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A B C

of

FORENSIC ACCOUNTING

DR. HEER SHAH SACHPARA

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PREFACE

Forensic accounting is relatively very new branch of accounting and auditing. Forensic accounting focuses on flaws of the standard accounting. Forensic accounting requires special investigative skills in an accounting professional. Forensic accounting could be a well-set fusion of criminology, accounting, law and investigative auditing. Financial scams of last decade like Satyam computers increased its need in accounting profession. As a discipline, it encompasses financial expertise, fraud knowledge, and a powerful knowledge and understanding of business reality and therefore the workings of the system. By the increasing use of forensic accounting, a replacement professional has been incarnated, namely forensic accountant. This study has conducted to grasp the extent of awareness of forensic accounting and its techniques among practitioners and academics. In India the core branch of accounting practitioners is controller. This study comprises public similarly as private sector's practitioners. In the public sector, Accountants, Assistant Account's Officer and Accounts officers are the most key holder of accounting wing where as in the private sector-chartered accountants play a significant role for the preparation of economic information. Whereas the matter of fraud may be a global one, the speed and extent to which it's perpetrated in India, particularly in the public sector, is sort of high and alarming. Literature reveals that different fraud prevention and detection mechanisms are being adopted to combat the menace of fraud; forensic accounting techniques appears to be the foremost effective and are currently utilized in most developed countries of the planet. However, the extent to which forensic accounting techniques are being applied in fraud prevention and detection in India isn't known. Also, the intention to use forensic accounting services in the public service has not been investigated.

This study was therefore geared toward examining the applying of forensic accounting techniques in fraud prevention and detection in India. Specific objectives were: (1) to research the mechanisms of fraud prevention and detection, and their levels of effectiveness in India, (2) to spot the foremost factors that hinder the applying of forensic accounting techniques in fraud prevention and detection in India, (3) to look at practitioners' opinions and behavioral intention to use forensic accounting techniques in fraud prevention and investigation in India, (4) to explore the extent of awareness of forensic accounting techniques in India and (5) to look at the readiness of universities in absorbing forensic accounting courses.

The study involved the gathering of quantitative data. These data were collected from two sets of populations, viz. accounting academics and accounting practitioners. The questionnaire served because the survey instruments. The information collected were analysed using appropriate statistical techniques and computer software. The study identified several fraud prevention and detection mechanisms that are currently employed in India, like systems of internal controls, operational audits and reconciliation statements. Students' t-test indicates a big difference between the perceived effectiveness and actual usage of fraud prevention and detection mechanisms in India. it absolutely was further discovered that the foremost effective mechanisms, just like the forensic accounting techniques, are the smallest amount employed in fraud prevention and detection. This means that the present mechanisms of fraud prevention and detection aren't proactive in managing the fraud menace.

Also, legal, educational and behavioral factors were identified to hinder the appliance of forensic accounting techniques in India. The amount of awareness in forensic accounting in India is usually low but it's quite high among academics. While the Z test analysis of variance indicates a major variation among the two populations, it had been discovered that practitioners had rock bottom level of awareness. Further findings of the study reveal that the colleges are able to take up forensic accounting courses. Using the bivariate correlation, all the opposite six propositions were supported.

Chapter 1 gives an introduction about accounting and its related branches as well as Forensic accounting in India. Chapter 2 shows the picture of forensic accountant and their functions and qualities. Chapter 3 supports role of forensic Accounting and its use in detection of Fraud. Chapter 4 is showing the use of Forensic Accounting in Auditing. Chapter 5 relates Indian Legal System's Response towards Forensic Accounting.

Dr. Heer Shah Sachpara

CONTENTS

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1

INTRODUCTION

A business house must necessarily keep a systematic record of what happens from day to day, so that it can know where it stands and so that it can satisfy the ever increasing curiosity of the income tax officer. If nothing else, most of the business these days is run by Joint Stock companies and these are required by laws to prepare periodical, mostly annual statements in proper forms showing the state of financial affairs.

A systematic record of daily events of a business leading to presentation of a complete financial picture is known as accounting or, in its elementary stages as book keeping. The financial picture mostly has 2 parts, one showing how much profit has been earned or loss suffered, and the other showing assets and liabilities and the proprietor interest in the firm/ company. Even institutions which do not have the earning of profit as an objective must know periodically whether the current income is sufficient to meet the current expenditure. What the financial state of affairs is .In fact, whatever the resources are scarce, it is wise to take stock regularly, monthly, six monthly or annually of what happened and where the institution concern stands. This reckoning must be in terms of money for there is no other common measure. Even Government have to do this and the process everywhere is that of accounting.

A firm or an institution constantly enters into transactions with outsiders. A transaction may be defined as the “actions and reactions having monetary implications of one person or firm in relation to another person or firm or groups of persons or firms. A transaction involves transfer of money or money's worth (goods and services) from one person to another. The transaction may be as spectacular as the ordering of a huge plant or as smallas utilizing the services of a labourer for an hour.

Largely transactions are entered into with outsiders, there are often events requiring a monetary record. One will have to record say the effect of a fire or fall in the prices for which no employee or outsider may be responsible.

Accounting is an ancient art, certainly as old as money itself even though the art must have been rudimentary in the beginning. Chanakya in India clearly indicates in his **"Arthshastra"** the existence and the need of proper accounting and audit.

The Indian system of accounting is as scientific and systematic as the one developed inthe west and is certainly older. However the modern system of accounting as we know it, owes its origin to Pacioli who lived in Italy in the 15^{th} century. Accounting or accountancy is the measurement, processing and communication of financial information about economic entities such as businesses and corporations. The modern field was established by the Italian mathematician Luca Pacioli in 1494. Accounting which has been called the "language of business", measures the results of an organization's economic activities and conveys this information to variety of users including investors, creditors, management and regulators. Practitioners of accounting are known as accountants. The terms "accounting" and "financial reporting are often used as synonyms.

Accounting can be divided into several fields including:

1) **Financial Accounting:** It is the original form of accounting. It is mainly confined to the presentation of financial statements for the use of outsiders like creditors, banks and financial institutions and also by owners. It is the process of identifying, measuring, recording, classifying, summarizing, analyzing, interpreting and communicating the financial transactions and events through financial statements.

2) **Management Accounting:** It is an accounting for the management i.e. accounting which provides necessary information to the top level management for discharging its functions. Management accounting covers various areas such as cost accounting budgetary control, inventory control, statistical methods, internal auditing. The purpose of management accounting is to supply all information that management may need in taking decisions and to evaluate the impact of its decisions and actions.

3) **Cost Accounting:** It is the process of accounting and controlling the cost of a product, operation or function. The purpose of this branch of accounting is to ascertain the cost, to control it and to communicate the information for management decision making.

Accounting information systems are designed to support accounting functions and related activities. Financial accounting focuses on the reporting of an organization's financial information including the preparation of financial statements, to external users of the information such as investors, regulators, and supplier and management accounting focuses on the measurement, analysis and reporting of information for internal use by management. The recording of financial transactions so that summaries of the financials may be presented in financial reports is known as bookkeeping of which double entry bookkeeping is the most common system.

Accounting is facilitated by accounting organization such as standard setters, accounting firms and professional bodies. Financial statements are usually audited by accounting firms and are prepared in accordance with generally accepted accounting principles (GAAP).

GAAP is set by various standard setting organizations such as Financial Accounting standard Board (FASB) in the United States and the Financial Reporting Council in the United Kingdom. As of now, “all major economies” have planned to converge towardsor adopt the International Financial Reporting Standards (IFRS)

The history of accounting is thousands of years old and can be traced to ancient civilizations. The early development of accounting dates back to ancient Mesopotamia and is closely related to developments in writing, counting and money, there is also evidence for early forms of bookkeeping in ancient Iran and early auditing systems by the ancient Egyptians and Babylonians. By the time of the Emperor Augustus the Roman government had access to detailed financial information.

Double entry book keeping developed in medieval Europe and accounting split into financial accounting and management accounting with the development of Joint Stock companies. The first work on a double entry bookkeeping system was published in Italy, by Luca Pacioli. Accounting began to transition into an organized profession in the nineteenth century with local professional bodies in England merging to form the Institute of Chartered Accountants in England and Wales in 1880

Both the accounting and accountancy were in use in Great Britain by the mid 1800s, and are derived from the words accompting and accountantship used in the 18th Century. In Middle English (used roughly between the 12th and late 15th Century) the verb to account had the form accounten, which was derived from the old French word aconter, Which in turn related to the Vulgar Latin word computare meaning “to reckon. The base of computare is putare, which variously meant to prune, to purify to correct an account, hence to count or calculate as well as to think.

The word “accountant” is derived from the French word compter, which is also derived from the Italian and Latin word computare. The word was formerly written in English as “Accomptan”, but in with passage of time the word which was always pronounced by dropping the “p” became gradually changed both in pronunciation and in orthography toits present form.

MEANING OF ACCOUNTING

Accounting is the analysis and interpretation of book-keeping records. It includes not only the maintenance of accounting records but also the preparation of financial and economic information which involves the measurement of transactions and other events relating to the entity. Accounting is the broader concept than the concept of book keeping. It refers to the process of summarizing and analyzing the business transactionsand interpreting the effects of those transactions on the business.

Accounting is defined as "the art of recording, classifying and summarizing in terms of money transactions and events of financial character and interpreting the results thereof." In simple words we can say that -

- accounting is an art…….
- of recording, classifying and summarizing………
- in terms of money……
- transactions and events of financial nature and
- interpreting the results thereof.

Accounting is an art of correctly recording of the day to day business transactions. The writer or book keeper has to use his/her knowledge, intelligence and judgment in recording the business transactions even whatever is level of complications so that anybody can understand them without any difficulty. It is a science of keeping the business records in a regular and most systematic manner so as to know the business results with minimum trouble. Therefore, it is said to be statistical procedure for the collection, classification and summarization of financial information.

"Accounting is a means of collecting, summarizing, analyzing and reporting in monetary terms, information about the business."

Now a day's accounting is regarded as a "service activity". In 1970 the Accounting Principles Board of the American Institute of Certified Public Accountants enumerated that, "The function of accounting is to provide quantitative information, primarily of financial nature, about economic entities that is needed to be useful in making economic decisions."

BASIS OF ACCOUNTING SYSTEMS

(A) **Cash or receipt basis;** Is the method of recording transactions under which revenues and costs and assets and liabilities are reflected in accounts in the period in which actual receipt or actual payments are made? "Receipt and payments account" in case of clubs, societies, hospitals etc., is the example of cash basis of accounting.

(B) **Accrual or mercantile basis:** Is the method of recording transaction by which revenues, costs, assets and liabilities are reflected in accounts in the period in which they accrue. This basis includes considerations relating to outstanding; prepaid, accrued due and received in advance.

(C) **Hybrid or mixed basis:** Is the combination of both the basis i.e. cash as well as mercantile basis. Incomes are recorded on cash basis but expenses are recorded on mercantile basis.

DEFINITION OF ACCOUNTING

Technical definitions of accounting have been published by different accounting bodies. The American Institute of Certified Public Accountants (AICPA) defines accounting as:

“ the art of recording, classifying and summarizing in a significant manner and in terms of money, transactions and events which are, in part of least of financial character, and interpreting the results thereof.

1) **Accounting is considered an art:- Accounting is considered an art because it requires the use of skills and creative judgme**nt. One has to be trained in this discipline to be able to perform accounting functions well. Accounting is also considered a science because it is body of knowledge. However, accounting is not an exact science since the rules and principles are constantly changing

2) **Accounting involves interconnected Phases:** Recording pertains to writing down or keeping records of business transactions. Classifying involves grouping similar items that have been recorded. Once they are classified, information is summarized into reports which we call financial statements.

3) **Concerned with transactions and events having financial character:** For example, hiring an additional employee is qualitative information with no financial character. Hence it is not recorded. However, the payment of salaries, acquisition of an office building, sale of goods etc are recorded because they involve financial value.

4) **Business transactions are expressed in terms of money:** They are assigned amounts when processed in an accounting system. Using one of the examples above, it is not enough to record that the company paid salaries for April. It must include monetary fingers- say for example, Rs 20,000/- salaries expense.

5) **Interpreting the results:** Interpreting results is part of the phases of accounting. Information is useless if they cannot be interpreted and understood. The amounts, figures, and other data in the financial reports have meanings that are useful to the users. By studying the definition alone, we learned some important concepts in accounting. It also gave us an idea of what accountant do.

NATURE OF ACCOUNTING

What is ‘Accounting’?

Accounting is the systematic and comprehensive recording of financial transactions pertaining to a business, and it also refers to the process of summarizing, analyzing and reporting these transactions to outside agencies and tax collection entities. Accounting is one of the key functions for almost any business; it may be handled by a bookkeeper and accountant at small firms or by sizable finance departments with dozens of employees at large companies.

The reports generated by various streams of accounting, such as cost accounting and management accounting, are invaluable in helping management make informed business decisions. While basic accounting functions can be handled by a bookkeeper, advanced accounting is typically handled by qualified accountants who possess designations such as Certified Public Accountant (CPA) in the United States, or Chartered Accountant (CA), Certified General Accountant (CGA) or Certified Management Accountant (CMA) in Canada.

Creating Financial Statements

The financial statements that summarize a large company's operations, financial position and cash flows over a particular period are concise statements based on thousands of financial transactions. As a result, all accounting designations are the culmination of years of study and rigorous examinations combined with a minimum number of years of practical accounting experience.

Generally Accepted Accounting Principles

In most cases, accountants use generally accepted accounting principles (GAAP) when preparing financial statements. GAAP is a set of standards related to balance sheet identification, outstanding share measurements and other accounting issues, and its standards are based on double-entry accounting, a method which enters each expense or incoming revenue in two places on a company's balance sheet.

Example of Double Entry Accounting

To illustrate double-entry accounting, imagine a business issues an invoice to one of its clients. An accountant using the double-entry method enters a debit under the accounts receivables column in Balance Sheet as Debtors and a credit under the Profit and loss account as Sales. When the client pays the invoice, the accountant Credit debits accounts receivables and Debits the Bank/Cash in Balance sheet. Double-entry accounting is also called balancing the books, as all of the accounting entries are balanced against each other. If the entries aren't balanced, the accountant knows there must be a mistake somewhere in the ledger.

Financial Accounting versus Management Accounting

Financial accounting refers to the processes accountants use to generate the annual accounting statements of a firm. Management accounting uses much of the same processes but utilizes information in different ways. Namely, in management accounting, an accountant generates monthly or quarterly reports that a business's management team can use to make decisions about how the business operates.

Financial Accounting versus Cost Accounting

Just as management accounting helps businesses make decisions about management, cost accounting helps businesses make decisions about costing. Essentially, cost accounting considers all of the costs related to producing a product. Analysts, managers, business owners and accountants use this information to determine what their products should cost. In cost accounting, money is cast as an economic factor in production, whereas in financial accounting, money is considered to be a measure of a company's economic performance.

IMPORTANCE OF ACCOUNTING

Accounting is the language of Business, where in all the dealings of business are reported and understood by the users. Accounting provides information about the position and performance of a business. Accounting helps in the preparation of the financial statement in the form of Profit and Loss and Balance sheet which further assist in the provision of the information about the financial health of an entity and about how it has performed financially over a given period of time. The correct and accurate preparation and presentation of Accounting data is of utmost importance. Various groups make use of the final accounting data in the form of financial statement for taking decisions. The following points bring out the importance of Accounting

- Present and potential investors in the company will consider their investment decision on the basis of information about profitability and ability to generate cash to pay dividends, and also about the risks in the investment. Financial statements should help the investors to assess both the cash generating capabilities of the company and also its ability to respond to risks and change inthe form of financial adaptability.
- Lenders to a company will be interested in any information that helps them to assess whether the company will have the ability to meet its obligations to pay interest and repay the loan principal on time. Potential lenders need similar information to decide whether to lend to the company and if so how and on what terms.
- Suppliers to the company and other trade creditors need to know how reliable the company will be in paying its debts and how much credit safely be given.
- Employees want information about the financial stability and profitability of their employer, particularly in the part of the company’s business where they work. Their decision to remain with the company will depend to a larger extent on the ability of the company to continue to offer them secure and well paid employment. They will also be interested in how much the company is earning in order to reach a view on what remuneration level should be
- Customers are interested in financial performance and position of company in order to decide to continue buying from it where the customers relies in long term warranty or expects to purchase replacement parts from the company over a long period it will want reassurance that the company in financially stable with good long term future prospects.
- The Government and it agencies can often obtain information it needs from a company for special purpose reports for example the tax authorities are provided

with specially prepared information about the company trading and profit to determine how much tax is payable. A comparison with general purpose financial statements can help the tax authorities to assess whether the tax amount seems consistent with published information.

- It helps the members of the general public as they might use the financial statements of a company to assess the trends and recent developments in its business and implication these might have in the future.

Any analysis of the accounting information should be set in the context of the particular user and their requirements for example lenders are interested in the ability of company to repay them they have little interest in the operational details, such as time taken for a debtor to clear its dues or the profitability of certain product line. This information is however of interest to management.

Accounting does have limitations in the form of backward looking reporting events that have already happened and does not assess what might happen in the future. It is usually based on historic costs which report items such as non-current at their original cost which may be different from their current market value.

The integration of accounting, auditing and investigative skills yields the specialty known as Forensic Accounting."Forensic accounting" provides an accounting analysis that is suitable to the court which will form the basis for discussion, debate and ultimately dispute resolution. Forensic Accounting encompasses both Litigation Support and Investigative Accounting. As Forensic Accountants, they utilize accounting, auditing and investigative skills when conducting an investigation. Forensic Accountants are trained to look beyond the numbers and deal with the business reality of the situation. 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'

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.

Forensic accounting is still at its infancy and the concept is new and yet to be explored by the professionals. This has made the study more relevant from the point of contribution it is going to make to society and will remain a deterrent to the financial frauds which are being committed without any detection. The topic will gainits importance in the years to come when the automation and information technology will enter in all parts of our life.

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 USas 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 themand 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.

INTRODUCTION TO FORENSIC ACCOUNTING

A lot is written about forensic accounting in the literature in Western countries. However, there was no specific definition of the word forensic accounting before 2003. Kasum,

A.S. University of llorin, llorin, Nigeria made the first reference to the research paper written by CA Mayur Joshi in year 2009 in his widely recognized research. Kasum gives the credit to Indian forensic accountant Mr Mayur Joshi in his research papers for defining the forensic accounting in India.

Forensic accounting is a complicated term. There are number of misconceptions about the term forensic accounting. Literal meaning of this term is analysis of the evidence of the financial statements before the court of laws. When the forensic accounting was coined in 1940 by American professionals it consisted of

- Accounting
- Auditing
- Investigative skill sets

This definition was challenged by Mayur Joshi in the year 2003 and he made an argument that Auditing is an extended skill of accounting and the definition in 1940's missed out the role of technology. In 1940s the technology was in nascent stage, hence there was no question of adding it as the skill set. Mayur changed the definition and re-defined the term which now consist of

- Accounting
- Investigative mind set
- Technology Understanding

Forensic Accounting has taken many great leaps of growth in recent history. The Accounting industry has gradually called for more and more Forensic Accountants. It is predicted that growth of the industry, based on the number of jobs reached 6.7% for the years between 2013 and 2018. The revenue the industry brings in is also steadily increasing as time goes on. Like any other job, Forensic Accounting has evolved with time. The industry has been affected by changes in technology, society and the economy. As one aspect of world changes so has the job of a Forensic Accountant. Continuing education is only one way in which Forensic Accountants learn how to adjust to new challenges. The profession has been around since the early 1990's and has greatly altered the way fraud is discovered and handled since then.

