



# Forensic Accounting

## 1. Introduction and Background:

The term, Forensic Accounting was coined by Maurice Paulobet in 1946. Worldwide, Sherlock Holmes is considered to be the first forensic accountant. However, in India, Kautilya was the first person to mention the famous forty ways of embezzlement in his book Arthashastra during the ancient times. He was the first economist, who openly recognized the need of the forensic accountants. Similarly, Birbal was the Scholar in the time of King Akbar. He used various tricks to investigate various crimes. Some of his stories give the fraud examiner a brief idea about the Litmus test of investigation.

Now in 21st century, Forensic accounting has come into limelight due to rapid increase in financial frauds and white-collar crimes. Fraud was something the internal or external auditors were supposed to guard against through their periodic audits. Now, the accountants know that auditors can only check for the compliance of a company's books to generally accepted accounting principles, auditing standards, and company policies. Thus, a new category of accounting was needed to detect the fraud in companies that suspected fraudulent transactions. This area of accounting is known as 'forensic accounting'.

### Statistic of scams in India

<b>Scam</b>	<b>Amount</b>
2G Spectrum Scam	Rs. 175000 Crore
Satyam Scam	Rs. 8000 Crore
Stock Exchange (Harshad Mehta)	Rs. 4000 Crore
Stock Exchange (Ketan Parekh)	Rs. 1500 Crore
C. R. Bhansali	Rs. 1200 Crore
Fodder Scam	Rs. 950 Crore

Source : Indian Stream Research Journal

## 2. What is Forensic Accounting?

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. 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

There are two major components of Forensic accounting:

- I. Litigation services- this recognizes the role of an accountant as an expert consultant and provides assistance of an accounting nature in a matter involving existing or pending litigation
- II. Investigative services-this requires use of forensic accountants skill and may require courtroom testimony

### Forensic Accountant

"Auditor should be watchdog and not be the bloodhound". It's a good quote that every auditor should know. This quote makes the definition of Forensic accountants even more simple. The forensic Accountant is a bloodhound of Bookkeeping. These bloodhounds sniff out fraud and criminal transactions in bank, corporate entity or from any other organization's financial records. They hound for the conclusive evidences.

The traits of the forensic Accountants could be compared to well bake Pizza:

Layers/Levels	Pizza	Forensic accountant
The base	Size and extent of baking decide the quality	The base is accounting knowledge.
The middle layer	Spread of cheese in a pizza, either deep layer or thick crust.	It consists of dispersed knowledge of auditing, internal controls, risk assessment and fraud detection
The toppings	Various choice of toppings- Paneer, baby corn, mushroom etc.	A basis understanding of the legal environment to support litigations, personal skills, common business sense etc. More the toppings, finer the Forensic accountant.

A perfect combination of the pizza base, cheese spread and good toppings makes the pizza delicious and Forensic accountant perfect.

### **3. What does a Forensic Accountant do?**

A Forensic Accountant is often retained to analyze, interpret, summarize and present complex financial and business related issues in a manner, which is both understandable and properly supported. He is trained to look beyond numbers and deal with the business realities of the situation.

A Forensic Accountant is often involved in the following:

- Investigating and analyzing financial evidence;
- Developing computerized applications to assist in the analysis and presentation of financial evidence;
- Communicating their findings in the form of reports, exhibits and collections of documents; and
- Assisting in legal proceedings, including testifying in court as an expert witness and preparing visual aids to support trial evidence.

As mentioned earlier a Forensic Accountant can be of assistance in two ways:

#### **Investigative Accounting**

- Review of the factual situation and provision of suggestions regarding possible courses of action.
- Assistance with the protection and recovery of assets.

Co-ordination of other experts, including:

- Private investigators;
  - Forensic document examiners;
  - Consulting engineers.
- Assistance with the recovery of assets by way of civil action or criminal prosecution.

#### **Litigation Support**

- Assistance in obtaining documentation necessary to support or refute a claim.
- Review of the relevant documentation to form an initial assessment of the case and identify areas of loss.
- Assistance with Examination for Discovery including the formulation of questions to be asked regarding the financial evidence.
- Attendance at the Examination for Discovery to review the testimony; assist with understanding the financial issues and to formulate additional questions to be asked.
- Review of the opposing expert's damages report and reporting on both the strengths and weaknesses of the positions taken.
- Assistance with settlement discussions and negotiations.

Attendance at trial to hear the testimony of the opposing expert and to provide assistance with cross-examination.

