

# FORENSIC ACCOUNTING IN INDIAN FINANCE

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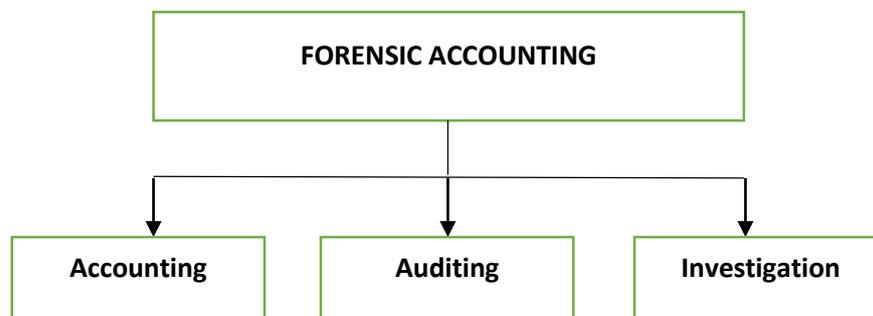
With a growth in technology, a subsequent growth can be seen in crimes and frauds related with the same. Forensic Accounting, a new age innovation in the age old system of accounting is a practice to investigate financial frauds. Forensic accounting combines the skills of investigator with the knowledge of financial accounting. It is basically the seeking the input of accountants in crimes relating to financial frauds, misconduct, management allegations etc. An article from 'Business Standard' claims that almost all banks in India helped initiate transactions sore pointed by the Treasury Department's Financial Crimes Enforcement Network (FinCEN) for suspicious financial crimes such as money laundering and financial fraud. With reference to India, the FinCEN files till now have authorized sender-receiver connections for 406 deals with all major banks, including SBI. According to the leaks Indian banks received \$482,181,226 from outside the country and \$406,278,962 moved from India. These transactions were sore pointed to the US authorities. (Roy,Anup. Business Insider, 21-9-2020, Mumbai)

## FORENSIC ACCOUNTING DEFINITION

Forensic Accounting can be defined by the Journal of Forensic Accounting, "Forensic accounting is sufficiently thorough and complete so that an accountant, in his/ her considered independent professional judgment, can deliver a finding as to accounts, inventories, or the presentation thereof that is of such quality that it would be sustainable in some adversarial legal proceeding, or within some judicial or administrative review.

Forensic accounting combines the skills of investigator with the knowledge of financial accounting.

In a decade where we have witnessed and first hand experienced the massive growth in FinTech business that uses technology to enhance and improve financial services with a view to increase the customer base and well as customer retention, a compounding growth can also be reflected in financial crimes as well. The increase in white collar crime and the problems and constraints in tracking down financial criminals by law enforcement agencies (still following age old laws which do not have enough provisions to cover new age fintech crimes) have also contributed to the growth of forensic accounting as a separate discipline, worthy of deep rooted study and learning. Organizations like Indiaforensic, Institute of Chartered Accountants of India (ICAI) and Association of Chartered Certified Accountants (ACCA) offer courses on forensic auditing in India both online and offline. Forensic Accounting stands on 3 pillars of Accounting, Auditing and Investigation skills.



The Reserve Bank of India has made forensic accounting mandatory for all banks in wake of all the red flagged transactions.

Forensic Accounting has dual focus, pointing at the following:

- a) In case of litigation, investigative skills of forensic accountant are used in two ways, he can be called upon to give his expert opinion based on his investigation and may require possible courtroom testimony.
- b) Forensic accountant's investigative skills are required for collecting, analyzing, and evaluating financial evidence, as well as the ability to interpret and communicate findings.

## THE EVOLUTION OF FORENSIC ACCOUNTING IN INDIA

Maurice E. Peloubet formulated the term Forensic Accountant in 1946, in his paper "Forensic Accounting: Its Place in Today's Economy." Studies say that during 3300-3500 BC, accountants in Egypt, were involved in the prevention and detection of fraud. During 1800, there is a reported close relationship between accountancy and legal profession". During the 1930s American Eliot Ness was credited in bringing down gangster Al Capone, based on the investigative work done by Elmer Irey, an accountant with the Internal Revenue Service (IRS) that ensured Capone's conviction for tax evasion. He was probably America's first high-profile forensic accountant.