Forensic accounting is a rapidly growing area of accounting concerned with the detection and prevention of financial fraud and white-collar criminal activities. George A. Manning in his book "Financial Investigation and Forensic Accounting" defines Forensic Accounting as the science of gathering and presenting financial information in a form that will be accepted by a court of jurisprudence against perpetrators of economic crimes. The integration of accounting, auditing, and investigative skills yields the specialty known as Forensic Accounting which focuses very closely on detecting or preventing accounting fraud. "Forensic", according to the Webster's Dictionary means, "Belonging to, used in or suitable to courts of judicature or to public discussion and debate."The word accounting is defined as "a system of recording and summarizing business and financial transactions and analyzing, verifying, and recording the results." The term forensic accounting' refers to financial fraud investigation which includes the analysis of accounting records to prove or disprove financial fraud and serving as an expert witness in Court to prove or disprove the same. Thus, basically, the forensic accounting is the use of accounting for legal purposes**.** Forensic accounting is very important tool to detect, investigate and prevent the frauds whether it is stock market fraud or bank fraud or cyber fraud, forensic accounting has become an indispensable tool for investigation. With India being ranked as the 88th most corrupt nation, the need for forensic accountants becomesall the more profound.

MEANING AND DEFINITION OF FORENSIC ACCOUNTING

The word forensic is derived from the Latin adjective, forensic which refers to one who is in the public square. In ancient Rome, forum or square was the place where various commercial and state affairs, debates and often trails were performed. The person, who would have been accused of a crime, had to appear in front of a group of individuals inthe forum and together with the person who had accused him, answer to the questions about the allegations.

For more precise definition of Forensic Accounting, many authors provide their interpretations, thus in the literature, various definitions of this term could be found. The authors Bologna and Lindquist define forensic accounting as a general term used to describe any financial investigation that could result in the judicial proceedings. Williams states that forensic accounting represents a certain type of professional expertise, which is supported by features that can be clearly identified as rationality, objectivity and independence. The aforementioned author states that forensic accountants have particular social recognition, which is crucial to the economic issues and its translation into trust T. Singleton and Singleton A. believe that the term “forensic” in accounting refers to therelation and implementation of financial items in legal problems, therefore the evidence in forensic accounting in related to the court. Over time , the court proceedings began toapply knowledge from other scientific fields, so today forensic has become an interdisciplinary field using different scientific achievements and knowledge, with the aim of assisting in delivering unbiased, substantiated and fact-based court judgments.

Considering the variety of services provided by forensic accounting, different authors use a wide range of activities that forensic accountants conduct in order to examine the financial, but also non-financial information for the clarification of disputed facts. Kahan, Manning and Wells state that forensic accountants by using financial information, can understand, interpret and distinguish the important from the insignificant as well as can reconstruct, identify, preserve, report and testify financial information, obtained in the process of investigating fraud in court. Forensic accountants often analyze financial statements through various indicators such as financial ratios, horizontal and vertical analysis of financial statements, data mining techniques like Benford’s Law and many others. The Member of the AICPA and professor, Dahli Gray, indicates that forensic accountants provide services in civil proceedings in respect of different situations, including commercial procurement, valuation of marital property in divorce proceedings compensations claims, lost profits due to fraud and other illegal acts, degradation of taxes and money laundering techniques.. Wells believes that investigation skills and research mentality should also adorn the forensic accountant, but many years of experience working on complex fraud cases in law implementation provide priceless knowledge and experience.

Although forensic accounting involves performing a wide range of activities, in general, it can be divided into two broad areas. Investigative accounting and Judicial support. As part of the investigative accounting there may appear Financial Crime examination and Independent forensic audit while judicial support refers to consulting services, expertise and other services.

Criminal activities represent an attack on basic social values and goods. Economic criminality as a specific type of criminal act, has all characteristics of criminality and can be seen as a concrete criminal occurrence, which took place in the past, while its detection and proving come later, through reconstruction based on indications and evidence. The increase in crime is one of the basic social disorders, which manifests in the crisis of the legal system and morality and represents a significant economic burden to the society The global report of the Association of Certified Fraud Examiners (ACFE), which includes the analysis of 1,483 occupational fraud cases in more than 100 countries, according to the respondents, estimates that a typical legal entity loses 5% of its revenue each year due to criminal acts committed in the organization Misappropriation of assets occurs in 85% of cases, with a median loss of 130,000 dollars. In contrast, only 9% of the cases related to fraud in the financial statements, although these cases, according to the survey, have the greatest financial impact, with an average loss of 1,000,000 dollars. Although external audits were conducted in many organizations, they proved to be the least effective method of control against fraud. External audit detected the fraud only in 3% of cases, compared with 7% of cases which were detected incidentally. Thus, although the independent audit plays a vital role in organizational management, the results suggest that it should not be seen as a primary mechanism for detecting fraud in financial reporting. Furthermore, with the increasing number of laws and regulations, their frequent changes, together with the increase in the complexity of criminal activity in legal entities, there is a need for further development of forensic accounting and forensic auditing. The ACFE as an international organization offers people interested in the field of forensic accounting, various programs and training, such as the certification for Certified Fraud Examiner - CFE, while the AICPA offers the certification for Certified in Financial Forensics – CFF intended for the Certified Public Accountants specialized for forensic accounting. Regarding the countries in our region, in the Republic of Serbia, in 2012 there was introduced a new professional title of Certified Forensic Accountant, while in the Republic of Croatia this title was introduced in 2009. Unfortunately, so far, in the Republic of Serbia, in 2011 there was introduced only a course of forensic accounting in financial investigations for prosecutors, organized by the Organization for Economic Co-operation and Development (OEEC) in Serbia and the Ministry of Justice of the United States. This course was aimed to improve the work of the Prosecutor’s Office, through the analysis of financial data, as well as gathering information on money laundering, corruption or other criminal acts of economic crime.

PILLARS OF FORENSIC ACCOUNTING

There are two big pillars of forensic accounting. These are;

1. **Litigation Support:** It provides assistance of an accounting nature in a matter involving existing or pending litigation. It deals primarily with issues related to the quantification of economic damage. A typical litigation support assignment would be calculating the economic loss resulting from a breach of contract.

2. **Investigative Accounting:** It is often associated with investigations of financial frauds. A typical investigative accounting assignment would be an investigation of occupational fraud. Other examples include securities fraud, insurance fraud, kickbacks. By and large the litigation support is the area of interest for the students of law but dealing with the financial frauds falls in the purview of any management student who understands finances. Hence the focus of this study is more on the investigation side than the litigation support. Fraud is a taboo subject which brings jitters to the management. Especially if the company is listed then the management personnel visualize losing jobs, falling share prices, downgrading by brokerage houses and complete fiasco. Hence understanding the impact of corporate frauds, and potential losses associated with fraud and establishing effective loss control measures are critical for companies from cost, cultural, and risk management perspective.

SCOPE OF FORENSIC ACCOUNTING

A large part of forensic accounting work relates to fraud detection and fraud investigation. Forensic accountants are asked to take up assignments related to disputes, financial crimes, corrupt practices, business leakages and siphoning of funds, whistleblowers complaints of any kind and the many other situations where any wrongdoing is suspected. Forensic accountants can be appointed by corporate management, third parties affected in any situation, bankers, or even under the law or by government agencies. In the last decade, some of the really intensive users of forensic accountants are the police, ED, Reserve Bank of India, tax authorities and large public sector corporations. A recent trend is emerging where in individual court room cases even judges appoint forensic accountants for their own evaluation of disputes.

Does forensic accounting relate only to financial Fraud?

Generally speaking, the answer is yes. However, it would be incorrect to say that forensic accountants are not approached to investigate non-financial crimes. For example in apublic listed company there was a lady employee who got an obscene letter placed on her desk. She threatened to complain to the police. However, the ethics counselor stepped in and assured the lady that the company would look into this matter seriously and investigate and apprehend the culprit. They requested her to hold on till they completedan internal investigation. She relented and the ethics counselor approached a professional forensic accountant and he did a remarkable job. The forensic accountant used his team which had comprehensive skill sets to perform computer forensics interviewingtechniques and handwriting evaluation to nail the culprit. The aggrieved lady was satisfied and the company management was saved by the astute forensic accounting work. Similarly, forensic accountants may even be used for marital disputes to understand what kind of assets and finances are held by the opposite spouse and to facilitate a fairer settlement. However non-financial cases are few in number.

FORENSIC ACCOUNTING BEGINNINGS

The term "forensic accounting" was first used in 1946 by Maurice E. Peloubet, a partnerin a New York accounting firm. He wrote about the use of accounting in courtroom proceedings as part of testimony, but acknowledged that investigation was becoming more prevalent for accountants due to the increase in government agencies that regulated financial practices. Journals began to publish articles about the connections between law and accounting. In 1953, a New York lawyer named Max Lourie claimed that he invented the phrase "forensic accounting," although Peloubet wrote about it first. Lourie stressed the need for forensic accounting literature and training. Forensic accounting service has been the growth industry in the 1990s. Called the private eyes of the corporate culture, forensic accountants must have an investigative mentality. A normal accountant acts likea watchdog, but a forensic accountant must be trained to act like a bloodhound. Theylook behind the facade and do not accept financial records at their face value.

"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. “Forensic accounting” is the practice of utilizing accounting, auditing, and investigative skills to assist in legal matters. Forensic accounting is the specialty practice area of accountancy that describes engagements that result from actual or anticipated disputes or litigation. Forensic accounting is the application of accounting principles, theories, and disciplines to facts or hypotheses at issue in a legal dispute, and encompasses every branch of accounting knowledge. There are two major aspects within forensic accounting practice -

1. Litigation support services that represent the factual presentation of economic issues related to existing or pending litigation. In this capacity, the forensic accounting professional quantifies damages sustained by parties involved in legal disputes and can assist in resolving disputes, even before they reach the courtroom. If a dispute reaches the courtroom, the forensic accountant may testify as an expert witness.
2. Investigative services that make use of the forensic accountant’s skills, which may or may not lead to courtroom testimony. It is the act of determining whether criminal matters such as employee theft, securities fraud (including falsification of financial statements), identity theft, and insurance fraud have occurred. As part of the forensic accountant’s work, he or she may recommend actions that can be taken to minimize future risk of loss. Investigation may also occur in civil matters. For example, the forensic accountant may search for hidden assets in divorce cases. An important criterionis the ability to respond immediately and to communicate financial information clearly and concisely in a courtroom setting. A forensic accountant must be open to examining all alternatives, scrutinising the fine details and at the same time seeing the big picture. Forensic accounting can involve the application of special skills in accounting, auditing, finance,

quantitative methods, certain areas of the law and research, and investigative skills to collect, analyze, and evaluate evidential matter and to interpret and communicate findings.

APPLICATION OF PRINCIPLES OF FORENSIC ACCOUNTING TO AN ORGANISATION

One premise of forensic accounting is to look for indications of abnormal occurrences in the accounting and financial reporting systems. Having a forensic accounting orientation to designing the accounting processes will provide an opportunity to design in steps for verification of key assumptions and data while also providing the opportunity for identifying possible fraud. The related area of forensic auditing can help in reducing the transaction processing risk by helping to perform audit type procedures on a routine schedule. Timely performance of audit type procedures can help management and internal audit function be more effective by helping to identify and resolve potential internal control breakdowns quickly and thoroughly. It can reduce external audit costs by regularly completing testing procedures that are part of the annual certified audit. In instances where information processing systems cover a broad array of businesses and/or locations establishing routine or continuous monitoring of all transaction processing systems, it can be considered as a type of forensic accounting. Some of the areas that the principles and activities of forensic accounting can apply in an organization include:

- Reviewing operational transactions for compliance with standard operating procedures and approvals.
- Completing analysis of financial disbursement transactions in the accounting system to determine if they are normal or outside company policy and, thus, possibly fraudulent.
- Reviewing general ledger and financial reporting system transactions for possible improper classification or manipulation of data or accounts and its impact on the resulting financial reports.
- Examining warranty claims or returns for patterns of fraud or abuse.
- Helping estimate the economic damages and the resulting insurance claims that stem from calamities such as fires or other natural disasters.
- Evaluating or confirming business valuation in mergers and acquisitions.

PROCESS OF FORENSIC ACCOUNTING

The conventional accounting and auditing with the help of different accounting tools like ratio technique, cash flow technique, a standard statistical tool examination of evidencesis all part of forensic accounting. In cases involving significant amounts of data, the present-day forensic accountant has technology available to obtain or source data, sortand analyse data and even quantify and stratify results through computer audit and various other techniques. Some of the techniques involved in Forensic Accounting to examine the frauds are:

(1) **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 scrutiny. The law states that fabricated figures (as indicator of fraud) possess 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 measure 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 is68% (almost 2/3rd) chance of no error or fraud. The first digit may not always be the only relevant field. Benford has given separate sets for 2nd, 3rd and for last digit, as well. 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.

(2) **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. In practice, there exist certainlimits (e.g. financial) for each entity such as vendor, customer, employee, etc. These limits may be defined or analysed 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 investigate further into it. It helps in better detection 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 find the relationship, thus establishing the truth.

(3) **Computer Assisted Auditing Tools (CAATs):** CAATs are computer programs that the auditor uses as part of the audit procedures to process data of audit significance 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) identifying 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.

(4) **Data Mining Techniques:** It is a set of assisted 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 modelling 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 explains various affinities, association, trends and variations in the form of conditional logic. In predictive modelling, patterns discovered from the database are used to predict 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 suspicious pattern. It mostly uses deterministic graphical techniques, Bayesian probabilistic casual networks. This method involves "pattern matching" algorithm to 'extract' any rare or suspicious cases.

(5) **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. Three commonly employed 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 studies relationships between specified costs and some measure of production, such as units sold, dollars of sales or direct labor hours. 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.

STEPS IN PERFORMING FORENSIC ACCOUNTING

The broad steps in forensic accounting are 1) Establishing a clear mandate outlining specific objectives and deliverables 2) Data and evidence collection 3) Data analysis and 4) Evaluation of all data and evidence collected and finally 5) Reporting

Forensic accounting and fraud investigation have been gaining more and more importance particularly after the commencement of Companies Act, 2013. Opportunities for Chartered Accountants are plenty and appear to be increasing every day. It would be well worth the effort of Chartered Accountants to learn and implement forensic type techniques. They will be useful in regular audits in any case and further enhance their areas of practice in the foreseeable future.

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.

(a) **Meet the client:** To understand the important facts and issues.

(b) **Perform a conflict check:** This should be carried out as soon as relevant parties areestablished.

(c) **Perform an initial investigation:** prior to detailed plan of action for better planningof the investigation.

(d) **Develop an action plan:** based on the meeting and investigation and set the objectives to be achieved.

(e) **Obtain the relevant evidence:** depending on the nature of the case documents, assets,persons, proof of the occurrence of the event.

(f) **Perform the analysis:** includes regression and sensitivity analysis, calculating economic dangers, perform tracing of assets, use computerized applications etc.

(g) **Prepare the report:** giving out clear exceptions, scope of assignment, approach,limitations to scope, findings and/or opinions

WHAT EXACTLY IS FORENSIC ACCOUNTING OR FORENSIC AUDIT? HOW DOES IT DIFFER FROM AN AUDIT?

A very simple description of forensic accounting is the use of accounting, auditing and investigative skills to analyze financial information for use in legal proceedings. Theword is "Forensic" means" suitable for use in a court of law". Forensic accountant also referred to as forensic auditors or investigative auditor; often have to give expert evidence at the eventual trial. There are many differences between an audit and forensic audit. The most important difference between the two can be described as follows.

An auditor usually relies on documentary evidence for expressing an opinion. While Forensic auditor examines the reliability of the documentary evidence for making an assertion or a statement in a court of law. The forensic accountant has much greater responsibility and his report may have far reaching ramifications in a court of law. Forensic audit is specific to an issue and more often than not its' genesis is a dispute andits objectives and deliverables are unique in each situation. The forensic accountant usually visualizes what kind of deliverables would be possible and there is some degree of flexibility in this aspect. However, an audit usually does not stem from any dispute and objectives and disclosures of audits mandated under the Companies Act, 2013 or the Income Tax Act, 1961 etc are defined in the relevant Acts.

The concept of forensic audit can be best understood through a real-life case, thechairman of a bank was worried. A borrower had failed to repay a huge loan of Rs 70crores. The bank had 2 options. One option was to take legal recourse and commence recovery proceedings. The second option was to agree to the borrower's request to fund a further 8 crores to revive his business. The borrower claimed the recessionary conditionswhich had caused his losses, had receded and now he had some big export orders onhand. Therefore he had a good chance to turn the corner and he expected to repay theloan to the bank in 4 years. Should the bank take the first option? If so it was certain thatthe legal battle would drag on for years and the chances of recovery , in the foreseeablefuture were slim. On the other hand, in option two, the bank would be able to get the money back in 4 years. But the question was “is the borrower taking the bank for a ride? Was the past loss purely due to recessionary conditions and not due to mismanagement or siphoning of funds? The borrower had indeed provided audited statements of his company for the past few years. However, the information given in the audited financial statement and the auditor’s report did not spell out the reasons for the business loss. Thefinancial information was not sufficient for the bank to ascertain whether there couldhave been any malpractice or abuse or misuse of assets or funds. This was a situation where the bank wanted information which was more specific, to enable it to decide whichof the two options stated above to be selected. Essentially the bank wanted to know whether the borrower was a genuine victim of recessionary business conditions or not.The bank had to rule out the probability that the borrower was a manipulative, conniving or deceptive borrower who had hoodwinked the bank in the past. The bank chairman was advised to get a forensic audit conducted to get answers to all these questions. The bank thus appointed a forensic accountant who was able to find a lot of information whichprovided valuable insights for the bank to take the right decision. The forensic auditreport, on the one hand, prevented the bank from losing a further sum of 8 crores peroption two. On the other hand, the report facilitated the bank to go in for option one ofrecovery and legal proceedings including the police compliant for criminal actions of fraud and falsification of documents.

What did the forensic auditor find out that the other officials of the bank, the auditor, the internal auditor, the tax auditor and others in corporate governance were unable to find? The forensic auditor found that the borrower had been transferring funds to satelliteentities, having his family concerns. Personal expenses and expenses of those satellite companies had been debited to the borrower’s company to show losses. Moreover the forensic auditor did some field investigation which revealed that the borrower used to take a lot of income in cash, thereby showing lesser sales. The combined effect of allthese methods was that the borrower had been able to siphon out huge funds from those loaned by bank and palm off such transfers as expenses resulting into losses. The processof collection of specific information and evidence which the bank could use for decision making and also for the court proceedings is what is forensic auditing all about. The terms forensic accounting and forensic audit mean the same and are often used interchangeably.

FORENSIC ACCOUNTING IN ABROAD

Forensic Accounting can be described as the use of auditing and investigative skills to examine financial statements in preparation to be used in a court of law. However, thereare many avenues and variations of the job that can be utilized that do not necessarily coordinate with that description. A Forensic Accountant can be hired to do everything from settle divorce disputes to uncovering fraud in large corporations. The amplified awareness and importance of catching and preventing fraud has begun a steady increase in the demand for Forensic Accountants. However, fraud is not the only reason the industry has changed since its inception. Forensic Accounting has taken many great leaps of growth in recent history. The Accounting industry has gradually called for more and more Forensic Accountants. It is predicted that growth of the industry, based on the amount of jobs, will reach 6.7% for the years between 2013 and 2018. The revenue the industry brings in is also steadily increasing as time goes on. In 2013 the industry brought in $4.5 billion and is expected to bring in $6.3 billion by 2018 (Chiang, 2013). Like any other job, Forensic Accounting has evolved with time. The industry has been affected by changes in technology, society, and the economy. As one aspect of the world changes so has the job of a Forensic Accountant. Continuing education is only one way in which Forensic Accountants learn how to adjust to new challenges. The profession has been around since the early 1900's and has greatly altered the way fraud is discovered and handled since then. In the 1990's the FBI announced that white-collar crime made up only 5% of all cases they saw. They also noted that white-collar crime was responsible for 95% of the financial losses suffered by victims (Manning, 2005). Forensic Accountants are used to mitigate these losses and recover them if possible.

