Forensic Accounting: A Conception for Fraud and Scams Detection in Indian Corporate Sector

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***Abstract*— *In the emergent economic situation, forensic accounting is an indispensable tool for uncovering or inquiry of financial crime and the direction of justice, providing decisive information about the facts found related to financial crime. It is a new area, but in recent years, banks, insurance companies and even police have increased taking help of forensic accountants. This paper scrutinizes the present status of solicitation and role of forensic accounting in India and commends steps that should be taken for the improvement of the utilization of forensic accounting as an effective tool for combating fraud and corruption in India.*

***Keywords*— *Forensic Accounting, Fraud, Auditing, Corporation*

I. Introduction

Forensic accounting, additionally called investigative accounting or fraud audit, is a merger of forensic science and accounting. It is the aggregate of Accounting, Auditing, and Investigation. The forensic accountant takes a greater proactive, skeptical technique in examining the books of accounting. They make no assumption of management integrity, show fewer worries for the arithmetical accuracy have nothing to do with the Accounting or Assurance Standards, however, are keen in exposing any opportunity of fraud. The job needs reporting, wherein the responsibility of the fraud is set up and the document is considered as proof within the court of law or inside the administrative proceeding. In addition to the specialized expertise about the strategies of locating out the frauds, one wishes persistence and analytical mindset.

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 claim, personal injury, claims, fraud, construction, or royalty audits. Financial forensic engagements may fall into several categories. For examples:

1. Economic damages calculations, whether suffered through tort or breach of contract.

2. Post – acquisition disputes such as earn outs or breaches of warranties.

3. Bankruptcy, insolvency and reorganization.

4. Securities fraud.

5. Business valuation and

6. Computer forensics / e-discovery

These accountants are regularly concerned in recovering cash of a serious felony and in different confiscation activities associated with proceeds as regards to real or potential cash laundering and crime. In our country India, there exists a completely unique elegance of forensic accountants named Certified Forensic Accounting Professionals. The qualifications held by way of extraordinary forensic accountants had been illustrated in figure.1 beneath:

Figure.1 Qualifications held by different forensic accountants

The main contributions and organization of this paper are summarized as follows: In section II we describe literature review of Forensic accounting. The section III methods and methodology. Finally in section IV we concluded the paper.

II. Literature Review

Forensic accounting is the specialty area of the accountancy profession which 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 (Crumbley et al.2005).

Joshi (2003) ascribed the origination of forensic accounting to Kutilya, the first economist to openly recognize the need for the forensic accountant whom he said, mentioned 40 ways of embezzlement centuries ago. He, however, stated that the term "forensic accounting was coined by Peloubet in 1946.

Crumbley (2001) wrote on same when he stated that a form of forensic accounting can be traced back to an 1817 court decision. He stated also that a "young Scottish accountant issued a circular advertising his expertise in arbitration support in 1824" but that Peloubet was probably the first to publish the phrase forensic accounting. Investigation of fraud and corruption is confirmed thus, not to be new, even in Nigeria. It is only gaining prominence because of the growing wave of the crime under the seemingly new nomenclature the last five years.

Coenen (2005) stated that forensic accounting involves the application of accounting concepts and techniques to legal problem. It 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 (Joshi). It provides an accounting analysis that is suitable to the court, which will form the basis of discussion, debate and ultimately dispute resolution (Zysman, 2001).

Okoye and Gbegi (2013), the study focuses on public sector to examine the role of forensic accountant in detecting and preventing . Further the study says that the Forensic accountant can help better in detecting and preventing fraud than the traditional accountant hence the study suggested that Forensic Accountants be replaced with the external auditors in Kogi State, proper training and retraining on Forensic accounting should be provided to staff of Kogi State and proper adherence to accounting and auditing standards should be followed.