Wide use of Forensic Accounting developed in India after Enron case (The Enron scandal drew attention of main stream media and the public in general to accounting and corporate fraud as its shareholders lost \$74 billion in the four years leading up to its bankruptcy, and its employees lost billions in pension benefits, showing to the world, how a crime of numbers can result in billions of losses), Rajat Gupta case (Gupta, was convicted in June 2012 on insider trading charges of four criminal felony counts of conspiracy and securities fraud) and Satyam Case (The Satyam Computer Services scandal, yet another corporate scandal where chairman Byrraju Ramalinga Raju confessed that the company's accounts had been falsified). Very few Chartered Accountant firms have fraud examination as a separate practice and fraud examination wasn't receiving the importance that it needed.. The establishment of Serious Fraud Investigation Office (SFIO) in India has become the turning point for forensic accountants in the country, a major revolution in the field of

forensic accounting and opened new doors for forensic accountants and for those aspiring to be one. The discipline is now popular in India due to:

1. Growing rate of financial crimes and offences
2. Lack of trained professionals to track down offenders.

The amendment of Companies Act, 2013 laid the steps for a special way to prevent economic fraud 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 blunders in acquiescence culture stressed the need for and the necessity in conducting proper investigation and also in building a strong wall against these crimes and to structure a strong preventive environment. Thus forensic accounting was called for to identify planning of the fraud, execution of the fraud, consequences of the fraud and to find the culprits without much time lag.

As per a study by EY conducted in 2012, frauds are even more complicated and sophisticated to detect than before. Nearly three out of five respondents had reported that their companies have suffered at least one economic crime in the past year, with major crimes being reported in the areas of telecommunication, financial services and real estate. The top five risks that emerged from the survey are

1. Data or information theft and IP infringement
2. bribery and corruption, including coercion,
3. fraud perpetrated by senior management officials
4. dealer fraud or kickbacks
5. regulatory non-compliance.

## AWARENESS OF FORENSIC ACCOUNTING IN INDIA

Forensic Accountants and Forensic Accounting as a profession began to be discussed as a prospective career choice only recently due to rapid increase in frauds and financial crimes both cybercrimes and well as non-cyber crimes. There is huge requirement for honesty, fairness, strictness and transparency in Indian Corporate reporting. The Institute of Chartered Accountants of India (ICAI) now provides a certificate course on forensic accounting titled “Certificate Course on Forensic accounting and Fraud Detection using IT and CAATs”. At present, very few universities and institutes are providing courses on forensic accounting. Indian universities are still following age old education syllabus and haven’t updated it to introduce these new trends in accounting such as Forensic Accounting, Responsibility Accounting etc. as compared to foreign universities. Some leading organization such as Indiaforensic (Pune, Maharashtra) offers a certification Course in Bank Forensic Accounting (CBFA), Certified Forensic Accounting Professional (CFAP). Institute of Chartered Financial Analyst of India (ICFAI) University offers a Postgraduate Diploma in Forensic Accounting. Although this is at sapling stage in Indian universities, many college and universities are introducing courses on “Forensic Science”. In the wake of increasing levels of frauds and economic

irregularities and considering to need to prevent it as the necessity of the day, it is expected that the prospects of forensic accountants are bound to increase considerably in the near future, their roles being:

- To aid in a settlement, claim, or jury award by reducing the financial component as an area of continuing debate.
- Avoiding fraud and theft.
- Restore and rejuvenate the public's confidence with the financial environment of the nation.
- To introduce a corporate governance policy giving due importance to forensic accounting and auditing.
- Helping in legal proceedings, giving one's expert opinion and facts in court as an expert witness and preparing visual aids to reinforce the trial evidence.

Some forensic accountants pursue and exclusively pioneer in forensic analytics which is the procurement and analysis of electronic data to reconstruct, find, or otherwise aid a claim of frauds in finance. The main steps in forensic analytics are

1. Data collection
2. Data preparation
3. Data analysis
4. Reporting.

There is a growing potential and future in forensic accounting as a 'specialised area' in accounting and finance. Given the abnormal levels of financial irregularities and frauds, the requirement for forensic accountants are more and is an in demand career in this decade.