Forensic Accounting in Action

One of the most well known cases of Forensic Accountancy is the capture of Al Capone. A team of Forensic Accountants gathered information in an irrefutable case against Capone in 1931 (Buckstein, n.d.). He captured their attention by failing to claim all of his "earnings" on his taxes. This income was from embezzlement, gambling, prostitution, and many other illegal activities. It is obvious why he would not want to declare this money on his taxes. The biggest irony of Capone's life was that of all of his illegal activities the one that finally put a stop to him was tax evasion. As horrible as his other crimes may have been the fact that he was stopped was all that mattered. Forensic Accountant's lay claim to that glory, though, Accountants have been used as expert witnesses in court cases since the case of *Meyer v Sefton* in 1817. The case is the first known instance in which an accountant was used as an expert witness in a court of law. This instance was how the profession Forensic Accounting began however it did not become well known or in high demand until much later. The same techniques and goals were used before but it was not a defined profession until this time. Forensic Accountants use techniques that have been referenced since the 18th century in Scotland (Tucker, 2011). The name Forensic Accounting wasn't even coined until 1946 implying that this specialty career path was not especially common. Even the first Forensic Accounting book did not come out until 1982 ("Introduction to Forensic," 2011). The popularity and need for the services Forensic Accountants provide has steadily and more rapidly grown in the past few decades. In the 1960's the FBI employed over 700 Special Agent Accountants. They have maintained a similar level of employment in their Financial Crimes Section to this day. They investigate cases of financial fraud, crimes over the Internet, money laundering, and many other economic crimes. Six weeks of intense training are required before anyone starts their job with the FBI Financial Crimes team.As most Forensic Accountants must, they testify to any findings in court on a regular basis and are often broken up into investigation and litigation support. However, the two go hand in hand. In the early 2000's the infamous Enron scandal took the accounting world by storm. Enron borrowed money in order to maintain their rate of growth, which had skyrocketed very quickly in 1999 and 2000. They hid debt from their books and investors by partnering with fake companies such as Chewco, named after the Star Wars character Chewbacca. They offered secret information about the company in order to get bigger investors interested. Skepticism about how Enron was making their money began to emerge in the news. In late 2001, the SEC began to investigate Enron's partnershipsand it soon became apparent they owed over $6 billion in debt.

The Reason for Need of Forensic Accountants

The more financial misrepresentation that were uncovered in the scandal the more pressure was put on accountants to prevent it. Sarbanes-Oxley of 2002 put major requirements on accountants but it also put pressure on Forensic Accountants to make sure the requirements get carried out correctly. Sarbanes-Oxley opened up a whole new field of investigation for Forensic Accountants. For one, it requires management to certify that their financial statements are free from material misstatement and fraud. Since the Enron scandal and others like it there has been in increased demand for audits and scrutiny of all companies. Often these audits take a Forensic Accountant with them for their expertise. Forensic Accountants have also been called in to discover whether any misstatements were intentional or by mistake. There isa lot of pressure on management to provide nearly perfect financial statements. therefore, there is an increase in demand for Forensic Accountants valuable knowledge in that area. In 1996, Orinda-Moraga Disposal Services was put under scrutiny when they wanted to raise their rates. The suspicion became known when California's Contra Costa County had to give their approval of such a raise. They knew the company had recently asked to lower rates. After Forensic Accountants got involved it became known from Orinda- Moraga's records that the company had been sending checks to fake companies at fake locations (Freeman, n.d.). Forensic Accountants were even critical when it came to Hurricane Katrina. They got involved with insurance companies when victims of the natural disaster had large claims and needed to make sure they had good estimates for claims. They understood the policy and coverage and made sure any lost items were classified and accounted for correctly ("Lodging Hospitality," 2008). Divorce, seemingly more often than not, involves a Forensic Accountant as well. In well-known Beatles singer Paul McCartney's divorce in 2008, they were called in to investigate how much he was really worth. McCartney claimed only about half of what he actually had. A team of Forensic Accountants found money he had put in bank accounts in Switzerland, laundered through business, hid in safety deposit boxes, and put in unregistered bearer bonds (Levine, 2008). Detecting this kind of fraud is very common in divorce cases.

Forensic Accounting Job

Education to become a Forensic Accountant is a relatively new concept. Until recently, it was common for a Forensic Accountant to learn through experience on the job. Now, students can attend schools that specialize in Forensic Accounting and offer programs and degrees in the subject. This is one indication that the profession is taking off. Now there are a variety of schools that offer actual programs in Forensic Accounting. Most colleges at minimum offer a course in the subject. Programs can be expected to pop up more often in the future. The job of a Forensic Accountant has recently been treated more like an FBI Special Agent with a CPA emphasis. In 1946, Maurice Peloubet coined the term Forensic Accounting commonly used now (Brown, 2008). The term literally describes the role of an accountant as using financial knowledge, technology, and techniques to provide information presentable to a court of law. In 1997 Derek Donohoe shared his views on the job of a Forensic Accountant: Principally, it involves the distinction between fact and opinion. Matters of fact can be investigated and determined by the forensic accountant who can then prepare a definitive report on the facts. Alternatively, it may be necessary for the forensic accountant, using professional judgment, to report the findings by using an opinion report. It's a well-known reality that accountants use facts and techniques that make their information highly dependable if not perfect. The criminal justice system employs the "beyond a reasonable doubt" rule. In the same way, the accounting world uses materiality as a threshold level of acceptability for misstatements. For Forensic Accountants there is no such thing. Sample testing is generally not done. All records in a time period would be reviewed. Sometimes even the smallest transaction can be an indication of fraud (Hecht, 2010). One tool that Forensic Accountants use to discover fraud is Donald Cressey's Fraud Triangle. Cressey developed this tool as a distinguished sociologist and criminologist in the 1940's. He became highly specialized in detecting fraud. Cressey interviewed 200 people that were found to have committed fraud to develop the Fraud Triangle. The Fraud triangle shows the three characteristics that must be present in the situation for fraud to be committed. These three things are opportunity, rationalization, and pressure. If a Forensic Accountant on the job feels that these three attributes are present in the organization it is likely that they will find fraud. They will use professional scepticism in situations such as these. Even if they do not find fraud though, it is still their duty to search for it to the best of their ability.

Legislation

Sarbanes-Oxley provided one of the biggest changes in history to the Forensic Accounting job. Even though the legislation was meant to affect internal auditors and management of organizations it also provided Forensic Accountants with new opportunities. After it became effective Forensic Accountants were in higher demand because whistle blowers were protected. Under the legislation, organizations could not retaliate against whistle blowers and they had to have an avenue available for them to come forward anonymously (Kleckner, 2004). Whistle blowers are often the reason

Forensic Accountants are called into investigate. Since they are now protected they are more likely to come forward. Sarbanes-Oxley also made it very difficult for organizations to handle fraud investigations internally. They will almost certainly need outside services to maintain their independence. If there is indeed a reason to call in outside auditors there may eventually be a need for a Forensic Accountant to be used as well. The issues that normally arise are from an unlawful reduction of the organizations assets. Legal involvement is almost always going to be necessary. Therefore, Forensic Accountants are the best option for organizations in that situation. In United States of America in July 2010, the Securities and Exchange Commission issued the Dodd-Frank Act. This piece of legislation is an even bigger motivator for whistle blowers to come forward. If a whistle blower brings forward information that results in successful enforcement of monetary penalties over $1,000,000 they will be rewarded monetarily. The award can be from 10-30% of the monetary penalties ("Federal Issues," n.d.). This is a huge motivating reason for people to act ethically and bring attention to fraudulent activity within their organization. With that comes more demand for Forensic Accountants to be involved andit will encourage other nations to bring in similar provisions.

Societal Changes

It has been said on numerous occasions that corporate fraud has been on the rise but is it really? In a survey done by Kroll provided by Georgetown University for their 2013/2014 Global Fraud Report it was discovered that over 70% of companies were affected by at least one type of fraud in the past year. That is an increase from the previous year that showed only 61% had been affected. Corporate fraud is just one area that Forensic Accountants deal with. The real reason behind the appearance of this increase might also be that the effectiveness of discovering fraud has increased. Fraud appears in many forms including internal financial fraud, bribery, corruption, and embezzlement. Not to mention all of the personal cases people may have such as divorce cases and identity fraud. Each form of fraud requires different skills to uncover and prevent. Additionally, society has changed the way it occurs and affects the process of Forensic Accounting. Therefore, the demand for Forensic Accountants is also rising. Society itself has changed the Forensic Accounting environment drastically. For instance, there have been improvements in technology that make it not only easier to commit fraud but can also be helpful to Forensic Accountants in catching fraud. There have been economic downturns that have put pressure on businesses. This can lead to even more pressure to commit fraud so as to hide bad financial numbers from investors. Society has put more pressure on people to become perfect and work harder. The pressure to succeed leads to more fraud as well. Pressure is one of the three points of the fraud triangle and society has had a great deal to do with that. In a study done by Caroline Flammer in 2012 it has been proven that there is a positive correlation between the announcement of an eco-friendly program and an increase in stock prices for an organization. It also found that this force, although still present, has weakened over time. The study looked at the years 1990-2009. The weakening of this force means that companies have to find other ways to make themselves look good to investors. It is a prime example of the evolving pressure society has put on businesses. All this pressure means that fraud is likely to increase. This is a horrible outcome for the world in general but it is what has made the Forensic Accounting field so viable. Fraud is the reason Forensic Accounting is necessary.

Advances in Technology

In the past 10-15 years Forensic Accounting has evolved its processes in order to bemore effective. In an article by Ankit Doshi, Rohit Mahajan of India's Deloitte Forensic said, "Earlier the investigations were restricted to books and records but now there is a significant element of intelligence gathering." One reason why intelligence gathering has become more important is because of the developments in technology. It has become easier for fraud to occur because technology has made it so. Therefore, it makes sense that Forensic Accountants would use the same technology to combat it. A second point to the Fraud Triangle is opportunity. Technology has given people plenty of opportunity throughout history. Since the creation of Quicken in 1983 and many other computer based accounting programs it has become easier for accountants to do their jobs. Unfortunately, with power come great responsibility and the opportunity to abuse it. Financial misrepresentation can be brought about by something as easy as creating fake invoices or changing a transaction in the general ledger. Using financial computer programs has saved hours upon hours of manual work for accountants. Even more opportunity for fraud has been created over this time once again increasing the demandfor Forensic Accountants. One example of technology being used to commit fraud is the case of Centennial Technologies, Inc. in 1996. They had created fake documents to makeit appear as though sales were being brought in. They reported over $12 million dollars in sales when in actuality they had lost about $28 million ("The biggest stock scams," 2011). As a technology company they knew just how to manipulate documents to make them appear real.

On the other hand, Forensic Accountants have used technology to find fraud as well. One way this can be done is to use software that detects when invoices or documents are entered into a system. For example, if an invoice is entered at the end of the year but dated for the beginning of the year a red flag would be raised. The example given is just one simple way Forensic Accountants have been able to find fraud in the past. The amount of software and information technology available now has escalated rapidly in the past few decades. In the 1920's a man named Frank Benford discovered an unlikely mathematical law so called Benford's Law ("Using software," 2003). The law states thatin almost any numerical set of data any certain digit will appear as the first or seconddigit at a predictable rate. For example, 1 is likely to be the first digit 31% of the time while 9 appears only 5% of the time. Although this seems unlikely it has been proven many times. In the early stages of Forensic Accounting this was a helpful tool simply because fraudsters were not likely to follow this rule when fabricating numbers. More recently software has been used that can detect when too many transactions have been made just below a threshold that requires a supervisor's attention. It would send a significant red flag up that fraud could be involved. It would indicate a Forensic Accountant should be involved and looking at each transaction individually. Even though technology has made it easier for fraud to occur it has become a double-edged sword. Forensic Accountants have developed their own technology in order to keep up with the growth of methods for committing criminal financial acts. Technology has provided the opportunity for fraud to occur as the Fraud Triangle predicts.

Economic Changes

It would be expected that with economic hardships at large fraud instances would follow suit. There would be many reasonable explanations for this pattern. For one, employee fraud might increase because when times are hard people tend to make drastic moves. If an employee can't afford to make his car payment he may rationalize the idea of stealing from his employer. For two, if organizations are losing investors because they cannot afford to stay invested during such economic hardship the organization might rationalize fudging the numbers on financial statements. They might tell themselves it will only be for a year or two until the economy sparks up again. However, in most instances once fraud has been committed it tends to snowball and become hard to undo. Forensic Accountants know that in hard economic times they will have to pay utmost attention to detail as it is likely they will discover more fraud than usual.In an article written for the American Institute of Certified Public Accountants, "With the current economic downtown, we have seen an increased demand for forensic accounting services as the public deals with financial collapses, increased white collar crime and growing occurrences of occupational fraud." With that being said, there have been increases in demand for forensic accountants throughout history. The Great Depression was obviously one of the times that increased demand for Forensic Accountants. There is a slight recession in the economy every 3 to 5 years and each time Forensic Accountants work a little bit harder to ward of fraud.

Personal Experience and the Future

In 2010 a survey of Forensic Accountants was done asking them what the biggest challenges in their job were (Baysden, 2013). The article explained the top answers. "'Keeping up with professional standards'" was No. 1, while "keeping up with the evolving valuation body of knowledge" placed second. "Bringing in new clients and client retention, "then categorized as a single response option, placed third in 2010." In the 2013 survey the answers were drastically different. After just three years the original number one answer was the twentieth most popular chosen and the original number two was the sixteenth. The difference is speculated to be because of the improvements in the economy. The new challenge being focused on by Forensic Accountants is attracting new clients. Forensic Accountant Bob Gray said, "FVS services don't involve repeat business as much." When he said FVS he was referring to forensic and valuation services (Farrell & Ogilby, n.d.). He calls the profession "the emergency room of the accounting hospital."

His analogy is quite fitting and timeless. Forensic Accountants have always been the ones to go to when something is wrong or out of place. They are used when something out of the ordinary comes up. Attracting new clients would definitely be a considerable challenge. “As forensic accounting evolves from being a department within the Big Four to a niche sector in its own right, it is only natural that the training model of forensic accountants will evolve,” said James Stanbury and Chris Paley-Menzies in an article in 2010. The job of a Forensic Accountant is becoming a staple in the corporate world.There will be more interest in having a permanent Forensic Accountant on staff as time goes on. There will also be more businesses specifically devoted to aspects of Forensic Accounting. Intellectual property, product liability, breaches of warranty, and business interruption are just a few of the specialty areas in which Forensic Accountants can focus their business. Mark Stephanic, Forensic Accountant at Walworth & Nayh, P.C. in Grand Rapids, Michigan, shared some of his 36 years of experience. When asked if he had seena shift in the nature of cases he has worked on over his career he responded with the following: Yes, I have noticed a shift lately. For many years the majority of assignments consisted of calculating lost profits usually resulting from a fire or flood. Today, we are seeing a lot more assignments for calculation amounts resulting from employee dishonesty or fraud. The computer and many software programs have reduced the number of individuals in the accounting department of many companies. Thus has led to a reduction in internal controls in many organizations which makes it easier for theft and fraud. His experience supports many of the changes that have been discussed. All aspects of theevolving world have played a role in the history of Forensic Accounting. The field has grown tremendously since it’s start as a profession and will continue to do so for many years to come.

FORENSIC REPORTING

Reporting is nothing but compilation of all the observations, results, conclusions gathered from the investigations. A poorly drafted report can mar completely the efforts by the forensic investigator. Documenting an investigation is as important as performing it. A poorly documented can lead to the following

- Disappointing audit conclusion
- Dissatisfied Client who gave the assignment
- Cause damage to the reputation of the forensic accountant

The form of report whether oral or written is a matter to be discussed with client and with counsel. Reporting is critical responsibility of the forensic accounting investigator, and adequate preparation is necessary to present the status of the investigation in a manner that enables the decision maker to assess how to proceed. What you say or write to qualify your comments once a document leaves your hands or words leave your lips, you cannot control the further distribution of the information you have communicated

Types of Forensic Reports

The following types of Forensic reports are relevant:

1. Written Forensic Reports

(a) **Investigation Forensic Reports:** This form of written forensic report is given directly to the company's management, board, audit committee of the board, in house counsel or outside counsel. The Forensic report should be complete in all aspects and should stand on its own, it should identify all the evidence that were used in concluding on the allegations under investigation. The Forensic report might be used for various purposes such as corporate filings, lawsuit, employment actions or diversion to procedures and controls.

(b) **Expert Forensic Report** filed in civil court proceedings.

(c) **Affidavit**- These are voluntary declarations of facts and are communicated in written form and sworn to by the witness before an officer authorized by court.

(d) **Informal Forensic Reports:** These consists of memos to file, summary outlines used in the reports, interview notes, spreadsheets, explanatory notes. These areused in the preparation of the final Forensic reports.

2. **Oral Forensic Reports:** These are given by the Forensic accountants to those who are overseeing an investigation e.g. Company board or those outside the company such investors or outside counsel. Oral forensic reports involves disposition which involves everything said by all the parties to the deposition is transcribed by a court reporter. One of the main ingredients in forensic reporting is working papers which plays an important role in forensic auditing. Working papers contains the data, information collected during the audit process and are to be preserved for future reference or if the similar assignment comes for scrutiny. The working papers may be permanent or temporary and may be reclassified as substantive, internal or administrative. Custody of working papers which might contain sensitive data influencing the audit report has to be kept safely and securing. It has to marked correctly for future identification and usage.

Characteristic of an Ideal Forensic Audit Report

An ideal Forensic audit report has the following characteristics:

1. **Preparation:** if the forensic investigation has been carried out and documented properly then reporting of procedures and findings should flow as a natural extension of the investigation.

2. **Accuracy:** All reporting should be accurate. Accuracy applies not only in terms of information conveyed in report but also with respect to communication, grammar, spelling, basic data, dates, events and names is critical

3. **Clarity:** The language used in report should be clear and simple. Forensic accounting investigators are fact finders, the fact pattern described in report should make the evidence clear for reaching to proper conclusion.

4. **Impartiality:** Bias destroys credibility. Integrity and objectivity should be used in reporting. Subjective opinions and impressions often express unstated bias and have no place in reporting written or oral. The facts must speak for themselves.

5. **Relevance:** The report should include only facts relevant to the facts being investigated.

6. **Timeliness:** The report should be released in a timely manner to be relevant

Basic Elements to be Included in the Forensic Reporting

(a) Knowledge about the client
(b) Identify the parties in case of lawsuit
(c) Nature of task for forensic auditing
(d) Scope and time frame of forensic examination
(e) Restriction and secrecy to the distribution of the forensic report
(f) Professional standards to be observed during forensic audit
(g) Exclusions and disclaimers related to Forensic audit assignment
(h) Procedures, technical pronouncements relied in the assignment
(i) Conclusions and summarization of findings at the end for the forensic accountingassignment.

Sample table of content of Forensic Investigation report

A) Executive Summary

- Background of Client
- Origin of Audit
- Objective
- Proposed results of Audit
- Implementation or road map of Audit,
- Audit program and layout

B) Risk Analysis

- Internal / External Environment risks and forces
- Customers, products, competitors, human elements
- Business processes
- Information Technology
- Influence of Economic forces and financial market conditions
- Political and legal scene
- Banking policy

C) Evidence of risk events

- Conflict of interest
- Bribery
- Extortion
- Cash Theft
- Inventory Frauds
- Fraudulent disbursements
- Misuse of business assets
- Financial statements fraud
- Audit recommendations

D) Governance on recommendation implementation

- Budgetary considerations
- Stakeholders

E) Enclosures/Annexure

- Interview of Members
- Organization Chart
- Financial Performance
- Audit recommendations
- Analysis of Key risk elements

Mistakes to be avoided in Forensic Reporting

1. Stick to facts and figures
2. Avoid judgmental statements
3. Avoids opinions which are personal and cannot collaborated by facts and figures
4. Report/Conclusions should be drafted in simple and straight forward language focused on facts
5. Report should be of ideal length and does not contain unnecessary facts which arenot relevant for the problem in hand
6. Jargons to be avoided so that layman can understand report clearly
7. Report should be signed and dated to give authencity.

