

FORENSIC ACCOUNTING: A TOOL FOR FINANCIAL FRAUD DETECTION AND PREVENTION

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ABSTRACT

Forensic accounting is basically, an area of accounting which describes how the disputes regarding how frauds and misrepresentations can be identified, analyzed, interpreted and solved. It is not fully investigating for the sources of fraud and misrepresentation, but on how understanding the problem, analyzing it and then if necessary, for any evidence to solve the dispute, then only proper as well as a basic investigation is held. The concept of forensic accounting is a mix of forensics, which is the group of tests and techniques needed to analyze the fraudulent acts and destroyed financial facts of an organization and accounting, which is the process of identifying, measuring and communicating economic information to various people like shareholders, stakeholders, employees etc. The purpose for which forensic accounting is useful depends from situation but in general, it helps in settlement of financial aspects of an organization and restoring the downgraded image and self confidence of the people about the organization. It also helps in well planned corporate governance policy making. The data used in this study is secondary data, which is from various journals, websites and other articles and almost 10 review of literature were reviewed for this purpose. This paper tries to focus on forensic accounting and how it can be made aware among people, which could lead to greater developments worldwide especially India.

KEYWORDS: *Forensic, Accounting, Skills, Forensic Accounting, Fraud, Financial Data, Audit.*

Introduction

Forensic accounting utilizes accounting, auditing and investigative skills to examine the company's financial examination. It provides a base for accounting analysis in courts. The forensic accountants are analyzed to look beyond what is seen i.e. the values mentioned in their financial statements and look through every loopholes and deal with the business reality of a situation. They frequently are involved in fraud related cases. In the history of forensic accounting, worldwide, we consider Sherlock Holmes to be the first forensic accountant. He used this technique to solve cases easily. However, some historic characters in India cannot be ignored for their part of contribution. In India, 'Kautilya' was the first person to mention the famous forty ways of embezzlement in his book 'Arthashastra' during the ancient times. Similarly, 'Birbal' was the scholar in the time of King Akbar. He used various tricks to investigate various types of crimes and thievery that happened in the kingdom and beyond the kingdom for which people came searching for him. In India during 321-184 BC, at least 40 different kinds of embezzlement were recorded and were punishable. In the emerging economic scenario where there is increase in white collar crime and there are a lot of problems faced by law enforcing agencies in uncovering fraud, forensic accounting is an essential tool for uncovering or inquiry of financial crime and the direction of justice, providing decisive information about the facts found related to financial crime. Even though it is a new area, in recent years, banks, insurance companies and even police have increased taking help of forensic accountants.

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Review of Literature

Ozili Peterson K (2015) in his study on the topic "Forensic accounting and fraud – A review of literature and policy implications" found that it was important to know that while forensic accounting is gaining significant research interests among academics, progress in forensic accounting research will continue and will depend on the extent to which fraud perpetrators leave traces. This is because fraud perpetrators leave traces after performing the act.

James A. DiGabriele (2015) in his study on the topic "Topics and Methods in Forensic Accounting Research" found out that Forensic accounting research is a function of the purpose(s) of forensic accounting. Through this study, it was found out that the purpose of forensic accounting research is to equip practitioners to do their job, and not to provide citation for future research than forensic accounting research that matters most as a focus on all domains of forensic accounting.

Bhavish Jugurnath, Roucheet Bissessur, Youvish Ramjattan, Hema Soondrum, Akshay Seedoyal (2017) in their study on "Forensic Accounting And Fraud Investigation: An Empirical Study From Mauritius" found out that forensic accounting must be introduced as a compulsory tool in dealing with financial fraud and corruption in the three stated type of companies to promote corporate governance. The practice and development of forensic accounting are fairly low in existing companies in Mauritius and thus the government should encourage the practice of forensic accounting by providing adequate training and resources to forensic accountants such that they become an expert in their particular field of expertise and develop new courses related to forensic accounting.

Alekya Settipalli (2018) through his study "Forensic Accounting and Fraud" has attempted to contribute to the ongoing dynamic changes in the commercial field of the country by way of addressing the issue of lack of awareness regarding forensic accounting and why it is so important to tackle fraud. The survey helped us know that people are ready to learn more about this area and its related concepts, albeit with the limitation of having to explain the background to most of them. Forensic accounting, without any doubt, is a much-required area and a highly esteemed profession in today's day and age due to the substantial rise in financial crimes and fraudulent activities. Even though the field needs to be explored further in India, the increase in interrelated world scams has set in motion, a paradigm shift in the finance and accounting sector of the country.