Nenyiaba, Ile Charles (2012) The study revealed that noncompliance with accounting standards is responsible for the increasing spate of white collar crime in the Nigerian public sector and that absence of forensic accounting courses in the training programme of practicing accountants are responsible for inability of auditors to detect, early enough, white collar crime in the public sector thereby aggravating the scam. Hence it is observed that forensic accounting will play important role in Nigeria public sector to control fraud.

Sylvia Veronica and Yanivi Sbachtiar (2005), the study about the relation between certain corporate Governance mechanisms and the likelihood of a company having accounting problem, as evidenced by a misstatement of its earnings. Further it focuses that good corporate goverance can helpful to reduce and prevent fraud.

Kasum, Abubakar Sadiq (2007), the paper studied financial crimes in developing economies. Fraud and corruption has affected the lives of citizens of third world countries negatively, it is engraved in the systems, and it is alarming and seriously devastating. The work specifically evaluates the extent of financial crimes in developing countries and compares the private and public sector with a view to determine the sector where the service of forensic accountants is more required. The results of the reviews are that fraud and corruption are fundamental problems of third world countries .Empirically, it is found that investigative or forensic accountant has a role to play, generally, but more in the public sector. The paper recommends the strengthening of forensic accounting institution and utilization of their services in public sector of developing nation‘s economies.

Hadi Khani (2014) study about the meaning of ethics and its role in accounting and audit. Paper emphasis that the professional ethics is of great importance for accountant those involved in auditing too. Further auditor is answerable to all the stake holder of the company and to the society. Author has mentioned various reason of ethics in accounting, fundamental principle of ethics and need of professional accountant to ethics.

Dr. Sudhir Yadav and; Dr. Sushama Yadav (2013) has discussed the basic of forensic accounting and its application to detect fraud in the industries article further discussed the use of professional accounting skills in matters involving potential or actual civil or criminal litigation. It discussed the various fraud cases of India in short.

Soni R.R. and Soni Neena (2013), study about the facility provided by the Bank to their customer it also focuses the facility provided by the public and private bank. The paper has shown the details of Calendar year wise cyber fraud in public sector bank and private sector bank. Further report shows that as we move forward and using technology, fraud has also increased as a result huge losses of money to people and institution.

Ashu Khanna (2009) paper study about the various reason of accounting fraud in banking sector. The paper further studies the reasons of increase in fraud like lack of training, over burden on staff, competition etc. Better internal control can minimize and prevent the fraud.

Ms Dhara Jitendra Chudgar and Dr. Anjani Kumar Asthana (2013) study about one of the serious problem in Insurance sector. The effect of insurance fraud is that it has increase the Overall Cost of insurer and increase in the premium of the policy holders. Paper suggests comprehensive risk management strategies that involve fraud risk assessment and fraud prevention.

G. Nagarajan and Dr. J. Khaja Sheriff (2012) study that growth of technology and education has lead to increase in white collar crime. It further state that professional loopholes in judiciary and support from the government has also played a role in increase of such crime. The paper studies the various white collar crime and suggest method to control it.

Dr. Manas Chakrabarti (2014), Forensic accounting has been in limelight after Satyam case, which urges a need of forensic accounting professional to detect and prevent fraud on time so as to control the white collar time. The study focus on the problems and future of the forensic accounting profession.

Statement of the problem: The failure of statutory audit to prevent and reduce mis-appropriation of corporate fund and an increase in corporate crime has put pressure on the professional accountant and legal practitioner in find a better way of exposing fraud in business world. A nationwide study conducted by Kessler International showed that 39 percent of organizations have considered the need for a forensic accountant. This study intends to find out how the knowledge of forensic accounting techniques can reduce corporate fraud and mismanagement along with discussing the scope and role of forensic accounting.

III. METHODS AND METHODOLOGY

1) To understand the scope of forensic accounting in India and its uses.

2) To understand the significance of forensic accounting through the discussion of various scams in India

3) To identify the role of forensic accountants in fraud examination.