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FORENSIC ACCOUNTANT

FORENSIC ACCOUNTANTS - THE BLOODHOUNDS OF BOOK-KEEPING

Forensic accounting requires the most important quality a person can possess: the ability to think. There is no book that tells you how to do a forensic investigation. It is about solving a puzzle or peeling an onion. It takes creativity. 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 claims, personal injury claims, fraud, construction, or royalty audits. Forensic accountants may be involved in recovering proceeds of crime and in relation to confiscation proceedings concerning actual or assumed proceeds of crime or money laundering. In the United Kingdom, relevant legislation is contained in the Proceeds of Crime Act 2002. In India, there is a separate breed of forensic accountants called Certified Forensic Accounting Professionals. Some forensic accountants are also Certified Fraud Examiners, Certified Public Accountants, or Chartered Accountants. Forensic accountants utilize an understanding of business information and financial reporting systems, accounting and auditing standards and procedures, evidence gathering and investigative techniques, and litigation processes and procedures to perform their work. 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 advisers to audit committees, fraud deterrence engagements, and assisting in investment analyst research. 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. External Auditors find out the deliberate misstatements only butthe Forensic Accountants find out the misstatements deliberately. External auditors look at the numbers but the forensic auditors look beyond the numbers. Forensic accountant takes a more proactive, sceptical approach in examining the books of Accounting. They make no assumption of management integrity (if they can assume so then there is no need for their appointment) show less concerns for the arithmetical accuracy have nothing to do with the Accounting or Assurance standards but are keen in exposing any possibilityof fraud. In addition to the specialized knowledge about the techniques of finding out the frauds one needs patience and analytical mindset. One has to look beyond the numbersand grasp the substance of the situation. It is basically the work of the intelligent accountants. He needs to question seemingly benign document and look for inconsistencies. He searches for evidence of criminal conduct or assists in the determination of, or rebuttal of, claimed damages.

Forensic accountants often have to give expert evidence at the eventual trial. Forensic accountants not only utilize their accounting and auditing skills, but also use their investigative skills to determine what events actually took place in a financial setting.

Engagements relating to civil disputes may fall into several categories:

- Calculating and quantifying losses and economic damages, whether suffered through tort or breach of contract.
- Disagreements relating to company acquisitions, perhaps earn outs or breaches ofwarranties.
- Business valuation.
- Forensic accountants often assist in professional negligence claims where they are assessing and commenting on the work of other professionals.
- Engagements relating to criminal matters typically arise in the aftermath of fraud. They frequently involve the assessment of accounting systems and accounts presentation – in essence assessing if the numbers reflect reality.
- Forensic accountants may be involved in recovering proceeds of crime and in relation to confiscation proceedings concerning actual or assumed proceeds of crime or money laundering.

WHO NEEDS FORENSIC ACCOUNTANTS?

Forensic accountants are more than just number crunchers who happen to work on criminal or civil disputes -- these accountants possess additional skills. They must conduct investigations, know how to use a variety of computer programs and communicate well. Some forensic accountants specialize in specific industries that are susceptible to fraud, such as insurance or banking, and learn the business practices associated with those fields. Forensic Accountants work in most major accounting firms and are needed for investigating mergers and acquisitions, and in tax investigations, economic crime investigations, all kinds of civil litigation support, specialized audits, and even in terrorist investigations.

Forensic Accountants work throughout the business world, in public accounting, corporations, and in all branches of government.

HOW TO BECOME A FORENSIC ACCOUNTANT

Commerce graduates can easily take up forensic accounting as a career. You need to become a chartered accountant and then specialise in forensic accounting. The forensic accountants prior audit and accounting experience will be of tremendous assistance. But ultimately, it is only through working with experienced forensic accountants on various cases that one can learn the skills necessary to become a capable forensic accountant. There are several organizations that provide training and additional certification for forensic accountants. Each organization requires that its members possess varying degrees of education and experience, and they must sit for additional exams. These certifications show that a forensic accountant has training and experience beyond that of a standard accountant. Some places where one can study and/or obtain certifications as Forensic Accounting Professional are

- Institute of Chartered Accountants of India, New Delhi
- Association of certified fraud examiners (ACFE), USA
- Indiana University, Bloomington, USA
- British Columbia Institute of Technology, Canada
- Charles Stuart University, New South Wales, Australia

Some forensic accountants take courses in:

- Sociology
- Psychology
- Law enforcement
- Criminal law
- Business law
- Business and finance
- Information systems
- Communication

Forensic accountants are trained to detect evidence of frauds. Forensic accounting is about more than legal matters and financial numbers. There is an acute shortage of forensic accounting skill sets in India. A huge demand for forensic accountants has come up in the wake of the requirements from the investors after the Satyam fiasco. There are only about 400 forensic accountants in the country though India loses approximately $40 billion because of frauds.

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:** 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, Ecommerce 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.

QUALITIES OF FORENSIC ACCOUNTANT

It requires lot of courage to be the forensic Accountant as it is not an easy task to do the litigation support work or investigative accounting work. Apart from the courage it also requires following qualities

1. **Suspicion:** Forensic accountant needs to be the bloodhounds of the accounting and not the watchdogs. Forensic Accountants should be cautious of obvious things and wary of persons who are quick to provide alibis and identification. Forensic Accountants should demand verification whenever possible as the evidence that a forensic accountant is required to be conclusive.
2. **Curiosity:** Forensic accountants should develop their own curiosity and follow up on it. Forensic Accountants should have the desire to learn the truth. An inquisitive mind is essential tothe forensic accounting professionals.
3. **Observation:** Five senses of the forensic accountants are important tools of the trade. It may be important for forensic accountants to remember unusual things about an individual (i.e., his manner and posture or the way he dresses). Learn to observe details.
4. **Memory:** The ability to recall accurately the facts, events and the physical characteristics of a suspect is a valuable skill every time everything cannot be documented unlike the auditors.
5. **An Unbiased and Unprejudiced Mind:** A fraudster can cause harm during the investigations. Forensic accountants should not form the opinions about any one unless there is conclusive evidence. Bias and prejudice will result in a poor investigation, unfairness to suspects and clouding of facts that need to be uncovered objectively. Do not let personal likes or dislikes interfere with investigations.
6. **Ability to Play A Role:** This skill is especially important for forensic accountants who work alone most of the time. Using his own identity could expose the forensic accountant to recognition and danger. The ability to assume convincing identities is particularly valuable in surveillance, under cover activities, and a variety of confidential inquiries.
7. **Persistence and Capacity for Hard Work:** Many times, you will find yourself working late into the night to follow up a promising lead or question a particularly valuable witness or even to seize the hard disks after the office hours get over for the origination.
8. **Ability to Obtain Cooperation of Others:** In the course of your work you will make many contacts. Some will be clients, some will be witnesses, some will be suspects and some will just be well-meaning citizens who can provide information. It is essential that you obtain cooperation from as many people as possible in order to secure the vital facts and information that you will need to conclude an investigation. You will need patience, courtesy, tact and understanding. A suspect or witness who has been intimidated, frightened, or angered by impatient forensic accountant is of no value.
9. **Interest & Pride of Accomplishment:** True success in any profession is based on sincere interest and pride in a job well done.The knowledge that your efforts

can bring a criminal to justice, locate a missing loved one, or save a business large sums of money can bring you immense satisfaction.

10. **Common Sense:** You should have an intuitive understanding of the way the world works and how people move through it. This can be developed and refined. The more time you spend on the street and the more attention you pay to detail, the sharper your street sense will become. This can be learned and sharpened as you work in the investigative field.
11. **Good Listening Skills:** Accounting data may be available easily but to turn it back in information is the skill of forensic accountant and one needs to conduct interviews for the same. You need to be a good listener in order to effectively communicate. In order to be a good interviewer, you must be able to understand the person who you are questioning. If you do not have good listening skills, you will never be an effective interviewer. Therefore, you will not be a successful legal or corporate forensic accountant.
12. **Ability to Put People At Ease:** In order convince people to submit to interviews, you need to be able to chat socially and agreeable which also help to make people feel comfortable talking to you. This is a very necessary skill to have in order to conduct successful interviews.
13. **Ability To Speak At The Level Of Audience:** There is nothing that turns a person off quicker than someone speaking down or using language that is difficult to understand. You must be able to speak to anyone from a high school drop out to a professional doctor in language that is appropriate and understandable.
14. **Understanding of Body Language:** To know if a person is truthful in an interview situation, you must be able to read body language. As a forensic accountant, you may interview a potential witness. At the end of that time, you must gauge that person's honesty and credibility as a potential witness.
15. **Intuitive Understanding of Human Nature:** People are people regardless of the circumstances you may be investigating. As a forensic accountant, we are people---our clients, subjects and suspects often at time of extreme emotional distress.
16. **Self Confidence:** You need to have belief in your ability to handle any situation. In my opinion, if you possess the above skills, you will be successful as a forensic accountants and, more importantly, as a human being.

SERVICES OFFERED BY FORENSIC ACCOUNTANT

There are various service lines where the forensic accountant can play an important role:

1. **Investigation Consultancy:** While financial statement scandals of Xerox, WorldCom have brought forensic accounting into limelight it accounts for only one fifth of total work. Corporate investigations into expense and purchasing frauds are the hot cake followed by the siphoning of funds also being relatively

frequent Due to the increased sophistication of fraud and the requirement of prior experience in conducting fraud investigations, organizations have begun to realize that it is best for an expert who is independent and unbiased to conduct an investigation. The overall objectives in a typical investigation are to

(a) Investigate and determine if the alleged material financial irregularities and /orimproprieties have occurred.

(b) Attempt to quantify whether or not any of these alleged financial irregularitiesresulted in a monetary loss.

(c) Attempt to identify persons who could be responsible for the aforesaid irregularities and /or improprieties

These kinds of services are required by the Banks, Corporate and Regulators such as RBI,SEBI and law enforcement officials

2. **Fraud Risk Assessment:** Operational Risk is an integral part of business. Managing the risk of fraud is a crucial and integral part. The upcoming regulations BASEL-II accord and the Sarbanes Oxley Act are the bi products of Fraud risk. A fraud risk assessment is aimed at creating an environment that frustrates the fraudster. Interaction of the clients with the Fraud Risk experts helps to leverage off the knowledge of the cultural and working environment and the Industry knowledge. This approach allows for any immediate buy-in on the recommendations made, as the client himself has been a part of the risk assessment exercise. The corporate kings of our country require these services.

3. **Due Diligence:** Due diligence enable the clients to enter a foreign market or open a foreign operations, seek new sources of capital; recruit new dealers, franchisees, or distributors; license their product or services to another company ; establish a strategic alliance or joint-venture partnership ; invest in a business ; acquire or merge with another business; appoint directors; extend credit. These kinds of investigations can also be carried out with the aid of the forensic accountant.

4. **Information Security Risk Assessment:** Information security is the buzzword of the new era. It includes formulating policies, practices and procedures to prevent any loss of sensitive and confidential information. These services address the concerns of clients in respect of safeguarding their critical information against unethical and illegal attempts by rivals and interested parties. Forensic accountants with technology exposures are the best fit candidates for the role of the information security assessment. In USA Sarbanes Oxley act has compelled the companies to get assessed their Information security systems. Generally, software companies prefer the technology forensic accountants.

5. **Asset Tracing:** Stamp Paper scam was the biggest scandal amounting to over 30,000 crores of rupees. However, when Telgi was arrested he had assets worth few billions of Rupees. The tracing of the bank transactions convertible into the

tangible assets is important since the assets are sold out to repay the losses. Understanding the bank transfers is a technical job which must be looked with the suspicion. Involvement of Benami Transaction into the creation of assets makes it even more difficult for the law enforcement officials to recover the assets. Tracing and identifying client assets that are in the unlawful possession or control of third parties is the area that is looked after by Forensic Accountants worldwide. When a loss arising from fraud is detected, an organization has the option of turning to forensic accountants to trace the assets created out of the illegal proceedings.

6. **Vendor Monitoring:** Companies who are involved in the production and marketing of consumer products internationally have become increasingly aware of the importance of monitoring the labor and business practices of their vendors. Similarly, the bankers in our country are also tracking their borrowers with full concentration. There are not less incidences where the companies across the world have duped the banks in the working capital loans.

7. **Money Laundering Compliance**: In the wake of Money Laundering Act 2003 the compliance program is the need of anhour. Money Laundering is a serious crime associated directly with the terrorism. The compliance program may address four areas

    (a) Compliance regulations

    (b) Designation of a Compliance officer

    (c) Independent Testing

    (d) Training

This programme provides our client with a highly trained, motivated and diligent work force. It further given them the comfort of proof that they have been diligent, in their compliance programme.

8. **Litigation Support:** The renowned Forensic accountants provide opinions on technical questions of audit, accounting, taxation or other areas. It may also involve quantification of losses in the context of fraud, disputed business valuation, loss of profits, insurance claims, and intellectual property disputes and in many other situations.

9. **Functional Consultancy:** The software companies have developed the internal audit tools for the compliance with the SOX provisions. Similarly, a pre-defined set of the rules for identification of the red flags of the frauds in software the functional consultants with Forensic Accounting Background are preferred. To sum up the forensic accounting field is the boom of tomorrow in the field of accountancy. The collapse of Enron gave birth to Sarbanes Oxley Act and proved to be boom time for the forensic accountants. Mishaps worldwide also increase the demand of forensic accountants.

10. **Other Services:** The services rendered by the forensic accountants are in great demand in the following areas:

(a) **Fraud detection where employees commit Fraud:** Where the employee indulges in fraudulent activities and are caught to have committed fraud, the forensic accountant tries to locate any assets created by them out of the funds defalcated, then try interrogating them and trying to find out the hidden truth.

(b) **Criminal Investigation:** Matters relating to financial implications the services of the forensic accountants are availed of. The report of the accountants is considered in preparing and presentation as evidence.

(c) **Cases relating to professional negligence:** Professional negligence cases are taken up by the forensic accountants. Non- conformation to Generally Accepted Accounting Standards (GAAS) or non compliance to auditing practices or ethical codes of any profession they are needed to measure the loss due to such professional negligence or shortage in services.

(d) **Arbitration service:** Forensic accountants render arbitration and mediation services for the business community, since they undergo special training in the area of alternative dispute resolution.

(e) **Settlement of insurance claims:** Insurance companies engage forensic accountants to have an accurate assessment of claims to be settled. Similarly, policyholders seek the help of a forensic accountant when they need to challenge the claim settlement as worked out by the insurance companies. A forensic accountant handles the claims relating to consequential loss policy property loss due to various risks, fidelity insurance and other types of insurance claims.

(f) **Dispute settlement:** Business firms engage forensic accountants to handle contract disputes, construction claims, product liability claims, infringement of patent and trade marks cases, liability arising from breach of contracts and so on.

WHAT ARE THE TASKS USUALLY PERFORMED BY A FORENSIC ACCOUNTANT?

A forensic accountant is expected to be able to perform all the tasks that an accountant and an auditor is able to perform. In addition, he should have in his team, reasonable expertise in interviewing, interrogation, data mining and investigative analysis, field investigations, computer forensic and handwriting and specimen signature analysis.

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 negligenceor 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 accessto 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.

VI. **Other areas include:**

- Shareholders' and Partnership Disputes
- Other Types of Insurance Claims
- Matrimonial Disputes
- 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.

FORENSIC ACCOUNTING IN INDIA

In India, Forensic Accounting has not got its due recognition even after alarming increase in the complex financial crimes and lack of adequately trained professionals to investigate and report on the complex financial crimes. The task of Forensic Accountants is handled by Chartered Accountants who apart from handling traditional practice of auditing as required under the Companies Act, 1956 or Income Tax Act are called upon by the law enforcement agencies or the companies or private individuals to assist in investigating the financial crime or scam. The CA or CWAs in India are best suited for this profession due to their financial acumen acquired during their rigorous training which can be further honed by introducing post qualification degree or diploma in Investigating and Forensic accounting/audit. The CA or CWA who acquire post qualification in Investigative & Forensic Accounting can use the designation CA-IFA or CWA-IFA and be legally recognized as the Forensic Accounting Experts to handle the investigation of financial crimes and give expert testimony in the Court of Law. However, growing financial fraud cases, recent stock marker scams, failure of non-financial banking companies, phenomena of vanishing companies and plantation companies and failure of the regulatory mechanism to curb it has forced the Government of India to form Serious Fraud Investigation Office (SFIO) under Ministry of Corporate Affairs which can be regarded the first step of Governmentof India to recognize the importance and advance the profession of forensic accountants. The SFIO is a multidisciplinary organization having experts from financial sector, capital market, accountancy, forensic audit, taxation, law, information technology, company law, customs and investigation. These experts have been taken from various organizations like banks, Securities & Exchange Board of India, Comptroller and Auditor International, General and concerned organizations and departments of the Government. However, the main important law enforcement agency involved directly in combating frauds is the Police, CBI, DRI etc.

Forensic accounting is unique in that it combines accounting with investigation. These bloodhounds— as opposed to the watchdogs that are auditors— attempt to sniff out fraudulent transactions from the financial records of banks and companies. Sherlock Holmes was probably the most famous practitioner But Kautilya was the first economist who openly recognized the need of the forensic accountants. He mentioned forty ways of embezzlement centuries ago. The Opportunities for the Forensic Accountants are growing at the rapid speed. Collapse of Enron and World Trade Centre twin towers have blessed the American Forensic Accountants with the opportunities. Forensic accounting is still nascent in India. However, the nature of fraud in India has undergone a change. Reserve Bank of India has made forensic accounting audit compulsory for banks in India. However banks are hesitant in approaching certified fraud examiners, and are mostly dependent on their internal auditors. In India the formation of Serious Fraud Investigation Office is the landmark creation for the Forensic Accountants. Growing cyber crimes, failure of regulators to track the security scams, series of co-operative 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 inthe wake of the growing frauds. After the Satyam scam, forensic auditors are much in demand as many companies want to understand what could be the initial warning signals of a Satyam kind of fraud in other Indian companies. Even the government's Serious Fraud Investigation Office (SFIO) has sought the help of forensic accountants to get tothe root of the financial fraud at Satyam.

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 India forensic is the only formal body that provides formal education about forensic accounting in India. India forensic is however not affiliated to any of the Universities. India forensic 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 i.e. Corruption. It also helps in resolving the bank fraud cases.

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ROLE OF FORENSIC ACCOUNTING IN DETECTING FRAUDS

INTRODUCTION

Fraud is a worldwide phenomenon that affects all continents and all sectors of the economy. Fraud encompasses a wide-range of illicit practices and illegal acts involving intentional deception or misrepresentation. According to Association of Certified Fraud Examiners (ACFE), fraud is "a deception or misrepresentation that an individual or entity makes knowing that misrepresentation could result in some unauthorized benefit to the individual or to the entity or some other party.

Fraud cheats the target organization of its legitimate income and results in a loss of goods, money and even goodwill and reputation. Fraud often employs illegal and immoral or unfair means.

The fraud involving persons from the leadership level or known under the name "managerial fraud" and the one involving only entity's employees is named "fraud by employees' association.

Fraud is a legal and not an accounting concept. For this reason, the accountants have traditionally chosen to treat it as a concept alien to them.

Fraud evokes a visceral reaction in us. It is an abuse of our expectation of fair treatment by fellow human beings. Beyond that, it is a blow to our self-image as savvy managers capable of deterring or detecting a fraudulent scheme. Whether we react because of values or because of vanity, nobody likes to be duped. Many elements of modern society are focused on maintaining an environment of fair dealing. Laws are passed; agencies are established to enforce them; police are hired; ethics and morals are taught in schools and learned in businesses; and criminals are punished by the forfeiture of their ill-gotten gains and personal liberty all with a view to deterring, detecting, and punishing fraud. The profession of auditing grew out of society's need to ensure fair and correct dealings in commerce and government. One of the central outcomes of fraud is financial loss. Therefore, in the minds of the investing public, the accounting and auditing profession is inextricably linked with fraud deterrence, fraud detection, and fraud investigation. This is true to such an extent that there are those whose perception of what can be realistically accomplished in an audit frequently exceeds the services that any accountant or auditor can deliver and, in terms of cost, exceeds what any business might be willing to pay .In the past few years ,public anger over occurrences of massive fraud in public corporations has spawned new legislation, new auditing standards, new oversight of the accounting profession, and greater penalties for those who conspire to commit or conceal financial fraud. Forensic accountant has a significant role in the larger effort to minimize fraud.