Gojko Grubor, Nenad Risti , Nataša Simeunovi (2013) in his study "Integrated Forensic Accounting Investigative Process Model in Digital Environment" found that in order to ensure the benefits of integrated forensic accounting investigative process model, many more financial fraud cases should be investigated and analyzed in the future. According to the authors opinions, both digital forensic analysis and financial accounting in digital environment are quite complex to be investigated by the same person.

Zabihollah Rezaee, Daniel Lo, Michael Ha, Alexis Suen (2016) through their study "Forensic Accounting Education and Practice: Insights from China" found out that demand and interest for forensic accounting practice is expected to continue to increase. They also found that business schools and accounting programs worldwide while contributing in preparing the most ethical and competent future business leaders and accountants, should pay attention to forensic accounting and integrate forensic accounting education into the accounting curriculum.

Asif Mahbub Karim, Md. Mamunur Rashid and Mollah Aminul Islam (2017) through their study "Forensic Accounting Importance And Concepts: Evaluating Its Scope Of Application In Bangladesh" found out that Forensic accounting in Bangladesh is still at its introductory stage with not much professional bodies to practice this form of accounting. They have a long way to go as concerned with maintaining and ensuring transparency of financial statements is concerned. By establishing forensic cells and making people aware of this type, its advantages and uses, a huge population still needs extra and proper allocation of this sector.

Partap Singh, Mr. Joginder Grewal, Mr.Virender Singh (2015) did a study on "Forensic Accounting As A Fraud And Corruption Detection Tool: An Empirical Study" and they found out that concept of forensic accounting is entirely new to them and people were to be made known about the same. It is not only used for fraud identification in some of the leading companies but can be used any type of organization. Through forensic accounting, the risk factor can be reduced, but not fully eliminated.

Ruchita Verma, Ms. Urvi Singh (2017) did a study on "Barriers in the Implementation of Forensic Accounting in India: An Analysis Of Academicians' Perception" and found out that almost half of the professors and academic scholars were aware of forensic accounting. The lack of training to these professionals and various other factors act as a barrier in developing and applying forensic accounting.

CA Kishore S. Peshori (2015) done a study on “Forensic Accounting A Multidimensional Approach To Investigating Frauds And Scams” found out that forensic accounting should be used more as a prevention tool rather than an investigation tool. Forensic auditing must be used in all possible sectors like corporate sector. By using it as preventive tool, many kinds of frauds can be prevented instead of investigating, which leads to wastage of resources and time.

Need & Importance of the Study

In the last few decades, accounting fraud as in manipulation of accounts, destroying documents and making fake documents to avoid tax and various other reasons having been drawing a great attention in the eyes of researchers and practitioners, as it is becoming very frequent and complex. They are considered as one of the most harmful crimes as it affects each and every individual and firm as well as the industry as a whole and since it is believed to be connected to other major white-collar crimes, such as securities offences, organized crime and money laundering.

In this topic, before more is understood about forensic accounting, we will discuss more about accounting frauds. Accounting fraud is defined as the misrepresentation calculated from the financial statement information that is to be publicly disclosed by companies to the members like shareholders, stakeholders, employees etc and to the public. The intention to create fraudulent practices is to mislead the stakeholders and the public who want to invest, regarding the firm's true financial position, by overstating its expectations on assets, or understating subtraction to liabilities; hence the artificial inflation of earnings, as well as its return on equity. Accounting fraud may take the form of either direct manipulation or via creative methods of accounting (Shilit and Perler, 2010).

As ways of implementing fraud in the financial aspects of the organization is changing from day to day and it is a continuously growing industry, the need for forensic accountants is increasing in the future. There is a bright future for fraud investigator because of introduction of globalization, new, innovative technology, and pressure due to competition, on firms to seek higher earnings. According to Joseph Wells (founder of ACFE), 25 percent of the population would commit fraud always, 25 percent never, and the remaining 50 percent could be swayed either way. So, in the next phase to Forensic accounting would be to prevent fraud before it takes place.

Objectives of the Study

- To understand the concept of forensic accounting and forensic audit.
- To analyse the need and importance of forensic accounting in India.
- To understand the tools, techniques of forensic accounting.
- To evaluate the stages in forensic accounting.

Research Methodology

The study is exploratory and analytical in nature, which is based on secondary data. The data for the study were collected from various published source like books, journals, research articles and websites. The main aspects of the study have been discussed in detail with experts, researchers, and other eminent personalities in this field in order to get an insight into the subject.