#### 4. What types of assignments does a Forensic Accountant perform?

Forensic Accountants become involved in a wide range of investigations, spanning many different industries. The practical and in-depth analysis that a Forensic Accountant will bring to a case helps uncover trends that bring to light the relevant issues. Forensic accountants are trained to look beyond numbers and deal with the business like situation.

Forensic accountants are also increasingly playing more 'proactive' risk reduction roles by designing and performing extended procedures as part of the statutory audit, acting as advisors to audit committees, and assisting in investment analyst research.

Detailed below are various areas in which a Forensic Accountant will often become involved.

- I. **Professional negligence:** Forensic accountants also take up cases relating to professional negligence. Whenever there is a breach of generally accepted accounting standards (GAAS) or auditing practices or ethical codes of any profession, forensic accountants are required to quantify the loss resulting from such professional negligence or deficiency in service.
- II. **Detection of fraud by employees:** This often involves procedures to determine the existence, nature and extent of fraud or embezzlement and may concern the identification of a perpetrator. These investigations often entail interviews of personnel who had access to the funds and a detailed review of the documentary evidence.
- III. **Criminal investigation:** Where the matter under investigation involves financial implications, the investigation department, law society, and etc avail of the services of a forensic accountant. The report of an accountant is very much useful in preparing and presenting evidence.
- IV. **Personal Injury Claims / Motor Vehicle Accidents:** A Forensic Accountant is often asked to quantify the economic losses resulting from a motor vehicle accident. A Forensic Accountant needs to be familiar with the legislation in place, which pertains to motor vehicle accidents. Cases of medical malpractice and wrongful dismissal often involve similar issues in calculating the resulting economic damages.
- V. **Business economic losses:** Examples of assignments involving business economic losses include; contract disputes, construction claims, product liability claims, trademark and patent infringements and losses stemming from a breach of a non-competition agreement.

#### **Other areas include:**

- VI. Shareholders' and Partnership Disputes
- VII. Other Types of Insurance Claims
- VIII. Matrimonial Disputes
- IX. Mediation and Arbitration

In the nutshell, the following services can be provided by a forensic accountant: quantifying the impact of lost earnings, such as construction delays, stolen trade secrets, insurance disputes, damage/loss estimates, malpractice claims, employee theft, loss of profits, financial solvency reports, disturbance damages, loss of goodwill, compensable losses suffered in expropriation determination, assessment of the potential business compensation costs, and consultation on business defalcation minimization.

## 5. What is a typical approach to Forensic Accounting assignment?

Each forensic accounting assignment is unique. Accordingly, the actual approach adopted and the procedures performed will be specific to it. However, in general, many Forensic Accounting assignments will include the steps detailed below.

- I. **Meet the client:** To understand the important facts and issues.
- II. **Perform a conflict check:** This should be carried out as soon as relevant parties are established.
- III. **Perform an initial investigation:** prior to detailed plan of action for better planning of the investigation.
- IV. **Develop an action plan:** based on the meeting and investigation and set the objectives to be achieved.
- V. **Obtain the relevant evidence:** depending on the nature of the case- documents, assets, persons, proof of the occurrence of the event.
- VI. **Perform the analysis:** includes regression and sensitivity analysis, calculating economic dangers, perform tracing of assets, use computerized applications etc.
- VII. **Prepare the report:** giving out clear exceptions, scope of assignment, approach, limitations to scope, findings and/or opinions

## 6. Who retains a Forensic accountant?

The following groups often retain forensic Accountants:

Lawyers;  
Police Forces;  
Insurance Companies;  
Government Regulatory Bodies and  
Agencies; Banks;  
Courts; and  
Business Community.

## 7. What characteristics/skills should Forensic Accountant posses?

A forensic accountant is expected to be a specialist in accounting and financial systems. Yet, as companies continue to grow in size and complexity, uncovering fraud requires a forensic accountant to become proficient in an ever-increasing number of professional skills and competencies.

The major skills can be divided in to two:

- I. Core skills (specialized skills and knowledge).
- II. Non-core skills (personal skills).

### I. Core skills:

Ability to critically analyze financial statements. Theses skills help Forensic Accountants to uncover abnormal patterns in accounting information and recognize their source.

Ability to grasp internal control systems of the client and to set up a system that achieves management objectives informs employees of their control responsibility and monitors the quality of program and changes made to them.

Proficiency in Information technology and computer network systems. These skills assist accountants to conduct investigations in the "E-Areas" (E-banking, E-commerce etc) and computerized accounting systems.

Knowledge of psychology in order to understand the thinking and motive behind

criminal behavior and to set up prevention programmes that motivate and encourage employees.