MEANING OF FRAUD

If we study deeply the social sciences of sociology, psychology and criminology, we can get insight and understanding of the behavior root causes of frauds who commits fraud and why there by enabling a business to pro actively manage their fraud risk exposure.

Fraud involves intentional acts and is perpetrated by human beings using deception, trickery and cunning that can be broadly classified as comprising 2 types of misrepresentation

- Suggestion falsi (Suggestion of falsehood) or
- Suppressio Veri (Suppression of truth)

Fraud encompasses asset misappropriation via theft or misuse of business assets, corruption through bribery, conflict of interest, and extortion and illegal gratuities false representation such as fraudulent tax returns, bankruptcy filings and employment application, financial statement fraud with intention to defraud.

The history of corporate scandals has highlighted the fact that fraud is often committedby individuals in managerial positions-position of trust in an organization. These people tend to be well connected able to manipulate others and hide their tracks by destroying and removing traces of evidences thus disrupting audit trials. Often they are seen to be first time offenders, prominent citizens and therefore difficult to prosecute. Cressey (1973) is his development of the fraud triangle described fraud perpetrators seek to find ways to justify their actions to themselves and other as a psychological coping mechanism. Cressey fraud triangle seeks to explain what must be presented for fraud to occur and there are 3 reasons namely;

- Opportunity
- Incentive and
- Ability to rationalize

The fraud triangle long used in audit classes has been re-interpreted by the Association ofCertified Examiners has three elements

- Perceived incentives/ Pressures
- Perceived opportunity and
- Rationalization of fraudulent behavior.

The psychology of the perpetrator influences each of these 3 elements. Personal incentives and perceived pressure drive human behavior and the need to rationalize wrong doing as being somehow defensible is very much psychologically rooted in the notion of cognitive dissonance. Therefore in trying to understand the root cause of fraud, we must seek psychological answers and explanations such as basic greed and acquisitiveness a “revenge motive” or a “catch me if you can” attitude not just logical answers.

By way of illustration, consider the classic example of the purchase of a used car. The salesperson is likely to make representations about the quality of the car, its history, and the quality of parts subject to wear and tear, ranging from the transmission to the paintjob. The elements of fraud may or may not arise out of such statements. First, there is a distinction between hype and falsehood. The salesperson hypes when he claims that the 1977 Chevy Vega “runs like new.” However, were he to turn back the odometer, he would be making a false representation. Second, the false statement must be material. If the odometer reading is accurate, the salesperson’s representation that the car runs like new or was only driven infrequently is, strictly speaking, mere hype: the purchaser need only look at the odometer to form a prudent view of the extent of use and the car’s likely roadworthiness. Third, the fraudster must make the material false misrepresentation with scienter, that is, with actual knowledge that the statement is false or with a reckless disregard for the truth. For example, the car may or may not have new tires. But if the salesperson, after making reasonable inquiries, truly believes that the Vega has new tires, there is no knowing misrepresentation. There may be negligence, but there is no fraud. Fourth, the potential victim must justifiably rely on the false representation. A buyer who wants a blue car may actually believe the salesperson’s representation that “it’s really blue but looks red in this light.” Reliance in that case is, at best, naive and certainly not justified. Finally, there must be some form of damage. The car must in fact prove to be a lemon when the purchaser drives off in it and realizes that he has been misled. Regardless of context, from Enron to WorldCom to Honest Abe’s Used Car Lot, fraud is fraud, and it displays the four simple elements noted above.

FRAUD TRIANGLE AND IT USE AS FORENSIC ACCOUNTANT

The first quantitative study of embezzlement was done in the late 1940s' by Donald R. Cressey who interviewed approximately 300 convicted fraudsters who had been confined to state prisons in an effort to determine if the offenders had any commonality in their causes. He observed the presence of 3 things in his study Opportunity, motivation and rationalization. In the context of this discussion of potential red flags, it is worthwhile to revisit the concept of the fraud triangle. As you will recall, SAS 99 identifies three categories of risk the fraud triangle and views them as key conditions that tend to be present when fraud occurs

- Incentive and pressure that is, need
- Opportunity
- Rationalization and attitude

Within each of these broad risk categories, many different and specific potential red flags may be visible within a company.

1. Incentive and Pressure

Management or other employees may find themselves offered incentives or placed under pressure to commit fraud. When, for example, remuneration or advancement is significantly affected by individual, divisional, or company performance, individuals may have an incentive to manipulate results or to put pressure on others to do so. Pressure may also come from the unrealistic expectations of investors, banks, or other sources of finance. Certain risk factors are usefully considered in the evaluation of whether or not the organization is at a greater or lesser degree of risk, owing to incentives or pressures that could potentially lead to material misstatements. These risk factors include:

1) Circumstances that threaten the profitability or financial stability of thebusiness
2) Excessive pressure on management to meet or exceed the expectations of thirdparties, including investors and lenders.
3) Significant threats to the personal wealth of management as a result of the performance of the business.
4) Excessive internal pressures on divisional or departmental management imposedby the board of directors or senior management.
5) A struggle to retain the company's listing on a stock exchange or debt rating.
6) Inability to meet debt covenants or satisfy conditions in merger or acquisition agreements.

Incentive and pressure can take a variety of forms within an organization: bonuses or incentive pay representing a large portion of an employee or group's compensation; triggers built into debt covenants tied to share price targets and levels; significant stock option awards throughout the organization but particularly to top management; and aggressive earnings-per-share and revenue targets set by top management and communicated to analysts, investment bankers, and other market participants, with resultant pressure from these groups.

With regard to the risk of material misstatement due to misappropriation of assets, therisk factors are:

1) Personal financial problems that might motivate an individual to misappropriate assets

2) Adverse relationships between the entity and one or more of its employees, which might create feelings of resentment or disloyalty.

Personal pressures have increased significantly in recent decades as stock options became a common means of compensating and motivating management. Many managers today have a large portion of their compensation and even their net worth tied to the performance of the company and, specifically, the performance of the company's stock.As a result of compensation and retirement contributions in the form of stock grants and as a result of stock ownership and personal debt secured by stock, the financial positionof many managers is inextricably tied to the financial performance of their employer.

Fear of losing one's position or of delivering bad news, the desire to be promoted, personal financial obligations, or simply greed can also be the driving forces behind fraudulent activity. Determining the presence and degree of these pressures or incentives is part of the auditor's goal in evaluating the risk that misstatements due to fraud may have occurred. Keep in mind that some people will go to extraordinary lengths to satisfy their needs. The ability to satisfy those needs through inappropriate measures is increased if the other components of the fraud triangle are present

2. Opportunity

Circumstances may exist that create opportunities for management or other staff to commit fraud. When such opportunities arise, those who might not otherwise be inclinedto behave dishonestly may be tempted to do so. Even individuals under pressure and susceptible to incentives to perpetrate a fraud are not a grave threat to an organization unless an opportunity exists for them to act on their need. An opportunity must exist to commit fraud, and the fraudster must believe the fraud can be committed with impunity. Absent or ineffective controls, lack of supervision, or inadequate segregation of duties may provide such opportunities. Opportunities may also be inherent in the nature, size, or structure of the business. Certain types of transactions lend themselves more than others to falsification or manipulation, as do certain kinds of balances or accounts. Certain corporate and group structures may be more opaque and susceptible to misuse. And certain types of asset are more prone to misappropriation.

Risk factors indicative of opportunities that could lead to material misstatements as a result of fraudulent financial reporting include:

1) Factors related to the nature of the industry in which the entity operates the nature of the entity's business and the transactions it enters into, and the manner in which they are recorded in the profit-and-loss account or balance sheet.
2) The nature of the entity's relationships with customers and suppliers and its position in its markets: the ability to dominate or dictate terms may create the opportunity for inappropriate or non–arm's-length transactions.
3) The degree of judgment involved in determining the level of income or expenditure or the valuation of assets or liabilities: Generally, a higher degree of judgment will give rise to a greater opportunity for deliberate manipulation.
4) The extent and effectiveness of supervision of senior management by independent corporate governance functions such as the audit committee, nonexecutive directors, and supervisory boards.
5) The degree of complexity and stability of the entity or group.
6) The overall control environment, including the continuity and effectiveness of internal audit, information technology, and accounting personnel as well as the effectiveness of accounting and reporting systems. In several large financial statement fraud cases, opportunity existed by virtue of management's role in the internal control structure and its ability to override or avoid existing controls.

With regard to the risk of material misstatement resulting from misappropriation of assets, the risk factors best categorized as related to opportunity can be summarized as follows:

1) Susceptibility of fixed assets, inventories, or other assets to misappropriation, depending on such variables as value, demand, portability, and convertibility
2) Weaknesses in the controls designed to safeguard assets, such as supervision, segregation of duties, employee screening, physical controls, reconciliations, and other accounting controls

3. Rationalization and Attitude

Some individuals are more prone than others to commit fraud. Other things being equal, the propensity to commit fraud depends on people's ethical values as well as on their personal circumstances. Ethical behaviour is motivated both by a person's character and by external factors. External factors may include job insecurity, such as during a downsizing, or a work environment that inspires resentment, such as being passed overfor promotion. The external environment also includes the tone at the top the attitude of management toward fraud risk and management's responses to actual instances of fraud. When fraud has occurred in the past and management has not responded appropriately, others may conclude that the issue is not taken seriously and they can get away with it. Risk factors that fall into this category of rationalization and attitude are typically the least tangible or measurable, and many are by nature difficult for an auditor to observe or otherwise ascertain. Fundamentally, rationalization and attitude are functions of the culture of an organization, the psychology of those who work in it, and the interaction between the two, for example, the level of employee loyalty to the company. The wider business environment must also be considered: hard times in an industry or in the overall economy may make it easier for some individuals to rationalize fraud. Risk factors to look for, in this somewhat intangible but critically important category, include:

a) Lack of clarity or communication about corporate ethical values or infrequent communication and reinforcement of such values
b) Disregard for the risk of fraud or ineffective measures when fraud rises
c) Lack of realism in budgeting and forecasting and in communicating expectationsto third parties
d) Recurring attempts by management to justify inappropriate accounting or disclosure policies and practices on grounds of materiality or other grounds
e) A bullying attitude, imposition ofunreasonable time pressure, or constraints on access to relevant audit evidence. Most frauds begin small and build over time. Many people can easily rationalize small infractions such as using the office phone for personal long-distance phone calls or stocking their home office with supplies from the company supply cabinet and the auditor will come into contact with individuals who are, of course, capable of these rationalizations. These rationalizations can be simple, even for a complex financial crime. Some of the most common rationalizations prove to be the following:
f) The company will do better next quarter and the act can be reversed. No one will ever know. It is not really fraud, right, if I book this entry one month and then reverse it the next? In the end, it washes and no one's harmed. The company stays in compliance with debt covenants, and we make our dividend payments.
g) Management does not seriously monitor internal controls. Management does not correct known deficiencies in controls. Management does not discipline this kind of behavior.
h) Management participates in, expects, and rewards this kind of behavior. Management has entered into certain transactions purely for the purpose of meeting specific reporting objectives. Management traditionally uses aggressive accounting policies, and we need to remain consistent with prior periods. The people being promoted helped the company achieve its objectives without regard to the means of getting there. Risk taking is rewarded. We are cowboys but nobody is allowed to saythat anymore.
i) It is not material to the company as a whole. But it makes a huge difference to ourproceeds from the public offering.

j) I was passed over for the promotion I deserved. I'm paid at less than the market rate for my services and the value I provide. The company has no loyalty to its employees; I'm likely to be laid off soon. This will make up for the benefits the company just eliminated. Determining whether a basis exists to rationalize a fraudulent act is a key part of the evaluation of the risk that misstatements due to fraud may have occurred.

Typically, all three conditions of the fraud triangle will be present in varying degrees when fraud occurs. They are closely related. When the incentive to commit, fraud is strong, it is likely to be easier for perpetrators to rationalize their actions. Easy opportunity may have a similar effect: when internal controls are absent or ineffective, an employee may conclude that management is indifferent to fraud that "nobody cares." The greater the extent to which all three conditions are present, the greater the likelihood that fraud will occur. Cultivating an environment that minimizes these conditions is vital to avoiding or limiting fraud risk. However, even if one or more conditions are absent, fraud risk is not eliminated. The incentive or pressure may be such as to drive an individual or group to commit fraud despite the absence of easy opportunities to do so. Similarly, predators may not need to rationalize their depredations on a firm: it just comes naturally.

IDENTIFYING AND EVALUATING RISK FACTORS

As noted earlier, fraud risk factors need to be evaluated in context. That context can be defined as an understanding of the business of the entity and the general economic and market environment in which it operates; the presence of other fraud risk factors, if any; and the existence and effectiveness of mitigating controls. Facts or circumstances that may constitute fraud risk factors in one context may have less significance in another. For example, a small owner-managed entity is likely to have in place less-sophisticated corporate governance structures and systems of internal control than is a large multinational organization. Basic elements such as independent supervision of management such as by way of an effective audit committee and segregation of duties between key operational and accounting functions may not be as well developed and may not even be practical in a smaller entity. Such matters might be cause for concern in a larger organization, but in a smaller one, their potential impact on fraud risk may be at least partially offset by the closer involvement of the owner-manager and perhaps by cultural differences. An adequate understanding of the entity's business and its relationship with business partners, suppliers, and customers is crucial to the proper evaluation of fraud risk factors. The ability to identify unusual or suspicious transactions, questionable financial ratios, and implausible explanations by management or others clearly implies an awareness and understanding of what is normal and expected in the context of the entity, the industry sector, and the general business and economic environment in which the entity operates. The auditor also considers the accumulation of fraud risk factors. For example, that a significant portion of management's remuneration is in the form of bonuses or stock options linked to so-called aggressive targets of one kind or another is listed as a fraud risk factor. Yet such arrangements are common in publicly listed companies and often viewed as effective ways of aligning the interests of management with those of stockholders. Further, the aggressiveness of targets may not be easy to judge. Therefore, in isolation, this risk factor may not immediately set alarm bells ringing. But if the auditor were to conclude that the audit committee was insufficiently robust in its stance vis-à-vis management decisions and that management including nonfinancial management appeared to be exerting undue influence over accounting policies in a manner likely to distort key financial measures in their favour, then the cumulative effect of these circumstances might be more persuasive of the existence of a risk of material misstatement due to fraud. In the immediately preceding example, the observed fraud risk factors exemplify the first two conditions of the fraud triangle: incentive and opportunity. While the presence of all three conditions is not a prerequisite to the existence of a significant risk of material misstatement due to fraud, the example illustrates that the presence of even two conditions tends to create more persuasive grounds for concern. The evaluation of the impact of fraud risk factors on the level of audit risk also involves consideration of any internal controls that might mitigate the risk of material misstatement due to fraud. Knowledge of controls will be drawn both from the auditor's cumulative audit knowledge and experience and from the results of the examination and testing of controls during the current audit. The additional internal control focus required by Sarbanes-Oxley will provide a further source of information on the internal control environment and may highlight gaps in the internal control structure that need to be considered from a fraud risk perspective. In placing reliance on a control to mitigate the risk of fraud, auditors may satisfy themselves that the control would, if operated properly, mitigate the risk in question and that the control has operated effectively during the period subject to audit. Even if auditors can obtain reasonable assurance on these counts, they should not discount the possibility that management or others may override controls or otherwise circumvent normal processes to manipulate results or balances. The identification and evaluation of fraud risk factors should not be seen as a one-time-only process carried out and completed at the planning stage. Rather, it is a cumulative process that continues through the audit. Auditors remain alert to the risk of material misstatement resulting from fraud at all stages of the audit so that their assessment may be updated in light of new information. Such information may emerge:

1. During planning and risk assessment
2. In discussions with management or other employees
3. As a result of controls testing or substantive analytic or detailed testing at the review or audit completion stage

The audit engagement leader ensures that a mechanism is in place within the audit teamfor the sharing of information concerning potential fraud risk factor or evidence of fraud so that any such information is brought forward and can be considered in a broader context. This helps ensure that the existing assessment of fraud risk is re-evaluated regularly in light of new evidence. To achieve these goals, the audit team holds discussions about the risk of material misstatement due to fraud and the need to apply healthy professional scepticism at all times. On larger audit assignments, in particular those whose audit team is divided among different locations or operating units, it may be advisable to establish procedures for channeling information about potential fraud risk factors, so that the information is readily available to the audit engagement leader and those assisting in the management of the audit. The team might also establish a formalstep during audit completion to discuss the cumulative evidence.

Discussion among Audit Team Members

Because discussion within the audit team is now a required part of the audit process, it bears a closer look. It is instructed that such a discussion take place and include an exchange of ideas about how the entity's financial statements" might be susceptible to material misstatement due to fraud, how management could perpetrate and conceal fraudulent financial reporting, and how assets of the entity could be misappropriated. It also put onus on the audit team to emphasize how to maintain "the proper state of mind throughout the audit regarding the potential for material misstatement due to fraud." The discussion of the entity's susceptibility to material misstatement due to fraud is expected to encompass consideration of fraud risk factors discussed in this chapter In addition, it is intended to cover the risk that management might override controls and set aside any previously held views concerning management's integrity. The discussion should also address how the audit team proposes to respond—such as with additional or alternative procedures to any fraud risk factors identified at this stage. It does not prescribe the manner in which the importance of professional skepticism is to be conveyed to the audit team in the course of the discussion, a reasonable approach might involve touching on each of the following issues, perhaps with the help of illustrative examples:

1. Impact of any issues emerging from the client acceptance or client continuance assessment.
2. Past experience: any frauds or accounting errors uncovered previously.
3. Assessment of the quality of accounting and reporting personnel or client employees involved in the internal control structure.
4. Fraud risk factors set out in the relevant guidance: Attendees might consider these factors in advance to allow for informed discussion during the meeting.
5. The information needed for assessing the risk of material misstatement due to fraud and how it will be gathered. Options include: Inquiries of management, Analytic procedures, Consideration of any fraud risk factors identified, Other sources
6. Additional steps required: Using information obtained to identify fraud risk Assessing fraud risks identified, taking into account an evaluation of relevant

controls, including the risk of management override of controls. Responding to the results of theassessment through additional procedures or other responses, as appropriate. Evaluatingaudit evidence

7. Indicators to look out for, and what to do about them The audit engagement leader's reaffirmation of the importance of professional skepticism at all stages of the audit
8. How to document audit work in relation to the consideration of fraud risk
9. Points to take from the team meeting and incorporate into the audit planning process. Not all of these points will be relevant in every case. The auditor has discretion to decide whether to deal with the points in one or more separate meetings or as part of a larger meeting.

Assessing the Potential Impact of Fraud Risk Factors

The auditor must apply professional judgment not simply in determining that there is a theoretical risk of material misstatement due to fraud but also in "the consideration of the attributes of the risk, including:

1. Assessing the Potential Impact of Fraud Risk Factors
2. The type of risk that may exist: whether it involves fraudulent financial reporting or misappropriation of assets
3. The significance of the risk: whether it is of a magnitude that could result in a possible material misstatement of the financial statements
4. The likelihood of the risk: the likelihood that it will result in a material misstatement in the financial statements
5. The pervasiveness of the risk: whether the potential risk is pervasive to the financial statements as a whole or specifically related to a particular assertion, account, or class of transactions

All of the above attributes will influence both the extent to which the auditor needs totake specific steps to respond to a particular risk factor and the nature of those steps. The range of possible responses is considerable. At one end of the spectrum, the auditor may reasonably conclude, after proper consideration of the foregoing attributes, that no specific c steps need be taken. At the other end, the auditor may have such grave concerns and therefore may feel unable to form an opinion. The auditor may even consider resigning the appointment. All but one of the foregoing attributes are simply more sophisticated statements of the common, intuitive risk formula: probability multiplied by downside. The exception is type, which has no direct bearing on either the probability or extent of a potential misstatement but has significant impact on the nature of the response to a particular risk. For example, the auditor's approach to addressing the risk of material misstatement resulting from intentional overestimation of the value of an asset in a highly judgmental area may be quite different from the approach taken to the risk of material misstatement arising through the concealment of theft of physical inventory. The likelihood or probability of a material misstatement due to fraud cannot be precisely quantified. An auditor's assessment of this attribute may be influenced by a personal assessment of the entity's internal controls (including the existence of an effective audit committee or other supervision of management) in particular, the effectiveness of internal controls designed to deter or mitigate the risk in question. In any event, in keeping with the need to apply professional skepticism at all times, the auditor should not base an assessment of likelihood solely on a general belief in the integrity of management or others or on the fact that material misstatements due to fraud occur relatively rarely. The attributes significance and pervasiveness are closely related; both address the potential scale of the misstatement that might arise. A risk is significant if it could potentially lead to a material misstatement in the financial statements. The pervasiveness of a fraud risk factor has to do with whether that risk threatens the accuracy of the financial statements as a whole or threatens only specific assertions, balances, or transactions. It is not necessary for both attributes to be present for there to be a risk of material misstatement. Naturally, in assessing whether a material misstatement could arise, the auditor should consider the impact on both the balance sheet and the profit-and-loss account. A deliberate overstatement of inventories may not be material in balance sheet terms but could nonetheless be material with regard to profit.