Analysis & Interpretation

• Concept of Forensic Accounting

- **Forensic:** According to Oxford Dictionary, Forensic refers to the scientific tests or techniques used in connection with detection of crime or fraud. It relates to the application of scientific methods and techniques to investigate a crime, in general. It is through forensics that evidence is compiled and proper findings are arrived at to detect the source of fraud or misrepresentation.
- **Accounting:** According to the American Accounting Association [AAA]; “Accounting refers to the process of identifying, measuring and communicating economic information to permit informed judgments and decisions by users of the information”. Accounting is combination of two elements- accounts and science where account is a statement of events which are measurable only in money terms while science is a disciplined knowledge of a particular matter. Therefore, accounting, in general terms, is the systematic recording of money related transactions of an organization to analyse the financial position and profitability of the same.

- **Forensic Accounting:** By understanding the terms Forensic and Accounting, it is easy to understand the concept of the term Forensic Accounting. Forensic accounting consists of reconstructing the financial information when a complete set of the financial records which are not available or have been destroyed. This can be used to retrieve all the records of a destroyed business, to reconstruct the fraudulent records which were destroyed to avoid it from reaching hands of the government officials and so forth. This career attracts auditors. Those in this field are likely to be found in insurance industry, legal support or may be specialized practitioner in an audit firm. Certain forensic accountants are full time consultants for few businesses.

Bologna and Lindquist (1985) had 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.”

Forensic accounting is defined in detail by Zia (2010) as

“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.” From the perspective of an attorney or a litigator, forensic accounting involves gathering, interpreting, summarizing and presenting complex financial issues in a clear, succinct and factual manner often in a court of law as an expert (Howard and Sheetz, 2006; Stanbury and Paley-Menzies, 2010). Such forensic evidence must meet standards required by courts of law and be presented in a manner that will be accepted by a court of jurisprudence.

Forensic Audit

A forensic audit is an examination and evaluation of a firm's or individual's financial information for use as evidence in court. A forensic audit can be conducted in order to prosecute a party for fraud, embezzlement or other financial claims.

Objectives of Forensic Accounting

As forensic accounting is used to detect not only all sorts of fraudulent activities but recovery of necessary as well as destroyed documents, there are various objectives which have to be achieved. Following are the objectives of Forensic auditing:-

- To use the forensic accountant's conclusions to facilitate a settlement, claim, or jury award by eliminating the financial aspect as an area of continuing debate.
- To avoid fraud and theft
- To restore the downgraded public confidence towards certain countries
- To formulate and establish a comprehensive corporate governance policy
- To create a positive work environment

Need of Forensic Accounting

According to Arnoff, Norman B., and Sue C. Jacobs. (2001) had clarified the administrations rendered by the forensic accountants are in incredible interest in the accompanying territories:

- **Fraud Detection where Employees Commit Fraud**

When the employees submit misrepresented records, the forensic accountant tries to find any benefits made by them out of the assets misapplied, and then take an attempt at questioning them and attempting to discover the concealed truth.

- **Criminal Investigation**

Where the matter in investigation involves financial implications, the services of a forensic accountant are utilized by the investigation department, law society, etc. The report prepared by a forensic accountant comes in handy while preparing and presenting evidence.

- **Outgoing Partner's Settlement**

When the retiring partner feels that he/she has been unjustly settled with, he/she can challenge or ask against the settlement with the help of a forensic accountant, who accurately assesses the value of assets and liabilities due to his/her client.

- **Cases Relating to Professional Negligence**

Forensic accountants are consulted when there is any professional negligence. If suppose, there is breach in any of the Generally Accepted Accounting Standards (GAAS) or any of the principles have been violated etc, forensic accountants quantify the losses resulting from such professional negligence or poor quality service.

- **Arbitration Service**

Forensic accountants render arbitration and act as mediators to the business community, since they undergo special training in the area of alternative dispute resolution.

- **Facilitating Settlement Regarding Motor Vehicle Accident**

As the forensic accountant is very much familiar with complexities of laws his/her services become indispensable in measuring economic loss, when a vehicle meets with an accident. He quantifies the loss incurred in such an accident and helps in recovering for the loss.

- **Settlement of Insurance Claims**

As forensic accountants provide their service to insurance companies, insurance agents will have a good connection with forensic accountants to have a precise evaluation of cases to be settled. Also, policyholders look for the assistance of these accountants when they have to challenge the case settlement as worked out by the insurance agencies.

- **Shareholders' and Partnership Dispute**

These often involve a detailed analysis of numerous years' accounting records to quantify the issues in dispute. For example, a common issue that often arises is the compensation and benefits received by each of the disputing shareholders or partners.

Importance of Forensic Accounting

The primary benefits of quality forensic accountancy include:

- **Minimized Losses**

The primary benefit of a strong forensic accounting is in the ways in which it can help minimise as well as prevent unnecessary loss. Fraudulent activity cost the business organization an unnecessary reason to spend an extraordinary sum of money, every hour of every day. The forensic accountant ensures this is not allowed to happen.

