration in the Court of Law. In neither case, endeavors have so far been made by the two driving statutory accounting proficient bodies i.e. ICAI and ICWAI to move in this heading and set up a foundation which can offer the post capability recognition in Investigative and Forensic Accounting to its individuals. However, developing budgetary fraud cases, defective administrative system, etc. have constrained the Government to shape SFIO under the Ministry of Corporate Affairs(MCA) as a primary step to perceive the significance and development of forensic accountant. FA though a new field in Indian accounting world has tremendous potential for CA. It has come into lime light in India only in the recent past due to rapid increase in the white-collar crimes and perception that Indian Judicial Law is not stern to unveil the frauds. Now as India has witnessed many frauds with the increase in modern technology, many sectors like banking, financial institutions, corporate, etc. have started using FA. The Indian Laws incorporating FA include: i) The Companies Act, 1956 and 2013(Provisions of the Sick Industrial Companies Act incorporated into the Companies Act); ii)The SEBI Act,1992;iii)The Insurance Act, 1938; iv) The Prevention of Money-Laundering Act, 2002; v)The Companies (Auditor's Report) Order, 2003.

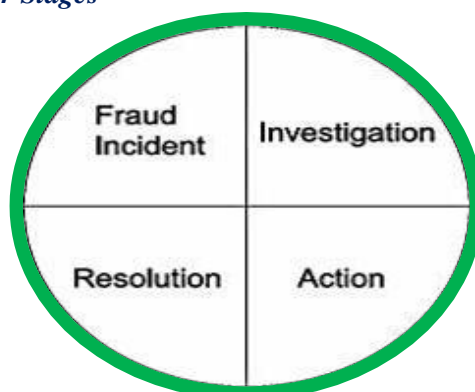
Role of Forensic Accountant under Indian Statutes

Various provisions for forensic accountants in the Indian statutes can be categorized as: a)Investigation and Inspection; b)Expert Opinion; and c)Forensic Accounting under Caro (The Companies Auditor's Report Order, 2003) comprising disposal of fixed assets; report on frauds; transactions with related parties, etc.

Dealing with Fraud-Current Model

Model shows four stages (**Exhibit-2**).

Exhibit-2. Four Stages



- ✚ **First stage-** Fraud incident awakens alertness. An organization affecting crisis manifestation attempts to identify the fraudster and prevents the event from becoming known publicly, saves losses, and reduces the impact of fraud on the organization.
 - ✚ **Second stage-**This stage includes all security procedures and internal control. Investigation is carried on with the help of interview and documentation. It does not stop with decision but takes sufficient time.
 - ✚ **Third stage-**An organization decides about the measures to be taken against the fraudster. Practicable measures include: do nothing, fire the fraudster, transfer the fraudster or start legal proceedings.
 - ✚ **Fourth stage-**At this stage, problem is resolved and nothing remains incomplete until a new fraudulent event happens. Fraudulent event does not decrease, rather, it may become a persistent problem.
- Forensic accountant renders valuable service like: i)Investigation and analysis of financial evidence; ii)Development of computerized applications; iii)Communication of the findings; and iv)Assistance in legal proceedings. FA also helps in detecting and preventing cases like: i)Tax fraud; ii)Securities fraud; iii)Money laundering; iv)Economic damages; v)Post-acquisition disputes; vi)Insolvency; vii)Business valuation; viii)Forensic computation, etc.

Discussion

Inadequate competence, complicated manipulation and senior management's involvement create difficulty in preventing fraud. Further, instances of conspicuous corporate fraud certified by unqualified audit report loses the confidence of the investors in corporate financial reporting. Deloitte India Fraud Survey,2016 accused management for the potential frauds. Incidence of fraud results in inefficient internal control systems, undue diligence checks and immorality. India Fraud Survey,2012 reported that unfortunately, Indian corporate sector has passive attitude towards frauds.MCA requires an auditor to immediately report any fraud against the corporate to the Government. This is a welcome move. Endeavor towards cashless economy has led to what we call as 'Digital Explosion'. But consumers unawareness and nebulous security standards have posed challenge before the present security and control systems. Accepting cyber-crime as new instrument of mass destruction, governing bodies must ensure uniform security guideline and effective monitoring mechanism. IT related fraud, intense business competition and deteriorating employee ethics accentuate the need for forensic accountants in India. Forensic training institute is inadequate. Corporate sector and the Government should realize the impact of economic and reputational repercussions of the scams and act accordingly. Indian businesses are moving towards self-regulation to defend themselves against the menace of corporate fraud. In the light of the new provisions in the Companies Act,2013, corporate are motivated to strengthen their internal control to reduce the feasibility of frauds. But this move also faces challenge for limited resources and competence to follow the same.

Problems of FA

- ✓ There is shortage of qualified technical persons having knowledge about forensic issues in India.
- ✓ Politicians in India being mostly involved in fraud cases, it is crucial to find evidence against them.
- ✓ Indian judicial system still follows age-old British judicial system involving huge expenditure to bring the matter to court and hire expert advocate.
- ✓ Liberalization and fast moving economy attracts foreign investors to invest more in India that makes it difficult to sue financial fraudsters from other countries.