INGREDIENTS OF FRAUD

There are four elements to any fraud

1. A false representation of a material nature (either misstatement or omission ofmaterial fact).
2. Scienter: Knowledge that the representation is a false or reckless disregard fortruth.
3. Reliance: The person receiving the representation has reasonably and justifiablerelied on it.
4. Damages: such receiving party has sustained financial damages on account of theabove.

Organizations of all types and sizes are subject to fraud. On a number of occasions over the past few decades, major public companies have experienced financial reporting fraud resulting in turmoil in the capital market, a loss of shareholder value, and in some cases the bankruptcy of the company itself.

Financial statement fraud was a contributing factor to the financial crisis and it threatened the efficiency, liquidity and safety of both debt and capital markets. Frauds have increased uncertainty and violability in financial markets, shaking investor confidence worldwide. It also reduces the creditability of financial information that investors use in the investment decisions. Taking into account the loss of investor confidence as well as reputational damage and potential fines and criminal actions, it is clear why financial statement should be every manager's worst fraud related nightmare.

Who Commits Fraud?

Generally there are 3 groups of business people who commit financial statement fraud. They range from senior management CEO, CFO; Mid and lower level management and organizational criminals. CEOs and CFOs commit accounting frauds to conceal true business performance to preserve personal status and control and to maintain personal income and wealth

Mid and lower level employees falsify financial statements related to their area of responsibility (subsidiary, division or other unit) to conceal poor performance and/or to earn performance based bonuses.

Organizational criminals falsify financial statements to obtain loans or to inflate a stock they plan to sell in a "pump an dums" scheme.

While many changes in financial audit processes have stemmed from financial fraud or manipulation history and related research repeatedly demonstrates that a financial audit simply cannot be relied upon to detect fraud at any significant level.

Consequences of Fraudulent Reporting

Fraudulent financial reporting can have significant consequences for the organization and its stakeholders as well as for public confidence in the capital markers

TYPES OF FRAUD

The delineation of fraud to 'occupational fraud and abuse' is a good start to study the desired scope of fraud. Yet still, a further classification is convenient. There are numerous ways of classifying occupational fraud. The classification most used is the one where two types of fraud are distinguished:

Financial statement balance fraud and asset-theft fraud. The main difference between the former and the latter is that there is no theft of assets involved in the former. (Davia et al., 2000)

Bologna and Lindquist (1995) classify fraud on many ways, amongst them fraud for versus against the company, internal versus external fraud, management versus non-management fraud and transaction versus statement fraud. Some of them overlap the above mentioned classification into financial statement balance fraud and asset-theft fraud. For example, asset-theft fraud will be fraud against the company and transaction fraud, without being classified as internal, external, management or non-management fraud. Various combinations can be made in this manner.

Two elaborate surveys, one in the United States (ACFE, 2006) and one worldwide (PWC, 2005), yield the following information:

- 45% of companies worldwide have fallen victim to economic crime in the years 2004 and 2005. No industry seems to be safe and bigger companies seem to be more vulnerable to fraud than smaller ones. Small businesses however suffer disproportionate fraud losses. The average financial damage to companies subjected to the PWC survey, was US$ 1.7 million per company

- Participants of the ACFE study estimate a loss of 5% of a company's annual revenues to fraud. Applied to the estimated 2006 United States Gross Domestic Product, this would translate to approximately US$ 652 billion in fraud losses for the United States only. Regarding to the types of fraud, asset misappropriation was number one in both studies. In the PWC survey, this was followed by financial misrepresentation and corruption, false pretences, insider trading, counterfeiting and money laundering. The ACFE report handles a different classification, where asset misappropriation takes 91% of the reported cases for its account, corruption 31% and fraudulent statements 11%. About the way fraud is detected, both studies stress the importance of tips and chance in detecting fraud. According to the ACFE report, an anonymous fraud hotline anticipates a lot of fraud damage. In the cases reviewed, organizations that had such hotlines, suffered a medianloss of US$ 100.000, whereas organizations without hotlines had a median loss of US$ 200.000. At the PWC study, no less than 34% of the fraud cases were detected by means of tips and other 'chance' means. Internal audit and internal control systems can have a measurable impact on detecting fraud after chance related means. The more control measures a company puts in place, the more incidents of fraud it will uncovered.

Types of Frauds and Financial Crimes

1. **Trojan Horse Frauds:** These are frauds which are committed in two parts or phases. Where systems laid down are reasonably good and well defined, the fraudster is not certain whether an act of fraud would be safe for him. In such situations, the fraud is done in two phases. The first phase is that during which the resilience and strength of a control is tested by the potential fraudster. If the act is noticed or questioned, the fraudster offers a plausible explanation of feigned ignorance or a simple lapse on his part. In such instances, the fraud usually does not enter the second phase. However, if the act is not noticed or questioned, the fraudster musters up the strength to commit the fraud. The second phase is then activated during which the actual act of damage is undertaken after the fraudster is satisfied that the critical period has passed and that he can go ahead with minimum of risk. A typical caseis where some collection of money is suppressed, but not pocketed immediately. Suppose an accountant receives some money for sale of junk or scrap. In a Trojan horse type of fraud, he will not pocket the money immediately; neither will he prepare the cash receipt. In the first phase, he would do something like this: He would put the cash received in an envelope, mention 'proceeds of scrap sale' on it in bold letters, mark the date on the envelope and initial it. He will keep it somewhere in one of the drawers in the office. Fora few days, perhaps weeks or even months, he would say or do nothing about it. After a sufficiently long time has passed, when he is reasonably certain that the scrap sale has been forgotten, (referred to as 'the critical period') the envelope with the money would be stolen. This act of stealing is the second phase. The second

phase is undertaken only if the first phase has yielded satisfactory results, i.e. the system or procedure has proved to be weak or fragile. This is a typical Trojan horse fraud. The name is derived from the Greek mythology of the Trojan horse where the Greeks could not break through the Trojan defence and they created an innocent looking wooden horse to test the Trojans. The horse was intended to test the strength of Trojans defence. If the Trojans destroyed the horse, the city would have been impenetrable. However, throwing caution to the winds, the Trojans took the horse inside the city and at a convenient time at night, soldiers who were hidden inside the horse came out and overwhelmed the Trojans. The Trojan horse was successful. In principle, a fraudster uses an object, act or some kind of a test as a Trojan horse to evaluate the level of risk or safety in a given situation. He evaluates the results of the act and then decides whether to go ahead. These frauds are perpetrated with considerable planning behind them and an shrewd mind masterminding them. The most effective preventive steps that could be taken are:

a) Identify key controls in every system and

b) To constantly test key controls.

For the first part, assistance from risk management specialists in this field may be effective, in addition to the usual compliance and internal audits. As regards the testing of key controls, using tiger teams testing could be effective. These 'tiger' teams test the strength of a control by attempting to break it. Various conditions are artificially created and the system is tested practically. Conditions under which the controls do not work or levels at which procedures wilt under pressure are then examined for possible remedial and corrective measures. Such tests enable the management to evaluate the resilience of controls against possible threats and exposures and possibly take appropriate measures. Moreover, this throws a spanner in the plans of a potential fraudster remarkably. The tiger teams approach has a double effect in that, on the one hand, it increases management preparedness and on the other hand, it weakens the confidence and reduces the safety level for perpetration of a fraud.

2. **Disaster Frauds:** These are frauds which thrive on situations of disaster, chaos, anarchy, and disorder. The fraudsters operate under the shield of the confusion created in such situations. In the event of a calamity such as fire, floods, earthquakes and other accidents, naturally the organisation is reeling from the aftermath and shock. It becomes impractical or impossible to comply with systems and procedures and information and evidence can be easily suppressed. Knowledge of asset location and whereabouts, weaknesses and strengths of controls and access to other sensitive information can be used or misused. Assets, valuables and information can be stolen, sold, damaged or destroyed for ulterior purposes. Just as a patient recovering from an accident has to be extremely careful to avoid catching a dangerous infection, so also an

organisation has to be very cautious while trying to stabilize itself after a disaster. Take the case of a warehouse keeper who was in a warehouse where there was a huge fire. There were stocks of electronic items such as calculators, memory chips, and other items which were lost by fire. By the timethe fire could engulf the entire warehouse, some stocks could be salvaged. However the insured might not have disclosed any or all of the stocks salvaged to the insurance company. That is why every insurance claim has to be carefully scrutinized and examined from several angles to ensure that all clues fit in satisfactorily. It is dreadfully simple fora claimant to inflate the claim and later explain it away as an error if caught. The insured also has the convenience of stating that all records are lost or in disarray and cannot be retrieved. These kinds of disaster frauds are the relatively simple ones, but there can be more malicious ones also. The example of the warehouse keeper is an example of a simple one, where at worst, some of the stocks may be reduced from the salvageable quantities. However the malicious frauds are those where a disaster is created as a shield to hide the fraud already committed. Such a disaster can affect an organisation in much greater dimensions and can take years to recover from. There was a classic case of a loss making hotel in a remote location where a new manager was able to show profits. There was a sudden turnaround and the hotel started making astronomical profits even though business conditions were gloomy and room occupancy had not perceivably gone up. Amazingly, the profits were evidenced through full cash receipts; therefore there was no room for doubt in the minds of the management. However what was really happening was that the manager was selling off expensive assets of the hotel such as chandeliers, paintings, cut glass show pieces, etc. Elegant teakwood furniture was replaced by commercial plywood furniture. Part of the money was routed back to the hotel as sale proceeds to show an upswing in the business and gain the confidence of the management, and part of the money was pocketed. When the hotel was fully stripped of all its resources, the manager decided to set it on fire to escape accountability and hide his fraud. Such a fraud is far more serious and affects the organizations' financial position, goodwill and can attract even statutory liabilities. One of the most effective methods is to evaluate the sheer logistics of a situation. The theory of inverse logic is one of the most effective ways to detect such frauds. It advocates application tests of 'impossibility': Are any of the events apparently incredible and impossible? In the case above of the hotel, there were enormous cash receipts on days of strike, bandhs, inauspicious occasions, whereas on days when the manager was on leave or ill there were nil sales. Detection of frauds in disaster situations in a direct manner is otherwise very difficult.

3. **Achilles Heel Frauds:** The fraudster applies the principle that no chain can ever be stronger than its weakest link. These frauds are the perpetrated by those with

a very sharp mind. Those fraudsters have an eye for detail. They can discern the smallest weakness or exposure in a system and exploit it. Such frauds are appropriately referred to us the Achilles Heel frauds, named after the legendary Achilles who was invincible but for his heel. It was his heel which was the only vulnerable part of his body which was attacked and which eventually brought about his downfall. Some systems are like that. They may be the most immaculately designed systems with controls and procedures of the highest order. But a small weakness can allow a fraud of high dimension to take place. To illustrate this point, a company had newly acquired an accounting system. As in every accounting system, there were several input documents, each of which had several fields for information. The management had bought the software off the shelf, on recommendation of a professional, and had not paid much attention to its minute details. However the accountant did, and found that the module for receipts had two fields for dates: the date of 'receipt' of a cheque and the actual date of the cheque called the date of the 'instrument'. For example a cheque may be prepared by a debtor on say November one (date of the instrument), but may reach the creditor by post only on the fifth of November. The software provided input of both dates to facilitate analysis of collections and corresponding entries in the records. The management was blissfully unaware that the accountant was entering the instrument date in the system to clear a favoured debtor's account. Accordingly the debtor was given a credit retrospectively for a payment made even a month, merely by dating his cheque a month earlier than the date of its delivery. This entitled the debtor to get all bonuses and the early bird incentives which he shared with the accountant. Such small little items often are inconspicuous but could have incredible impact. In the above case where the company had a panel of 1000 debtors, the fraud damaged the company's working capital to an average of almost 20 lacs per month.

What can be done to understand the circumstances in which these kinds of frauds can occur? Each feature of the accounting system must be comprehensively examined and understood before audit. From the point of view of the management, customized systems are much better than ready off-the-shelf systems.

Each organisation has its own strengths and weaknesses, its own culture, attitude and employee morale. Rarely does an alien system adapt itself automatically. Unless customization is done, a system can bring in inherent weaknesses which can be exploited by sharp minded people. System testing is essential not only at the beginning but also for some time during actual implementation to learn, understand and combat flaws which surface only on practical usage.

4. **Corporate Espionage:** There was a simple fresh graduate recruit junior level clerk in the purchase and procurements department of an engineering company. His antecedents showed that he was of a lower middle class background drawing a salary of Rs 5,000 and generally meager means. His

father was in debt and had poor health. One fine day, the clerk invited his colleagues to a party and announced that he had recently purchased a new flat. When the colleagues attended the party, they were stunned to see that the flat was a huge four bedroom flat which had been embellished with marble and granite fittings and expensive furniture. The explanation given was that he had made a lot of money on the stock exchange. However what did not make sense was that he neither had the money to make the initial investment nor the nerve, initiative nor the intelligence to undertake speculation. He did not seem to have a known broker and could not even clearly discuss which scrips he had invested in and during which periods he had made profits. It was clear that the stock exchange earnings were merely a front for some other source. Since he had virtually no decision making authority, it was unthinkable that he would be able to make money through vendor frauds or payroll frauds or expense frauds. Then how did he generate the money? A field investigation was carried out and it was found that he was selling company information. Information about the company's research, products, technology and methods, which he had easy access to was a saleable product. Today, information carries the highest value and frauds which sell information about a company to its competitors are on the rise and considerable time and money is being spent on this by large corporate houses. Such frauds are almost impossible to prevent and deter. For one thing, information is intangible and cannot be missed such as a pilfered asset or money. Secondly, facilities for transporting it through email, internet etc., are easily available. This makes it even more impractical to monitor misuse or theft of information. No amount of security will completely prevent a fraud. The only thing that can be done is to minimize damage. This can be partially achieved by applying the 'red herring method'. Use of decoy storage is found to be very effective. Keep sensitive information in two or three places, of which only one has the full correct information. The chances of the correct information leaking out are that way reduced to one third. This must be supplemented with constant patrolling of all priority systems to see that there are no security breaches and violations, however small insignificant or accidental they may seem to be. In one EDP department, it was found that there were computer breakdowns which had a pattern. They happened only during duty hours of a particular EDP manager. It was later learnt that under the guise of carrying out repairs, data access restrictions had to be relaxed, and important data files were copied, or damaged or downloaded for sale to competitors. Thus even accidents must be examined for causes and sinister possibilities. Noncompliance of security rules must be viewed very seriously to enforce discipline. Lastly, special training sessions must be held to educate employees at all levels as to the dangers of such corporate espionage activities, the company policies, and penal action.

5. **Technical Frauds.** These are frauds which can happen right in front of the eyes of the management and it may not even know that it has been defrauded. This is because technical aspects are beyond the comprehension and frauds using these as a cover, are difficult, if not impossible to detect. A fraud of a high magnitude was observed in a case in which a plastic component manufacturing company used the services of external vendors possessing moulds for manufacture of such components. The raw material was sent to the vendors moulders to process and return the components on the basis of norms fixed in advance. Apparently, the vendor was giving a good yield for the material sent and the company had no reason to complain. However in reality, the vendor was not utilizing the raw material fully. About 90 % of the raw material received was mixed with scrap and processed. The balance 10 % unused raw material was used for personal consumption or sold outside and the proceeds pocketed. Since the volumes of production were high, even a mere 10 % scrap mixed amounted to a raw material saving equivalent to Rs 25 lacs annually. The quality control division of the company did not possess sufficiently sophisticated tools to evaluate the quality of components produced. The norms for input output ratios had not been revised for a long time. The vendors also kept the quality control inspectors happy so as to ensure a smooth approval and acceptance of processed material. Such frauds can happen in any kind of manufacturing activity where the controlling authorities have little or no technical knowledge, or where there aren't sufficient tools to check such frauds. **Here too such frauds are difficult for anyone to detect.** In the above illustration of the plastic components, it was during the physical verification of stocks which produced the first anomaly. A huge pile, apparently of scrap, was observed at the vendor's site. This was unusual since the vendor was doing business only for the above company, and as per insurance policies taken out by the company, only stocks of raw material were expected to be on the site. The company also confirmed that this was not the usual production scrap accumulated over a long time. It was something different. Further, the physical raw material stocks showed some shortages on comparison with records. On inquiring about both these above issues, the vendor was visibly disturbed. As regards the shortage he readily accepted the responsibility and was prepared to make it up to the company. As regards the pile of scrap, he stated that this was a pile belonging to one of the neighbouring factories, allowed temporarily to be kept, to help out with their storage problems. However the auditors were not fully convinced. They took a round in the factory and inquired about the pile of scrap with one of the workers. The cat was out of the bag; that scrap was inferior raw material to be mixed with the company's good raw material received for processing in a certain proportion. The clandestinely saved good raw material was disposed outside and proceeds pocketed.

6. **Employee Fraud/Misappropriation of Assets:** This type of fraud involves the theft of cash or inventory, skimming revenues, payroll fraud, and embezzlement. Asset misappropriation is the most common type of fraud. Primary examples of asset misappropriation are fraudulent disbursements such as billing schemes, payroll schemes, expense reimbursement schemes, cheque tampering, and cash register disbursement schemes. Sometimes employees collude with others to perpetrate frauds, such as aiding vendors intent on overbilling the company. An interesting distinction: Some employee misdeeds do not meet the definition of fraud because they are not schemes based on communicating a deceit to the employer. For example, theft of inventory is not necessarily a fraud it may simply be a theft. False expense reporting, on the other hand, is a fraud because it involves a false representation of the expensesincurred. This fraud category also includes employees' aiding and abetting others outside the company to defraud third parties.

7. **Financial Statement Fraud:** This type of fraud is characterized by intentional misstatements or omissions of amounts or disclosures in financial reporting to deceive financial statement users. More specifically, financial statement fraud involves manipulation, falsification, or alteration of accounting records or supporting documents from which financial statements are prepared. It also refers to the intentional misapplication of accounting principles to manipulate results. According to a study conducted by the Association of Certified Fraud Examiners, fraudulent financial statements, as compared with the other forms of fraud perpetrated by corporate employees, usually have a higher dollar impact on the victim identity as well as a more negative impact on shareholders and the investing public. As a broad classification, corruption straddles both misappropriation of assets and financial statement fraud. Transparency International, a widely respected not-for-profit think tank, defines corruption as "the abuse of entrusted power for private gain." We would expand that definition to include corporate gain as well as private gain. Corruption takes many forms and ranges from executive compensation issues to payments made to domestic or foreign government officials and their family members. This point is primarily concerned with fraud committed by employees and officers, some of which may lead to the material distortion of financial statement information, and the nature of activities designed to deter and investigate such frauds. Circumstances in which financial information is exchanged (generally in the form of financial statements) as the primary representation of a business transaction are fairly widespread. They include, for example, regular commercial relationships between a business and its customers or vendors, borrowing money from banks or other financial institutions, buying or selling companies or businesses, raising money in the public or private capital markets, and supporting the secondary market for trading in public company debt or equity securities.