- **Improved Efficiency**

Forensic accountants play a key role in examining and investigating the current processes and financial standards, which can help in the identification of more effective and efficient solutions. The whole process is one of detecting problems and areas of improvement for the benefit of the business.

- **Reduced Exploitation Risk**

By actively mending the gaps in current financial operational standards, the forensic accountant can ensure that risk of future exploitation is significantly reduced and prevented from occurring. It's a case of protecting the best interests of the business *before* fraudulent activity can take place.

- **Avoidance of Legal Problems**

Dealing with instances of fraud (internal or external) can be spectacularly disruptive and costly for the business. In an ideal situation, forensic accountancy can be used to avoid such scenarios from ever occurring by both preventing fraudulent activity and removing any problems detected from the source from where it occurs.

- **Improved Brand Reputation and Authority**

A brand that leaves itself wide open to manipulation and fraud is a brand that is very difficult to respect, trust and work with. Fraud can do all kinds of damage to the reputation that is close to impossibility of repairing. Hence it is important for thorough and ongoing forensic accountancy. Forensic Accountants have come to the spotlight only recently due to rapid increase in frauds and white-collar crimes. There is huge requirement for honesty, fairness and transparency in Indian Corporate reporting. The Institute of Chartered Accountants of India (ICAI) started a course on Forensic accounting for only its members. It is "Certificate Course on Forensic accounting and Fraud Detection using IT and CAATs". At present, very few academic institutions are offering courses (full time or part time) on forensic accounting. Although this is at nascent stage in most of the Indian universities, many college and universities are providing courses on "Forensic Science".

Tools and Techniques of Forensic Accounting

There are different tools and techniques which are used and followed by the forensic accountants, which are as follows:

- **Benchmarking**

It is one of the main tools of forensic accounting. Through this tool, the financial results of one period over another, of one cost centre, or business unit is compared with one another and overall performance of the business is analyzed with its pre determined standards

- **Ratio Analysis**

It is a means of measuring the relationship between two different financial statements of an organization and understanding the financial position of the same. This form of financial statement analysis can be useful in detecting problems which need special attention for the purpose of fraud examination.

- **System Analysis**

It is mainly used to oversee loopholes, if any, in the running of the business. Through this, the accountant will examine the system followed in the organization and identify and tap the weak spots which could be great opportunities for fraudsters.

- **Specialist Software**

It includes software for the purpose of audit like audit tools for data matching analysis.

- **Exception Reporting**

When the Point of Sale (POS) data is fed into this Exception Reporting System, it is compared with the typical daily transactions or regular transactions. Those transactions which when compared, fall out of this range are considered suspicious and looked into it deeply. Exception reporting will allow you to quickly and easily flag up if your actual work has varied from your agreed work schedule.

Stages of Forensic Accounting

The stages in forensic accounting generally consist of investigation and analysis of the data, developing a computerized application, presentation of the findings and assistance of solving the dispute. But there are certain common steps that are followed which are:

- **Meeting the Client:** It is essential to understand the parties involved, the problem between them, the reason, if any mentioned by them and various other facts.
- **Performing a Dispute Check:** It is the second step in stages. In this step, the basis on which the conflict occurred is understood from both the parties and they are heard before heading into a detailed investigation.
- **Performing a Basic Investigation:** After checking the basis of their dispute, the forensic accountant conducts a detailed investigation. In this stage, the accountant formulates a plan of action that the accountant has to follow to complete the assignment to analysis the situation.
- **Developing Strategy:** In this stage, the accountant creates a master plan on the basis of facts that were received from the previous stage, keeping in mind the reason and goal to be achieved.
- **Accumulating Relevant Evidence:** It involves collecting various evidences and locating and connecting those data in connection with the dispute.
- **Analyzing the Evidence:** It includes tasks like calculating damages, tracing assets, summarizing transactions, performing sensitivity analysis, calculating present value of assets as per discount rates, utilizing computer applications and other tools for explanation of the findings, and such others.
- **Preparing the Report:** The findings should be explained in a clear, precise and comprehensive manner as the main goal of forensic accounting is forensic accounting legal support. Therefore, the report needs to provide ample data analysis to support, or refute, the claim in question.

Conclusion

Forensic accounting is an indispensable aspect of the people. Institutions like ICAI and ICWA are providing opportunities to explore new areas like forensic accounting which will make a better change for the future generation. More experienced accountants arise as the number of fraudulent activities and crimes are in the scene. During an investigation these forensic accountants, with their experienced skill spend more time at the corporation, working with the employees of the company, gathering and

analyzing information about the entire structure of the business as well as the financial data that they maintain. Its scope has expanded from being a mere tool for prosecution to a tool for life. It assists in the day to day functioning of the organization by helping in formation of various policies and combat fraud

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