- ✓ Continuous adoption of new IT by fraudsters is also another obstacle to forensic accountant to cope up with the situation.
- ✓ FA is still an expensive field compared to other investigative fields in India.

Prospects of FA

An auditor dissecting the agreement of financial statements to the GAAP or IFRS is not in the capacity to substantiate fraud or misconduct. Hence, the inability of statutory auditor in preventing and detecting corporate frauds and embezzlement of assets fosters the need of FA. Moreover, an upward surge in the number and complexity of corporate frauds, misconduct and disagreement has steered to increasing demand and opportunities for professionals in the budding field of FA in India. Prakash (2013) and Chakrabarti (2014) highlighted the scope of FA to include activities involving fraud detection, criminal investigation, dispute resolution, professional negligence, arbitration services, insurance claim settlement, etc.

Owojori and Asaolu (2009), Shaheen et al. (2014) and Eyisi and Ezuwore (2014) viewed that a forensic accountant collects evidence by scrutinizing financial statements and key documents. SFIO is in operation with the basic objective of unraveling fraud cases of public at large. India Fraud Survey Report, 2012 highlights the crucial statistics about the extent, prevention, perpetrators and resolution of frauds to appraise perspectives of corporate fraud from time to time. Anti-Money Laundering Report guides corporate towards avoiding money laundering activities through increased compliance and detailed understanding of risks for possible solutions. Introduction of the new Companies Act, 2013 has suggested the organizations of national interest like ICAI, India Forensic and Department of International Forensic Sciences (IFS) to conduct various certification courses in FA. These are all momentous endeavors. India Forensic Center of Studies is yet another Indian organization committed to deliver FA education and training. The registered participants have to undergo practical training and examination to get awarded with the designation of Certified Forensic Accounting Professional (CFAP). The organization also provides accreditations of Certified Anti-money Laundering Expert (CAME) and Certified Bank Forensic Accountant (CBFA). CBFA provides participants with analytical and investigative skills for methodological forensic analysis whereas CAME focuses on discovering dubious transactions. Forensic Accounting and Financial Fraud Examiner of the education department of the Government provides course to create awareness about forensic education. Academicians are procuring research interest in FA, but its progress depends on the extent to which fraud perpetrators leave trace on fraud. In future, regulators have to be more acquainted with fraud perpetrators. If the perpetrators gather sufficient knowledge about accounting and investigative skills, industry regulators may face problem.

Research GAP

Future of FA literature depends on the extent to which it informs practice and policy. However, forensic academic research has done little in this direction. A researcher uses several mechanisms to support the existence of fraud in the analysis. But this approach is not of much useful to regulators. Regulators take interest in detecting on-going fraudulent activities while academic research focuses on past fraud events. Academic research may inform policy if FA research shifts its focus from units with past fraud history to units without no such history at all. With the recent advancement in the knowledge of human behavior and financial engineering, regulators perceive that techniques used to detect past fraud facts may not have explanatory power to predict future fraud. Future research on FA depends on reconciliation of these two important factors.

Conclusion

FA is still an undeveloped area in the Indian economy. Until recently, focus is still on preventing and detecting conventional and well-known frauds and not on the emerging sophisticated ones. Much of the FA practices are reactive, rather than proactive in nature. There is a need to identify and control the uncontrollable. Unawareness of the sophisticated FA techniques and the scarcity of qualified and well-trained professionals contribute to its rudimentary stage of evolution in the aftermath of increasing financial crimes. This urges the pressing need for the development of FA as a separate discipline. If forensic auditing is made mandatory in various sectors, many of the scams can be restricted.

Formation of SFIO by the Government is a positive step to recognize the advancement of the profession of forensic accountants. Framing new law for the prosecution of fraudsters should always be keeping in mind the uses of IT in fraudulent practices.

In an environment of increased exposure to fraud risk, there are immense possibilities to assume separate '*niche*' and opportunities for forensic experts to offer litigation support, investigative accounting and consultancy services.

Recommendations

- FA services should be provided with necessary tools to deter fraudulent activities.
- FA should be provided with appropriate provision of professional services in the law courts.
- FA will institute good corporate governance in the public sector installing public confidence in the Government and the entire system.
- As traditional auditing has limitation in detecting fraudulent practices, forensic accountants will effectively fill it with professional ability to break into the organization system and examine the books, make discoveries and present the documentary evidence in the court of law.
- Eradication of economic and financial crimes through FA can improve the image of corporate sector in India. The most important thing corporate have to do is to prevent crime from being committed.
- The Government with regulatory bodies should ensure the guidelines to regulate forensic activities and, above all, embrace integrity, objectivity, fairness and accountability in their activities.

Research Remarks

FA as a distinct specialized area has vast future. With the growing levels of financial irregularities, requirement for forensic accountant is bound to magnify in the coming times. Also, shortage of qualified and experienced FA skill in India makes it a reputable and valuable career for CA to pursue. Financial sector reforms aim at making India more competitive, versatile, efficient and productive.

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