This financial fraud focuses primarily on two types of fraud:

(1) Frauds perpetrated by people within the organization that result in harm to the organization itself and

(2) Frauds committed by those responsible for financial reporting, who use financialinformation they know to be false in order to perpetrate a fraud on investors or other third parties, whereby the organization benefits.

8. Revenue Frauds

- Fictitious sales revenue: Sale of non-existent goods, sales to non-existent customers.
- Inflated sales: Shipping of goods not ordered, treating consignment as sales, ignoring shipping terms that deals such ownership transfer.
- Overbilling customers: Billing customers above agreed upon price.
- Deceptive sales practices.
- Defective parts: Sale of defective parts that will be returned subsequently
- Reimbursement for services not provided or not covered under government program
- Underwriting fraud scheme: Rigging the research reports on companies to gain advantage in underwriting e.g. bullish reports by Smith Barney on AT & T to benefit in the underwriting of AT & T spinoff of its wireless subsidiary.
- Billing, Collection or recording of Vendor allowances and support earnings management by setting unrealistic sales target, reporting under achievement to vendors, marking down prices, and claiming allowances from vendors to share up revenues.
- Deceptive sales practices, including slamming. Slamming is the practice of switching the long distance telephone service from one carrier to another without the customer consent.
- Skimming: Abstracting cash by delaying the recording of transaction or not recording it at all.
- Product diversion: Diversion of products to markets/ users not intended usually in exports sales, promotional offers excess merchandise destruction, charitable donation.
- Inflated claims: often by Pharma Benefit managers(PBM)
- Round trip Trading: An action that attempts to inflate transaction volumes through the continuous and frequent purchase and sale of a particular security, commodity or asset.
- Ricochet Trading, sometimes known as Megawatt Laundering arbitrate trading involving buying at low price from one market and selling the same product in another market at a much higher price.

- Inter-positioning specialist in a stock inter-positioning himself by trading separately with the buy order and the sell order rather than executing the orders thereby obtaining higher profits.
- Sim Card cloning: Selling of cloned sim cards of mobile phones

9. Assets Frauds

- Theft of competitors secrets.
- Theft of 3rd party intellectual property.
- Manufacturing and material frauds.
- Frauds involving revenue sharing arrangements, reinsurance arrangements.

10. Violation of Law

- Anti- trust violations/ market rigging / price fixing
- Violation of environmental laws and regulations
- Violation of Occupational health and safety (OSHA) Laws
- Late trading and Market timing violations facilitating unlawful late trading and deceptive market timing of mutual funds by its customers and customers of its introducing brokers

11. **Bank Frauds:** The number of bank frauds in India is substantial. It is increasing with the passage oftime in all the major operational areas in banking. There are different areas where fraud may exist, like Bank- Deposits, Inter-Branch Accounting, Transactions, etc. As a customer you may be seen as a potential target for fraudulent activities. However by arming yourself with information and tools you can protect yourself from becoming a victim of fraud. The biggest threats of frauds are categorized as under

- Electronic fraud
- Identity fraud
- Credit/Debit card fraud: Credit card and debit card fraud is a crime whereby your credit or debit card can be reproduced in order to use the credit balance to obtain a financial advantage. The creation and /or alteration of a credit/debit card occur when the information contained on the magnetic strip is reproduced. This type of crime is known as “Skimming”. Credit or debit card fraud can also occur whenyour card is lost or stolen and used by a third party to purchase goods with those cards or to remove cash from the cards. Credit or debit card can also be intercepted in transit while being sent to you. Your cards can also be compromised by a dishonest merchant who undertakes unauthorized duplicate transactions on your card.
- Cheque Fraud: Cheque fraud is the use of a cheque to get financial advantages by

1. Altering the cheque (payee/amount) without authority.
2. Theft of legitimate cheques and then altering them.
3. Duplication or counterfeiting of cheques.
4. Using false invoices to get legitimate cheques.
5. Depositing a cheque into a third party account without authority
6. Depositing a cheque for payment knowing that insufficient funds are in the account to cover the deposited cheque.

It is the use of potentially illegal means to obtain money, assets, or other property owned or held by a bank or financial institution, or to obtain money from depositors by fraudulently posturing as a bank or other financial institution. In many instances, bank fraud is a criminal offence. The number of bank frauds in India is substantial. It is increasing with the course of time in all the major operational areas in banking. Bank fraud is a big illegal business in today's world.

12. **Corporate Frauds:** Corporate Frauds can be defined as "Activities undertaken by an individual or company that are done in a dishonest and illegal manner and are designed to give an advantage tothe perpetrating individual or company" In India, corporate frauds are on a rising trend, Satyam Computers stunned the national financial world in 2009 by inflating profit and jacked up the company's balance sheet by more than one billion dollars. It is an unlawful activity undertaken by an individual or a company to give an advantage to the perpetrating company. In India, it has raised from 37% in 2010 to 45% till date. In the corporate environment frauds which are committed by employees of the organization are referred to as Occupational or Employee frauds. Occupational Fraud is also defined as an employee's misuse or abuse of his position forhis own enrichment by intentional misappropriation or misuse of company assets. This may include fraud by an employee, manager or statutory representative Occupational Fraud is broadly classified into 3 types

    (a) **Asset Misappropriation**: This type is the most common, probably because they are the frauds that occur most often and are the easiest schemes to understand. An asset misappropriation might include things like cheque forgery, theft of money, inventory theft, payroll fraud, or theft of services. Misappropriation happens in over 91% of fraud schemes. This easily makes it the most common fraud.

    (b) **Fraudulent Financial Statements:** The least common type of fraud amongst the 3 categories of fraud in terms of occurrence is the financial statement fraud. Although it occurs least frequently, in only 10% of all fraud cases. It is easily the most expensive. The average financial statement fraud cost to a Company is very high. This type of fraud centers on the manipulation of financial statements in order to create financial opportunities for an individual or entity. Stock price, increased year-end bonuses, favorable loan terms or other indirect benefits arefew of the reasons as to why financial statement frauds are committed.

Financial Statement fraud means manipulation, falsification and alteration of accounting records, inventory manipulation, over & under invoicing, Advance billing, Non impairment of assets, and use of related party transactions not at arm's length pricing. This manipulation could be done by booking fictitious income or Advance Booking of Income or non-booking/ non-accrual of expenses to increase profits to avail loans/ credit or boost share prices or reduce income or inflate Expenses to reduce profits with a view to pay lower taxes. Alternatively assets like stock or book debts could be inflated to arrive at an inflated drawing Power to enable more credit to be obtained. Falsifying documents wholly or in part is termed Forgery. The practice of presenting a rosier picture than what is in reality is also termed as "Window Dressing or Ever Greening

(c) **Corruption:** The next most frequently occurring fraud scheme is corruption and bribery, which is part of about 30% of all fraud that is uncovered. Bribery and corruption include schemes such as kickbacks, shell company schemes, bribes to influence decision making, manipulation of contracts, or substitution of inferior goods. The average bribery/corruption scheme is far more costly than asset misappropriation but less costly than Financial Statement Fraud.

13. **Insurance Frauds:** Insurance fraud is any act committed with the intent to obtain a fraudulent outcome froman insurance process. This may occur when a claimant attempts to obtain some benefit or advantage to which they are not otherwise entitled, or when an insurer knowingly denies some benefit that is due. According to United States Federal Bureau of Investigation the most common schemes include

- Premium Diversion
- Fee Churning
- Asset Diversion and
- Workers Compensation Fraud.

The perpetrators in these schemes can be both insurance company employees and claimants. False insurance claims filed with the intent to defraud an insurance provider Insurance fraud has existed since the beginning of insurance as a commercial enterprise. Fraudulent claims account for a significant portion of all claims received by insurers Types of Insurance fraud are diverse, and occur in all areas of insurance, insurance crimes also range in severity, from slightly exaggerating claims to deliberately causing accidents or damage. Fraudulent activities affect the lives of innocent people both directly through accidental or intentional injury or damage, and indirectly as these crimes cause insurance premiums to be higher. Insurance fraud poses a significant problem and governments and other organizations make efforts to deter such activities. Such instances of Fraud have been occurring both in the life and non-life sector. There are significantopportunities for professional in the field of forensics and risk management both in the assessment of risk for insurance sector as well as in determining the veracity of theclaims

According to a survey carried out by E& Y "Fraud risk possess a very big challenge for the insurance sector. Business leaders are aware of the need to address this risk, but the lack of a comprehensive and integrated approach to fraud risk management continues to be a concern. The increasing number of frauds and the growing degree of risk necessitates that the insurance companies regularly review their policies build in checksand use new and advanced technology to avoid such issues. However, no system can be foolproof, but a proactive and dynamic approach can make a company ready to counter fraudsters and gain an edge over its competitors.

The key finding of the survey are still valid today:

- There have been increased incidences of fraud over the last one year.
- Fraud risk exposure from claims or surrender is a major concern area for industry players. They have emphasized the need for increased anti-fraud regulations in the area of claims management.
- Frauds are driving up overall costs for insurers and premiums for policyholders.
- There is a need for a more robust data analytics tools to effectively detect red flags.
- It is imperative to screen all the key vendors.

There is different type of frauds in insurance sectors. E.g. health insurance, claims fraud, false claims, insurance speculations, application frauds etc.

Similarly, policyholders seek the help of a forensic accountant when they need to challenge the claim settlement as worked out by the insurance companies. A forensic accountant handles the claims relating to consequential loss policy, property loss due to various risks, fidelity insurance and other types of insurance claims

14. **Cyber Frauds:** Cyber-crime encompasses any criminal act dealing with computers and networks (called hacking). Dr. Debarati Halder and Dr. K. Jaishankar (2011) define Cybercrimes as: "Offences that are committed against individuals or groups of individuals with a criminal motive to intentionally harm. Additionally, cyber-crime also includes traditional crimes conducted through the internet. For example, hate crime, telemarketing and internet fraud, identity theft and credit card account thefts are considered to be cybercrimes when the illegal activities are committed through the use of a computer and the internet. The computer may have been used in the commission of a crime, or it may be the target. Net crime is criminal exploitation of the Internet. the reputation of the victim or cause physical or mental harm to the victim directly or indirectly, using modern

telecommunication networks such as Internet (Chat rooms, emails, notice boards and groups) and mobile phones (SMS/MMS)".Such crimes may threaten a nation’s security and financial health.

15. **Securities Frauds:** These scams occur because of manipulation of the market by other “insiders” or large players in the stock market who cause stock prices to fluctuate unusually for their own personal gain, either through use of insider information or through unfair trading practices. As a result common small investors lose a lot of money as through ignorance they fall into temptation and invest in stocks which they would not have had they had any idea of how the markets were being manipulated. Securities fraud, also known as stock fraud and investment fraud, is a deceptive practice in the stock market that induces investors to make purchase or sale decisions on the basis of false information, frequently resulting in losses, in violation of securities laws. Offer of risky investment opportunities to unsophisticated investors who are unable to evaluaterisk adequately and cannot afford loss of capital is a central problem.

16. **Consumer Frauds:** Consumer frauds means defrauding consumers of various products and services which do not perform as advertised. These types of schemes take the form of false advertising,unfair terms and service conditions, unfair pricing etc.

17. **Identity Theft:** The fastest-growing type of fraud in the world is identity theft. It occurs when the fraudster uses your credit card or bank account information to buy items and then charge them.

CONCEPT OF RED FLAGS

Red flags are sign or warning of any impending danger or inappropriate behavior. Red flags do not necessarily indicate the existence of fraud however are indicators that caution needs to be exercised while investigating the situations. Red flags are classified in the following categories

1. **Financial performance red flags**: They include aggressive goals and performance measures both at the individual and companywide levels. When a certain level performance is mandated by the boss, investors, and the bank or otherwise there can be a temptation to turn to fraud to meet these goals. Companies whose financial performance suggests the possibility of fraud might include some of these signs.

- Significantly outpacing competitors in the industry.
- Outstanding results when the rest of the industries has suffered a downturn.
- Unusual financial ratios when compared to competitors.
- Persistent cash flow problems, even when the company has regularly reported profits.
- A pattern of similar audit adjustments proposed year after year.

2. **Accounting system red flags**: They refer to the organization of the accounting system and the level of internal controls that are in place. A good, secure accounting system cannot exist without such controls. Some of the basic red flags that might be noted in a company's accounting records include

   - Unusual timing of the transaction. This includes the time of day, the day of the week or the season.
   - Frequency of transaction that is occurring too frequently or not frequently enough are suspicious. Each company has its own operating patterns and the transactions should be booked accordingly.
   - Unusual accounts recorded. Take notice of whether an account has many large round numbers entered. Consider whether some of the transactions in the accounts are far too large or far too small.
   - Questionable parties involved. Payment being made to a related party? Is the company paying large sums to a vendor whose name is not easily recognizable oris not a normal vendor of the company?

3. **Operational Red Flags:** They highlight how a company does business each day. Do things run smoothly, minimizing the chance for errors and problems? Or are things managed in such a fashion that errors go unchecked and employees do whatever they want, whenever they want?

4. **Behavioral Red Flags:** They include behavioral pattern of the employees In report to the nations on occupational Fraud and Abuse by ACFE identified the behaviourlal indicators displayed by Fraud Perpetrators. The below figures shows the distribution of those red flags. Approximately 44% of fraud perpetrators were living beyond their means while the fraud was ongoing and 33% were experiencing known financial difficulties. Other common red flags were an unusually close association with a vendor or customers (22%) displaying control issues or unwillingness to share duties (21%) a general wheeler-dealer attitude involving shrewd or unscrupulous behavior (18%) and recent divorce or family problem (17%) These six red flags were also the most common behavioral indicator in each of ACFE's last three studies.

5. **Structural Red Flags:** They relate to the way that a company is set up and the policies and procedures that are in place. Those very systems create opportunities for fraud each day. Employees become familiar with operations and they begin to understand what accounts are unmonitored, which areas of the company are poorly supervised and what size of transaction that creates added scrutiny.

6. **Personal Red Flags:** They refer in the employment policies and procedures within a company, including hiring procedures, advancement policies, employee monitoring programs and disciplinary standards

FRAUD INDICATORS

After many dramatic fraud cases were identified a list of red flags associated with these examples of frauds were developed. Had these red flags been noticed, then the organizations management or employees might not have committed fraud or it might have been caught sooner .The red flags include the following

1. Lack of independence between the organization management , external auditors ,audit committees and internal auditors
2. Lack of competence oversight or diligence in or by the organizations audit committee and internal auditors
3. Weak internal control processes
4. Management style that pressured employees to take actions beyond financial statement management to manipulation to outright misrepresentation which is fraud.

Personal related practices allowing financial statement misrepresentation include low employee morale that is possibly due to inadequate compensation, high turnover and inexperienced managers. This tends to result when there is inadequate screening of potential employees and managers. Accounting practices indicating that someone has committed fraud include frequent external audit or firm changes restatement of prior year reports in parts to large and frequent accounting errors.

An organization that losses financial records may have lost their financial records on purpose to hid fraud. Fraud is easier to commit when there is no strong accounting information system. Company's financial condition that can indicate possible fraud include insider trading and inventory manipulation

INTERPRETING POTENTIAL RED FLAGS

It is not, of course, as easy as it sounds to identify and interpret potential red flags. First, flags are a bit of a misnomer and create a false impression of plainly visible warning signs. While this is true of some frauds, it is important to remember that fraud is fundamentally a crime of deception and deceit. Calling to mind a mental picture of a scarcely visible red thread waving in the wind is more accurate than picturing a bold red flag. Some of the difficulties inherent in identifying and interpreting potential red flags are summarized in the following:

1. **Fraud risk factors are not the same as evidence of fraud**: Risk factors are not evidence of fraud. To the extent that risk factors are evidence of anything, they point to an environment or situation in which there is an increased risk that material misstatement due to fraud might occur either generally or in a specific functional or geographic sector of the entity's operations. Individuals may be motivated by the prospect of bonuses and other incentives to manipulate results to their advantage and in a manner that may amount to fraud. Several high-profile instances of financial statement fraud have been motivated in part by

bonus and incentive arrangements. As an example, a chairman and CEO was accused of earning substantial bonuses and profiting on the sale of shares in the company on the basis of fraudulent financial reporting that misrepresented the company's results. This does not mean, of course, that the presence of bonus and other incentive schemes is prima facie evidence of fraudulent financial reporting, but it may be considered in the overall risk assessment. Another example of a fraud risk factor is the so-called dominant CEO. Over the years—in a number of notorious cases, including the collapse of the Robert Maxwell Empire—a larger-than-life individual apparently held sway over a cowed and ineffectual board and senior management, which enabled him to perpetrate or preside unchecked over a material financial reporting fraud. Even absent a dominant CEO, similar risks can emerge whenever corporate governance is weak—for example, when power is concentrated in the hands of senior management without an effective counterbalance from the board. No one would seriously suggest, however, that the existence of a CEO with a forceful personality and a strong sense of mission is indicative of fraud. It is simply a risk factor.

2. **Fraud risk factors may indicate the existence of risks other than fraud**: Many risk factors are not exclusively indicative of fraud risk. They may also suggest a heightened risk of material misstatements due to human or process error. For example, deficiencies in internal controls may be regarded as fraud risk factors, but they also pose the risk that errors may occur and go undetected without any intent to commit fraud. Sometimes, weak internal controls simply fail to limit or identify accounting or reporting mistakes.The auditor should not discount either possibility without reasonable grounds for doing so. Fraud risk factors can be ambiguous. Many fraud risk factors are susceptible to both innocent and sinister interpretations. The fact that a company has a complex structure with a large number of overseas subsidiaries and significant intra company trading may indicate an increased fraud risk, or it may simply be a legitimate characteristic of that business. On one hand, that a ledger clerk drives a car he appears to be unable to afford may indicate a risk that he has misappropriated company assets. On the other hand, he and his wife may have a two-income household that allows them certain luxuries. The focus must be on fact-finding and critical assessment of cumulative evidence.

3. **There is no linear relationship between the number of fraud risk factors and the level of fraud risk:** It may be that, in general, the more risk factors the auditor identifiesin a client, the greater the overall risk of fraud. But even a few risk factors in key areas may be grounds for concern. A simplistic attempt to quantify fraud risk by a count of risk factors is misguided. The objective is not to estimate how likely it is that a material misstatement due to fraud will occur but, rather, to identify where and in what mannerthat might happen.

4. **Fraud risk factors are of limited significance in isolation:** In general, individual risk factors are of limited significance in isolation. Rather, they need to be considered as a whole. The point about the dominant CEO factor, for example, is that it may actually contain a number of separate risk factors that when looked at together, create a risk situation: a bullying CEO, lack of counterweight among other senior executives, and apparent absence of an effective audit committee, supervisory board, or similar corporate governance function. The auditor attempts to interpret evidence of potential risk factors within the wider context of other observations about the company, its management, and the business environment in which it operates. Nonetheless, the identification of an anomaly or loose thread can lead to the identification of multiple risk factors and control weaknesses or actual instances of financial statement fraud or misappropriation of assets. The auditor considers whether one particular risk factor may, in fact, be linked to one or more other factors.

5. **Some fraud risk factors are very difficult to observe:** Certain fraud risk factors are essentially states of mind or related to an individual's private life or personal financial affairs. They may be impossible to observe directly. The auditor might nonetheless become aware of indirect signs that relevant states of mind or private-life factors mayexist. All of these issues increase the challenge faced by the auditor in trying to identify indications of the existence of fraud risk within the substantial body of information available from the audit process. The accounting standards distinguishes between risk factors relevant to the risk of material misstatement due to fraudulent financial reporting and those relevant to the risk of material misstatement arising out of the misappropriation of assets. In practice, as the standard acknowledges, many risk factors are potentially common to both kinds of misstatement. Risk factors related to weaknesses in control or supervision may, for example, be equally applicable to either type of fraud.