An in-depth understating of the fraud schemes such as misappropriations, money laundering, bribery and corruption.

Thorough insight and knowledge into company's governance policies and laws that regulate these policies.

Interpersonal and communication skills, which aid in acquiring information about the companies ethical policies and assist forensic accountants to conduct interviews and obtain crucially needed information.

Command of criminal and civil laws, legal system and court procedures.

**II. Non-core skills:** includes, but are not limited to

Sound professional judgment.

Look beyond numbers and grasp substance of situation.

A "sixth" sense that can be used to reconstruct details of past accounting transactions is also beneficial.

A photographic memory that helps when trying to visualize and reconstruct these past events.

Curiosity, persistence and creativity.

Pay attention to smallest of detail, observe and listen carefully

Ability to maintain his composure when detailing these events on the witness stand.

In addition to personal characteristics accountants needs other requirement i.e. a professional qualification or a certificate, acknowledging his competence. One can learn forensic accounting by obtaining a diploma given by Association of Certified Fraud Examiners (ACFE) in the US. Indian chapter of ACFE offers the course based on the white-collared crimes prevalent in US, based on their laws. However, there is no formal body that provides formal education of the frauds in India.

## **8. What is the presence of Forensic Accounting in India?**

As mentioned above Indian chapter of Association of Certified Fraud Examiners (ACFE) offers courses in India but they are based on laws prevalent in US. Other than this Indiaforensic is the only formal body that provides formal education about forensic accounting in India. Indiaforensic is however not affiliated to any of the Universities. Indiaforensic offers three types of programs:

- . Certified Forensic Accounting Program - CFAP
- . Certified Bank Forensic Accounting - CBFA
- . Certified Anti-Money Laundering Expert - CAME

In India Serious Fraud Investigation Office (SFIO) is the landmark in creation of Forensic Accountants. SFIO is the dedicated division of the Department of Company affairs, which looks into the frauds that involves the violations of multiple laws such as Income Tax, FEMA and RBI Act etc. SFIO recognize CFE as the designation for the purpose of employment and empanelment.

Other than SFIO there are few more agencies that are dedicated to combating frauds in India such as Central Bureau of Investigation (CBI), Central Vigilance Commission (CVC) . CBI has specialized wing to deal with financial frauds called as Economic offences wing. CVC handles the crucial part of the occupational frauds ie. Corruption. It also helps in resolving the bank fraud cases.

## 9. Why Chartered Accountants should enter in to Forensic Accounting?

Growing cyber crimes, failure of regulators to track the security scams, series of cooperative banks bursting - all are pinpointing the need of forensic accounting, irrespective of whether we understand the need or not. In the Indian context the Forensic Accountants are the most required in the wake of the growing frauds. The law enforcement officers are the experts of analyzing the fingerprints and the Narcotics but what about the digital evidence analysis. Very few know about it.

Maurice E. Peloubet who coined the term Forensic Accountant in 1946 said that the preparation of financial statements has some but not all of the characteristics of forensic accounting. This statement is enough for the chartered accountants in India to foray in this field. It is new child on the block. Both CBI and CID cops do the forensic accounting work.

The growing number of regulator and the administrative agencies will demand the services in the nature of forensic practice. Chartered Accountants are going to find themselves more involved in what is essentially a type of forensic practice. Nearly 40 percent of the top 100 American accounting firms are expanding their forensics and fraud services, according to Accounting Today. If this data is of some sense to Indian scenario then the day is not far away when forensic practice will contribute to the total revenue of the Indian CA firm.

## 10. Conclusion

A large global accounting firm believes the market is sufficiently large to support independent unit devoted strictly to 'forensic' accounting. All of the larger accounting firms, as well as, many medium-sized and boutique firms have recently created forensic accounting departments.

Because forensic accounting is relatively a new area of study, a series of working definitions and sharing of corporate experiences should be undertaken and encouraged to ensure a common understanding. Indeed, there is great future in forensic accounting as a separate "niche" consulting.

While the forensic accounting and auditing practice had commenced in the US as early as 1995, the seed of this specialization has yet to take off in India. Forensic accountants are only dealing with financial implications of the cases entrusted to them and not engaging in auditing exercise. On account of global competition, the accounting profession must convince the marketplace that it has the "best-equipped" professionals to perform such services.

While majority of CAs have excellent analytical skills, they need to acknowledge that 'forensic' services require 'specialised' training as well as real-life 'practical' corporate experience.

Department of Accountancy

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