4) To understand various techniques employed in forensic accounting for detecting and preventing frauds.

Different tool and techniques used for Forensic Audit are:

1. **Benchmarking** – comparison of financial result of one period with another or the performance of one cost centre, or business unit, with another and overall business performance with its pre decided standards.

2. **Ratio analysis** – to identify any abnormal trends and changes.

3. **System analysis** – to examine the systems in place and identifying any weaknesses which could be opportunities for the fraudsters.

4. **Specialist software**- like audit tools for data matching analysis.

5. Exception reporting –Generating automatic unchangeable reports that to find out deviation from the norms.

Problems of Forensic Accounting in India :

1) Forensic accounting is developing field of financial fraud detection. There is acute shortage of qualified accountants with adequate technical knowledge of forensic issues in India.

2) In India, most of the financial fraud cases involved politicians, so it is crucial to find evidences against them.

3) Indian judicial system still follows age old British judicial system. It is expensive to bring the matter to court and hire expert advocates.

4) Due to liberalization and fast moving economy, more and more investors from foreign countries invest in India and so, it is difficult to sue financial fraudster from other countries.

5) Because of continuous adoption of new techniques of Information and Technology by fraudster, it is difficult to Forensic Accountant to cope up with them.

6) Forensic accounting is an expensive field compared to other investigative fields.

7) It is not mandatory for companies to appoint forensic accountant in companies.

8) There is no specific guideline or act on forensic accounting in India.

The fast-changing world of information technology and the exponential increase in the use of computer systems threaten the forensic accounting fraternity. The technology used by criminals and fraudsters is changing constantly and forensic accounting need to stay on top of their game to prevent and detect these fraudulent practices. All Indian accountants are not information technology savvy. Some of the techniques involved in Forensic Accounting to examine the frauds are:

Benford's Law maintains that the numeral 1 will be the leading digit in a genuine data set of numbers 30.1% of the time; the numeral 2 will be the leading digit 17.6% of the time; and each subsequent numeral, 3 through 9, will be the leading digit with decreasing frequency. This expected occurrence of leading digits can be illustrated as shown in the chart "Benford's Law." The resulting curve pictured in this green bar chart closely resembles a steep water slide and is sometimes referred to as the Benford curve. Today, armed with any version of Microsoft Excel, CPAs can count the leading digits contained in virtually any data set, chart the findings, and compare the results to Benford's curve to see if that data set obeys the expectations set forth by Benford's Law. Transaction level accounting data for a large firm would almost always have a very large number of observations. If some accounting data is expected to conform to Benford’s law but doesn’t, it doesn’t necessarily mean the data is fraudulent. It would however provide a good reason for further investigation. Auditors have long applied various forms of digital analysis when performing analytical procedures. For example, auditors often analyze payment amounts to test for duplicate payments. They also check for missing check or invoice numbers. Benford’s law looks at an entire account to determine if the numbers fall into the expected distribution. It also works for combination numbers, decimal numbers and rounded numbers. There are many advantages of Benford’s Law like it is not affected by scale invariance, and is of help when there is no supporting document to prove the authenticity of the transactions.

