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CONCEPTUAL STUDY OF FORENSIC ACCOUNTING

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ABSTRACT

In current scenario with increasing cases of cyber crimes, corporate mismanagement, bank scams, employees embezzlements, traditional audit techniques are not providing adequate assurance. Corporate, Banks, Insurance Companies are incurring huge economical losses due to such incidents. Forensic Accounting is the only solution to win this battle. However forensic Accounting is still not popularly adopted in India. This paper highlights some of the key points of Forensic Accounting.

Key words: Forensic Accounting, Frauds, techniques and tools of Forensic Accounting

Historical perspective of Forensic Accounting in India

Maurice E. Peloubet introduced the term Forensic Accountant in 1946 essay "Forensic Accounting: Its Place in Today's Economy." Archaeological findings reveal that, during 3300-3500 BC, accountants of their day in Egypt, were found in the prevention and detection of fraud. However, During 1800" close relationship established between accountancy and legal profession. Many amendments to financial statement disclosure can be attributed to frauds in corporate. In 1930"s America Eliot Ness was credited to bring down gangster Al Capone, but his case was based on the investigative work done by Elmer Irey, an accountant with the Internal Revenue Service that ensured Capone"s conviction for tax evasion. He was America"s first high-profile forensic accountant. But in Indian context history of investigative accounting goes back to prehistoric times of Mauryans. Kautilya was the first person to bring up the famous forty ways of embezzlement in his famous Kautilya arthashastra. A fraud examination is the area of expertise of the Chartered accountants because it involves techniques in accounting. In India Chartered Accountants are taking such investigative assignments. However, Very few Chartered Accountant firms are practicing in this area.In India still this area is dominated by the big four consultancy firms such as Deloitte, KPMG, Pricewater House Coopers and Ernst and Young. In India the formation of Serious Fraud Investigation Office is the milestone establishment for the Forensic Accountants. With increasing cyber-crimes, failure of regulators to track the security scams, trend of bank scams forensic accounting has become vital.

Definitions of Forensic Accounting

Bologna and Lindquist (1987) defined forensic accounting as "the application of financial skills, and an investigative mentality to unresolved issues, conducted within the context of rules of evidence. As an emerging discipline, it encompasses financial expertise, fraud knowledge, and a sound knowledge and understanding of business reality and the working of the legal system." This conveys the forensic accountants must to be talented in forensic accounting, as well as in interior control

frameworks, the law, other institutional prerequisites, investigative capability, and interpersonal aptitudes.

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."

According to Zia(2010) : "The science that deals with the relation and application of finance, accounting, tax and auditing knowledge to analyse, investigate, inquire, test and examine matters in civil law, criminal law and jurisprudence in an attempt to obtain the truth from which to render an expert opinion."

Crumbley (2005) : Forensic accounting is performed for an assortment of customers however in all cases it is to find the concealed story behind a presentation of an arrangement of records. Forensic accountants can wind up finding extortion or, regardless of the fact that not illicit, a deception of a budgetary circumstance. Forensic accounting aptitudes are utilized to settle shareholder and association question, marital debate, protection claims. Forensic accountants are likewise utilized as a part of misrepresentation examinations.

Forensic Audit is the application of accounting methods to the tracking and collection of forensic evidence, usually for investigation and prosecution of criminal acts such as embezzlement or fraud. Also called forensic accounting.

Scope of Forensic Accounting

- ❖ Following services are included in the purview of Forensic Accounting.
- ❖ Business valuations
- ❖ Divorce proceedings and matrimonial disputes
- ❖ Personal injury and fatal accident claims
- ❖ Professional negligence

- ❖ Insurance claims evaluations
- ❖ Arbitration
- ❖ Partnership and corporation disputes
- ❖ Shareholder disputes (minority shareholders claiming
- ❖ Civil and criminal actions concerning fraud and financial irregularities –cross examination, formulate questions
- ❖ Fraud and white-collar crime investigations

Techniques of Prevention of Fraud (Forensic Accounting)

Benford's Law- It is a mathematical tool, and is one of the various ways to determine whether variable under study is a case of unintentional errors (mistakes) or fraud. On detecting any such phenomenon, the variable under study is subjected to a detailed inspection. The law states that fabricated figures (as indicator of fraud) show a different pattern from random figures. The steps of Benford's law are very simple. Once the variable or field of financial importance is decided, the left most digit of variable under study extracted and summarized for entire population. The summarization is done by classifying the first digit field and calculating its observed count percentage. Then Benford's set is applied. A parametric test called the Z-test is carried out to compute the significance of variance between the two populations, i.e. Benford's percentage numbers for first digit and observed percentage of first digit for a particular level of confidence. If the data confirms to the percentage of Benford's law, it means that the data is Benford's set, i.e. there is 68% (almost 2/3rd) chance of no error or fraud. The first digit may not always be the only pertinent field. Benford has given separate sets for 2nd, 3rd ,… and for last digit as well. It also works for mixture numbers, decimal

numbers and rounded numbers. There are various advantages of Benford's Law like it is not affected by scale invariance and also help in situation when there is no supporting document to prove the genuineness of the transactions.