#### FRAUD INVESTIGATION IN INDIA

In India the formation of Serious Fraud Investigation Office is the landmark creation for the Forensic Accountants. With a day-by-day increase in cyber crimes, failure of regulators to track the security scams, or even failure to prevent or even detect any frauds from happening or a crime from being committed, series of co-operative banks bursting - all are pinpointing to the need of forensic accounting.

The SFIO - Serious Fraud Investigation Office is a statutory corporate fraud investigating agency set up by a resolution of Government of India coming under the legal framework of Companies Act Section 211.

It is under the jurisdiction of the Ministry of Corporate Affairs & primarily supervised by officers from Indian Administrative Service, Indian Police Service, Indian Corporate Law Service, Indian Revenue Service and other Central Services, having experts from financial sector, capital market, accountancy, forensic audit, taxation, law, information technology, company law, customs and investigation. The agency has four regional offices in Hyderabad, Mumbai, Kolkata and Chennai.

## FORENSIC ACCOUNTING IN THE CONTEXT OF VARIOUS LAWS AND ACTS IN INDIA

**Securities and Exchange Board of India Act (SEBI Act), 1992** gives SEBI the power to direct any person to inquire into the activities of intermediaries both financial as well as non-financial, brokers and any other person associated with the securities market whose transactions may be of detrimental effect to the investors or the securities market in general. The share market operates in a highly volatile environment and the brokers indulge in various unfair and fraudulent trade practices like synchronized share trading, manipulate and fabricate the books of accounts etc. The fraudulent and unfair trade practices of the brokers or market intermediaries are investigated by the investigator appointed by SEBI, and they are given the powers to ask the broker or market intermediary to furnish information on books of accounts, registers, documents etc. which is then scrutinized by the investigator to find out any manipulation, fraudulent practice or otherwise of the broker. Thus, Forensic Accountant can play a lead role in assisting the SEBI investigator, or as independently to unearth share related frauds.

**Prevention of Money Laundering Act, 2002** defines the offence of money laundering as involvement of a person in any process or activity connected with the proceeds of crime and projecting it as untainted property.

The three important stages in the money laundering process are:

- ❖ Placement: Physical disposal of cash acquired from illegal or undisclosed sources by depositing the cash in domestic banks.
- ❖ Layering: Working through complex layers of financial transactions to distance the illicit proceeds from their source and disguise the audit trail.
- ❖ Integration: Making the wealth derived from crime appears legitimate.

Forensic Accountant can often be involved in the following anti money laundering activities:

- Investigating and analysing financial evidence to establish a suspicious transaction;
- Developing computerized applications to assist in the analysis of financial evidence;
- Communicating their findings in the form of reports and collections of documents that assist the banks in submission of the suspicious transaction report to the regulator
- Assisting in legal proceedings and preparing visual aids to support trial evidence.

**The Companies (Auditor's Report) Order, 2003:** CARO, 2003 directs the auditor or the person so concerned to report that if a major portion of fixed assets have been disposed off during the year by any means that results in generation of a revenue. In order to carry out the duties, the auditor has to draw a corollary and reference to the section 293 of Companies Act, 1956, AS 24 ('Discontinuing Operations') and to AAS 16 (Going Concern) and thereafter make his observations on this matter. It also requires the auditor to report on Frauds.

## CONCLUSION

Forensic accounting is a holistic content of financial skills and expertise in all aspects of finance, fraud knowledge, malpractice awareness and a strong understanding of business reality, legalities when it comes to business and corporate finance and the working of the legal system with a flair for investigation. Its development can be achieved usually through on-the-job training as well as getting certified in different levels of forensic accounting. Forensic accountants specialize on detecting fraud and criminal transactions in banks, corporate entities, public sector or from any other organization's financial statements and books of accounts. With an increase in the rate of financial crimes, financial fraud cases, recent stock market scams, failure of non-banking financial corporations, money laundering and even hawala transactions, the number of cases are actually being reported at an abnormal rate and an absence of a proper regulatory mechanism to weed it out from the roots has forced the Government of India to form Serious Fraud Investigation Officer (SFIO) under the Ministry of Corporate Affairs which can be regarded as a positive step from the Government of India to recognize the importance and advance the profession of forensic accountants.

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