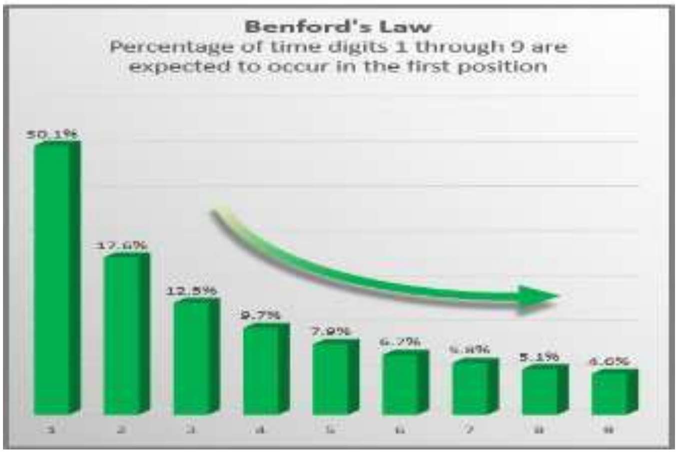

Figure.2 Benford’s law looks at an entire account

Theory of relative size factor (RSF): It highlights all unusual fluctuations, which may be routed from fraud or genuine errors. RSF is measured as the ratio of the largest number to the second largest number of the given set. The RSF test finds subsets where the largest number is out of line with the remaining numbers and is possibly an error. It has detected errors in accounts payable when staff miscoded the decimal point in the invoice amount. The relative size factor (RSF) for a subset is: RSF = Largest number in subset / Second largest number in subset. For example, a high RSF in payroll data could signal an overtime error and a high RSF for inventories could signal a calculation or count error. If there is any stray instance of that is way. Beyond the normal range, then there is a need to investigate further into it. It helps in better detection of anomalies or outlines. In practice, there exist certain limits (e.g. financial) for each entity such as vendor, customer, employee, etc. This test finds identical entries, such as duplicate payments in accounts payable. While many AP systems can make this identification, duplicates may still occur if some of the purchase details are miskeyed or when there are a number of payment centers or multiple payment systems. Duplicates are detected when all the payment data are analyzed together. This test can also be used in inventory, payroll, accounts receivable and sales.

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 system, without depending on him. CAATs are the practice of using computers to automate the audit processes. CAATs normally include using basic office productivity software such as spreadsheet, word processors and text editing programs. Using CAATs the auditor can select every claim that had a date of service after the policy termination date. The auditor then can determine if any claims were inappropriately paid. CAATs provide auditors with tools that can identify unexpected or unexplained patterns in data that may indicate fraud. Whether the CAATs is simple or complex, data analysis provides many benefits in the prevention and detection of fraud. Evaluations of financial information made by studying plausible relationships among both financial and non-financial data to assess whether account balances appear reasonable.

Data Mining Techniques:

Data mining techniques are providing great aid in financial accounting fraud detection, since dealing with the large data volumes and complexities of financial data are big challenges for forensic accounting. The implementation of data mining techniques for fraud detection follows the traditional information flow of data mining, which begins with feature selection followed by representation, data companies have left a dirty smear on the effectiveness of corporate governance, quality of financial reports, and credibility of audit functions. The detection of accounting fraud using traditional internal audit procedures is a difficult or sometimes an impossible task. First, the auditors usually lack the required knowledge concerning the characteristics of accounting fraud. Second, as the fraudulent manipulation of accounting data is so infrequent, most of the auditors lack the experience and expertise needed to detect and prevent frauds. Finally, the other concern people of finance department like Chief Financial Officer (CFO), financial managers and accountants are intentionally trying to deceive the internal or external auditors.

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. Detection of financial statement fraud is on the front burner. With billions of losses behind us from such companies as Enron, Tyco, and WorldCom, the numbers of cases has slowed but not stopped.

Three commonly employed ratios are: -

- The ratio of the highest value to the lowest value (Max/min);
- The ratio of the highest value to the second highest Value (max/max2); and
- The ratio of the current year to the previous year.

For example, to arrive at overhead costs per direct labor hour – Total overhead costs might be divided by total direct labor hours. Ratio analysis may help a forensic accountant to estimate expenses.

IV. CONCLUSION

Forensic Accounting is used as an investigative tool in India rather than a preventive tool. Based on the findings of the study, from the following conclusion have arrived are Forensic accounting has significant effects in reduction and prevention in frauds as compare to auditing. The techniques of forensic accounting and its application will significantly examine the fraud and various computer forensic techniques will significantly help in reducing and preventing fraud. Finally if forensic accounting is made mandatory in corporates, scams worth crores can be avoided which will be beneficial for the economy.

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