Theory of relative size factor (RSF) - It reflects 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. It helps in better discovery of anomalies or outliners. In records that fall outside the prescribed range are suspected of errors or fraud. These records or fields need to relate to other variables or factors in order to locate the relationship, thus establishing the truth.

Computer Assisted Auditing Tools (CAATs)- CAATs are computer programs that an auditor use as part of the audit procedures to process significant auditing data contained in a client's information systems, without depending on him. CAAT helps auditors to perform various auditing procedures such as: (a) Testing details of transactions and balances, (b) locate inconsistencies or significant fluctuations, (c) Testing general as well as application control of computer systems. (d) Sampling programs to extract data for audit testing, and (e) Redoing calculations performed by accounting systems.

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 discovers the usual knowledge or patterns in data, without a predefined idea or hypothesis about what the pattern may be, i.e. without any prior knowledge of fraud. It exhibits various affinities, association, trends and variations in the form of conditional logic. In predictive model, patterns identified from the database are used to forecast the outcome and to guess data for new value items. In Deviation analysis the norm is found first, and then those items are detected that deviate from the usual within a given threshold (to find anomalies by extracted patterns). Link discovery has emerged recently for detecting a doubtful pattern. It mostly uses deterministic graphical techniques, Bayesian probabilistic casual networksThis method involves "pattern matching" algorithm to 'extract' any uncommon or suspicious cases.

Ratio Analysis - Another useful fraud detection technique is the computation of data analysis ratios for key numeric fields. Like financial ratios that indicate the financial health of a company, data analysis ratios locate the fraud by identifying possible symptoms of fraud. Three important ratios are - 1. The ratio of the highest value to the lowest value (max/min); 2. The ratio of the highest value to the second highest value (max/max2); and 3. The ratio of the current year to the previous year. Using ratio analysis, a financial expert identify the relationships between specified costs and measure of production, such as units sold, dollars of sales or direct labour hours. For example, overhead costs per direct labour hour may be find out by dividing total overhead costs by total direct labour hours. Ratio analysis may help in approximation of expenses

LITERATUTE REVIEW

(Mehta, 2007) Found in their study that throat cut competitions among organisations and individuals have

resulted in to huge number of frauds. This increasing number of frauds emerges need of a specialist who can combat frauds with the help of their skills and professionalism. The study also points out need for such professionals who can play major role in detection and prevention of frauds.

(Beattie, 2012)The author mentioned in his article that even life insurance companies have also suffered due to major frauds in different areas like deliberate and false declaration at the time of accepting the life insurance policy, Frauds by Life Insurance agents, wrong claim by nominees.

(Dipak K. Dash, 2018)As per an article in Economic Times ,"Fight For RERA", the umbrella body of home buyers, which had played key role in enactment of RERA, has made an appeal to Narendra Modiji, to order forensic audit of all real estate projects and if found guilty confiscate their assets including personal and utilize for completion of project.

(Shaheen & Sultana, 2014) Revealed in their study about the forensic accounting and its use in India. The study revealed that forensic accounting tools are effective to control fraud. Not only that authors also pointed out for the need of making forensic accounting compulsory in public sector and large scale companies in order to control white crimes.

(et.al, 2013)The authors revealed in their study that corruption has become uncurable virus in India. Dr. CK Prahalad, Management expert, University of Michigan, has estimated that due to corruption about 2.5 trillion of money is being lost annually by the Indian economy. Transparency International has ranked India as the 84thmost corrupt countries from a total of 180 countries.The study recommended compulsory introduction of Forensic Accounting in current scenario. Forensic Accounting is specialized investigation of financial frauds through the use of specialized skills and techniques. Forensic Accounting

includes accounting, auditing, and investigative skills for legal purposes. It consist of two major components , one where data and evidences are collected, analyzed and evaluated through investigation and the other is providing expert opinion or presenting the same before a court of law. The authors also mentioned several incidences of frauds from 1957 Mundhra scam till the latest 2013 Augusta helicopter scam involving hundreds of crores of money by way of kickbacks.The authors concluded that due to increasing frauds, Forensic Accounting must be introduced as a compulsory subject. The study also suggested creating awareness in top management and government departments for adoption of Forensic Accounting as a preventive-detective-investigative tool to check irregularities in financial transaction.

CONCLUSION

From the above previous studies it is evident that there is huge increase in frauds and irregularities in different sectors like corporate, real estate and Insurance, which also results in to huge economical loss to organisations. In such scenario specialised field of Forensic Accounting involving expert skills and knowledge becomes vital. Authors also suggested for compulsory adoption of Forensic Accounting in Public Sectors. However some of the authors stressed upon increasing awareness of Forensic Accounting. From the above studies it can be concluded that Forensic Accounting has bright future ahead in developing countries like India.

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