FRAUD DETECTION TOOLS &TECHNIQUES

There are several tools which can be used in fraud detection. Some of the ones commonlyused are:

1. Audit software
2. Mathematical Tools
3. Statistical Tools
4. Electronic or digital tools
5. Advanced Use of Audit Software in Audit and Fraud Detection

With the advent of more and more sophisticated accounting systems, and rapid improvements in technology, soon it will be unthinkable to conduct an audit without using audit software. Therefore, it's essential that auditors sharpen their skills in the use of such tools. Auditors must keep pace with the changing environment because inevitably there will be occasions when a mere working knowledge of these audit tools will be insufficient. For better and more pervasive results in audits, auditors must become experts in applying audit software. Routine or elementary application of audit software, the use of simple commands such as sorting, statistical analysis, totaling and sub totaling, grouping, indexing and filtering certainly offer considerable support when applying audit tests and evaluations. By using software, an auditor can carry out three types of audit checks:

- data input or validation checks through tests of sequential control, and use of commands for scanning missing numbers and record counts
- data processing or report validation checks through simple and standard re-performance tests; for example, reprocessing the debtors aging report using software and comparing it with the auditee's aging report output control checks through distribution and access tests and verification of exception reports
- Similarly, investigation software can help an auditor to apply certain commands for detecting duplicate invoices/ checks / payment vouchers.

Even phantom vendors or employees can be spotted and certain software can even detect suppliers with the same addresses or telephone numbers, and can perform interesting and effective tests for audit and fraud detection.

Most of these tests are usually not possible manually, especially in sophisticated computerized accounting systems and where audit populations have massive amounts of data. To reiterate, without using sophisticated computer tools, auditors would not be ableto conduct such tests. However, the actual creativity, imagination and expertise of the auditor have not yet been used, or if used, only marginally; auditors can scale greater heights and achieve much more meaningful, penetrative and focused results if they build their own experience, foresight, judgment and vision in the audit software.

Auditing has always been a creative process and the auditor's judgment, skills, and experience play an important role in the audit process. While the elementary tests explained above are essential, they are not always adequate to achieve the desired objectives. Towards the end of any audit or investigation, in order to achieve the audit objectives, the auditor must also view the data both on a macro and micro basis, and arrive at his/her own conclusions based on:

- Control and substantive tests' results
- Data trends

Consistency of the data with the given facts in the audited and control environment in the first two points, the elementary tests offer considerable support and assist the auditor in his evaluation process. However, it's the lastpoint in which the use of audit software phenomenally increases the depth and extent of the audit; this is where the advanced application of audit software comes in. After all the routine control and substantive tests are satisfactorily applied and results evaluated, the auditor takes a macro look, in the context of the audit objectives, to satisfy him/herself that all the clues or facts fit properly. This is the place where the auditor's expertise supported by the audit tool can work miraclesin terms of audit results and findings. What should be done at this stage is to compile Data Query Models (DQM) to test the goodness of fit of all the earlier findings with the facts in the auditee and control environment. Quite simply, such DQMs are programs or macros built using audit software for specific queries. These are possible even in simple spreadsheets, as well as in advanced audit software.

The strategy for preparing DQMs always stems from the auditor's study of the auditee's environment, the control environment, and the regulatory statutes applicable to the auditee. The information he/she collects provides various audit clues in the form of facts and conditions that govern the various transactions, operations and the activities under audit. Based on these clues, the auditor can build up a DQM that can be applied to test the fulfilment of conditions or facts that affect the activity. He/she may require the aid of anIT manager to provide technical assistance, or achieve the desired reports. This can be more easily understood from the following examples.

An auditor found that travelling expenses in a certain company were high (as well as voluminous), and controls were weak. Management had not insisted on air/train ticket receipts, and had been loss in monitoring travel expenditures. In this context, the auditor wanted to ascertain whether there was a possibility of any inflated or false travel claims. He made a list of all the metro cities to which senior employees' travel was high. He also obtained from a travel agent the details of flight and train connections, and the days on which such flight/train connection were available from the city in which the company was situated. He asked his IT manager to create a DQM which would filter the client's travel expenses, and each of these were further filtered by city, with details of days and dates of travel. The DQM was required also to compare the dates of actual travel with the dates of flight and train connections available, which were obtained from the travel agent, and generated exception reports. These exception reports were expected to spot instances where any person had travelled to any city when the air/train connection was not there.Sure enough, the report threw up four tours made by the same person to a city on days when the air/train connection was not available. On making further inquiries, the auditor found that this person's expenditures were supported by fictitious bills for hotel, food and conveyance during his four trips. Such a comprehensive test was obviously impossible manually wherein, at best, a sample test would have been applied. However the DQM, compiled through audit software, made it possible to check the travel of every employee for the entire period under audit with accurate results.

Other similar examples are:

A DQM compared employee swipe cards' attendance swipes with dates in tour and travel reports. Since there should be no swipes on dates of travel, inflated claims made by employees were easily detected by comparing dates of travel with swipe card entries.There were plenty of instances where employees extended the dates beyond the actual travel in their reports in order to claim extra travel allowances. In another DQM, freight charges for railway freight were compared with clearing agent's charges for the same consignments. The number of boxes for which railway freight paid was compared with the number of boxes for which the commission was paid to the clearing agent. It wasfound that the agent had inflated his claim by almost four times the actual amount. For a company having several warehouses, a DQM computed the actual dimensions of warehouses and compared the storage volume available with the actual volume of inventory reported. In one case, the computed area, as per the stock statement, was foundto be three times in excess of the physical possibility to store such stocks.

Conclusion all these are relatively simple examples based on certain facts and possibilities. In practice, DQMs can be quite comprehensive, There are various concepts and principles which have been successfully applied in fraud detection and perhaps could be used effectively in similar or closely resembling situations. Some of these concepts and principles are:

1. The theory of Inverse Logic
2. The concept of 'Distrust the Obvious'
3. The Birbal tips and tricks
4. The principle of mirror imaging
5. The three dimensional vision

The theory of inverse logic is a technique which would be useful to detect some frauds at the early stages.Often, it is not possible to ascertain whether any assertion is reliable for want of information. For example, in an insurance claim, in absence of all supporting records, which may have been destroyed or lost, it may be difficult to accept the claim made by the insured, which could be inflated. In such situations, the theory of inverse logic could prove to be invaluable and very effective. In simple words, if you cannot find out whatthe truth of the matter is, find out what it cannot be and eliminate all such possibilities. This process of elimination is application of inverse logic which sometimes is the only method left to ascertain the truth or fact in a given case. This principle is wonderfully exemplified by the doctrine of the Neti Neti Vaada spiritually elucidated in our Upanishads. This doctrine explains that the whole world as we see it is an optical illusion, and consequently it is not possible to reach or access the Truth (Parmatman) directly. There is another way to reach it indirectly, by the process of renunciation. By renouncing the world, the body, the mind, the ego and everything in this unreal world, what shall remain is the real truth. This has been explained in the 'Brihadaranyaka Upanishad' bysage Yagnavalkya. In simpler words, in order to achieve salvation or moksha or nirvana, use the process of elimination. Fraud detection is exactly the same thing: a quest for the truth in a given situation. Because of alterations and deceptions, which can be compared with optical illusions in the above theory, it is possible that the truth is distorted, hidden or suppressed. By eliminating what is not true, the investigator will come much closer to the truth. How this can be applied is explained below in a few examples. Take the case of inventories in an organisation. While the sophisticated software and inventory control systems do provide a high level of comfort in the reliability of the reports generated, there have been cases found where inventories had been conveniently inflated for banker's hypothecation or insurance claims. There is a famous 'Salad Oil Scandal' fraud case which features in practically every audit or fraud related publication. In this case, the intelligent fraudster took loans from several banks against hypothecated salad oil stocks in warehouses to such an absurd extent that, the aggregate quantity of all salad oil stock pledged with the banks exceeded even the stock of salad oil in that whole country. None of the banks had bothered to ascertain whether the total stock so hypothecated was reasonable and acceptable. They failed to recognise the reality and practicality of the situation. In the same manner, the reliability of production figures can be greatly enhanced by ensuring that they are within the installed capacities Production can never be greater than the machine capacities. Similarly sales or closing stocks cannot be greater than produced or manufactured quantities plus opening and bought quantities. The auditor must seek to identify and provide for all such absurdities, impossibilities or improbabilities. In a situation of disorder, chaos and disaster such healthy checks and balances must be constantly applied to ensure a smooth recovery till proper systems are redesigned and implemented In another case a steamer agent's fraud of raising fictitious bills Rs 40 lacs on the client was easily caught due to a simple clue: The fictitious bills raised by the steamer agent were for terminal handling charges which were well supported with full details of tonnage, number of packets in break bulk cargo, the reference of the bill of entry, the vessel name, the date of arrival, customs duty paid etc. However, the fraudster made one small mistake. He did not know that Terminal Handling Charges were levied by port authorities only in respect of container cargo and were not applicable to packages in break bulk cargo! In exceptional circumstances, where the information is missing, incomplete or deliberately modified, fraud detection becomes very difficult. How then, does the examiner determine and prove the existence of fraud, particularly if he does not have full details and correct facts and information? The following is one such case study where all facts were not available and the examiner found that certain clues did not fit, and he applied 'Inverse Logic' using his investigation software to prove the impossibility of an insurance claim for stocks by fire.

Detecting fraud is difficult, especially frauds involving material financial statement misstatements, which occur only in about 2 percent of all financial statements. Fraud is generally concealed and often occurs through collusion. Normally, the documents supporting omitted transactions are not kept in company files. False documentation is often created or legitimate documents are altered to support fictitious transactions. While fraud detection techniques will not identify all fraud, the use of sound techniques can increase the likelihood that misstatements or defalcations will be discovered on a timely basis knowing where to look is the first step in fraud detection. Understanding the motivations of those committing fraud and knowing in which accounts fraud is more likely to exist based on a risk assessment helps identify the areas that might be subject to greatest scrutiny. Similarly, being aware of the types of transactions that warrant further review, as well as other potential red flag indicators, may alert auditors to areas that might require a closer look. Specific detection techniques discussed in this chapter include carrying out analytic procedures, using unpredictable audit tests, observing and inspecting, making inquiries, and conducting interviews. While these techniques may be performed routinely in the course of a financial statement audit, approaching them with the mind-set of professional skepticism and with better knowledge of the various types of fraudulent schemes may make the difference between detecting and not detecting fraud. This chapter also discusses the importance of continually bringing together all of the information obtained through the application of these detection techniques and evaluating the risk of fraud on the basis of such information. The detection techniques discussed in this chapter including techniques performed as a routine part of audits rely on certain procedures and attitudes to achieve the desired result of detecting fraud. These key procedures and attitudes include the following:

- Perform all procedures with an attitude of professional skepticism.
- Consider deception techniques during the review of documents, including the possibility of falsified documents.
- Thoroughly understand and be alert to potential red flags that are possible indicators of irregularities and likely indicators of areas requiring further analysis.
- Request more documentation in fulfilling audit responsibilities. Trust but verify.

Most audits do not result in the detection of material misstatements owing to fraud by management or others, for the simple reason that most audited financial statements are free of such misstatements. On the face of it, this is good news and it is important not to lose sight of this fact in any discussion of fraud risk. But the fact that material misstatements due to fraud are relatively rare does not diminish the grave consequences for companies, auditors, and stakeholders when such cases arise. No one in the corporate reporting chain can become complacent about the honesty and integrity of management. When a material misstatement due to fraud arises, the actions or omissions that give rise to the misstatement often occur over an extended period. The initial financial accounting impact may be relatively insignificant but can accumulate over time. Management may seek, for example, to mask a revenue shortfall in one period by accelerating recognition of certain transactions that belong in the subsequent period. The impact at the initial stage may not be material, and the intention may not be consciously fraudulent. Management may have persuaded itself that is, may have rationalized that its actions are justified to smooth over a short-term dip in sales and that the long-term effect will be negligible when business recovers. Should business fail to pick up in the next period, however, management is faced with a double problem: it has contributed to unrealistic revenue expectations, and the shortfall is now compounded by the fact that revenues that should have been booked in the current period were recognized in the previous period. Should management choose to persevere in plugging the gap, it may need to be even more aggressive in its revenue recognition to the extent that at some point it may create fictitious transactions to make the numbers. The challenge for the auditor is to recognize early any signs that a material misstatement may have occurred or might occur if the same policies and practices are continued. The international Accounting Standards envisages a series of steps, as follows, which are designed to assist the auditor in identifying, evaluating, and responding to the risk of material misstatement due to fraud:

- Holding discussions among the audit team concerning fraud risk.
- Obtaining information relevant to the identification of fraud risk.
- Identifying the risk of material misstatement due to fraud.
- Assessing the identified risks, taking into account the internal controls designed toaddress those risks.
- Responding to the results of the assessment.
- Evaluating audit evidence.

The collation and interpretation of evidence that may indicate the presence of fraud risk factors require a holistic, iterative approach that is unlikely to be achieved simply by adhering to a set of procedures or applying a checklist. The steps set out in international accounting standards are means to an end, not an end in themselves. This holistic, iterative approach instructs the auditor to consider whether audit test results identifying misstatements may be indicative of fraud. If the auditor believes that misstatement are or may be the result of fraud but the effect of the misstatements is not material to the financial statements, then the auditor nevertheless should evaluate the implications, especially those dealing with the organizational position of the persons involved. There are two reasons for this. First, even immaterial frauds can prove embarrassing to the company and the auditor, thereby diminishing investor confidence in the quality of the audit and the reliability of management's representations. In addition, frauds often occur gradually, starting small and growing over time. Finding a small fraud may be the window to an even larger one not yet discovered The discovery of material misstatements in a set of financial statements, resulting from deliberate acts or omissions on the part of management or others, commonly prompts questions as to how such a situation could have arisen, whether it could have been discovered sooner, and if so, why it was not.With hindsight, it is all too easy to see facts and circumstances that, had they been identified earlier and interpreted differently, might have enabled the auditor to uncoverthe fraud and make appropriate disclosure. The attempt to convert some of this hindsight into foresight has become an increasing focus of auditors, standard setters, and regulators alike. Their approach is to try to distill from past experience those events or circumstances related to any business, its management, and its environment that are commonly associated in one way or another with fraudulent acts or omissions. These are referred to as fraud risk factors or, more informally, potential red flags.

- Due to growing competition, some of the suppliers were willing to favour the firm bynot insisting advance payments.
- Lastly, due to heavy traffic, a large consignment of stocks came at late night when the usual warehouse keeper was not in and one of the partners had himself come and accepted the stocks.

Thus, the normal direct audit approach did arise doubts and highlighted anomalies, but did not bring the auditor any closer to the truth. Obviously, some concrete evidence was required to disprove the claim. How could the auditor do this? This was the stage whereall the aspects of the direct audit had been tried out. Now was the time to apply the 'inverse logic' approach! The auditor shifted his focus to the negative aspects. What was the value of the stocks which could not possibly be true? Since the value was a functionof rate and quantity, an inquiry into each was done. Manipulation of the rate seemed unlikely because it was unchanged for most of the large sizes and models for almost one and half years. That left the question of correctness of quantities. Since the correct quantities as on the date of fire could not be known, the auditor decided to find out what the quantities could not be. It was here that he hit upon the solution to the problem of proving the absurdity of the claim. The physical dimensions of the warehouse posed a limit to the number of cookers which could be stored there. Further restrictions were imposed by stacking norms which permitted only 9 cooker boxes in a column and vacant space needed for human movement within the warehouse. The audit software used by the auditor was capable of data interrogation and processing by applying queries and mathematical operations on a given set of data. The auditor keyed in quantities of stocks as on the date of fire as per the claim statements and using the following constants worked out the total Occupied Volume:

ROLE OF COMPANY CULTURE

A company's culture consists of its shared history, values, beliefs, and goals. To this must be added the shared operating style—at all levels and in all parts of the organization— through which behavior in keeping with the culture is encouraged and rewarded, while conduct that disregards or defies the culture is deterred, detected, and eliminated or, if need be, penalized. Appearances can deceive. The need to discern the substance of a company' sculpture and not be swayed by form or appearance is key for both forensic accounting investigators and auditors. Codes of conduct, ethics statements, and conflict- of-interest policies are important, but unfortunately, some companies have all those documents in place yet fall far short of honouring them. Essential to fostering a healthy and widely shared corporate culture are the commitment and attitudes of top management, vigilantly monitored by an engaged board of directors. The lofty phrase tone at the top is often heard in discussions of these matters, but a rough proverb is more to the point: "A fish rots from the head." The CPA's Handbook of Fraud and Commercial Crime prevention compares the environment and culture of entities with a high potential for fraud with entities that are far less likely to experience or generate fraud.

The factors listed in Exhibit given below are only representative or directional indicators of what may likely be encountered within a business and should be supplemented by the knowledge of the individuals experienced on the engagement. There will frequently be exceptions to these general characteristics; there is no substitute for good judgment. In one matter, a senior executive of a subsidiary would annually participate in the planning process and include in the budget the amount of money he intended to steal. In this way, his expenses never exceeded the plan. He escaped detection for more than 10 years.

ESTIMATES- CAUSE OF COMPLEXITY IN FINANCIAL REPORTING

Another area that often causes complexity in financial reporting, as well as confusion among users, is the pervasive need for estimates. Estimates appear in financial statements due to the continuous nature of business. Unlike a footrace that ends at the finish line or an athletic contest that ends with the final buzzer, a business and its transactions are continually in varying stages of completion. There are many items in a financial statement for which the final outcome is not known with precision. Given the complexity and continuity of business, it is difficult to capture a clear snapshot of a company's financial position and performance at a point in time. As a general matter, estimates are most commonly made concerning the final amounts of cash that will be received or paid once assets or liabilities are finally converted into cash. Such estimates can encompass, for example, allowances for uncollectible customer receivables, estimates of liabilities for claims or lawsuits brought against a company, the amount of profit or loss on a long-term contract, and the saleability of inventory that is past its prime. Most estimates are based on three types of information: past performance of the same or similar items, what is currently occurring, and what management perceives as the probable outcome. Further complicating matters, the weight to assign each type of information varies depending on the particular circumstances. But no matter how determined, unlike the score of a sporting contest, an estimate in financial statements is a prediction of what will happen, not the objective tally of what has already taken place. Estimates can create difficult challenges for auditors. The following Public Oversight Board report addresses the significance of estimates and their implications to auditors. The amounts involve subjective estimation and judgment. Unlike most third-party transactions, the amounts involved are not fixed. They may be based on a range of potential results, and reasonable people may disagree on the most likely outcome or amount activity in reserves may be driven principally by management's intentions and decisions rather than by external events or transactions. (For example, management has the ability to determine whether it will offer to settle outstanding litigation.) Indeed, determining just when management's intentions create a liability has vexed accountants and auditors for decades, and, for example, has been a significant factor in the uncertainties surrounding the accounting for restructuring and similar reserves All of these features could have an impact on a forensic accounting investigation into the propriety of an estimate that turns out to be incorrect. A legitimate assertion of managerial confidence in the business's ability to achieve certain estimated results is one thing. A deceptive misinterpretation that is intended to generate a favourable estimate is another thing altogether and may pose a substantial investigative challenge. The forensic accounting investigator is often vexed by the myriad complexities and alternative rationales that may be offered to explain the difference between an estimate and an actual result. Given that estimates often constitute the cause of material differences in financial statement presentations, the ability to distinguish between the manipulatively self-serving and the merely incorrect is a critical element of many investigations For the foreseeable future, corporate fraud is likely to present substantial challenges to both auditors and forensic accounting investigators. Remembering the analogy of the patrol officer, we can recognize that auditing cannot realistically prevent financial reporting fraud or prevent employees from looting corporate assets. It may deter some fraud and detect others, but it is unlikely that auditors using the traditional audit concepts of selective testing (sampling) to obtain reasonable not absolute assurance that financial statements are fairly presented not necessarily 100 percent accurate will always identify material misstatements caused by fraud. As contemplated by international accounting standards, auditing techniques and procedures can and will be improved, and future standards will likely institute further improvements. However, it must be recognized that the complexities of the business world and the ingenuity of highly educated, white collar criminals will always manage to produce schemes that unfortunately go undetected until they reach significant proportions. Forensic accounting investigators will investigate, prosecutors will convict, and regulators will react with new and more requirements. However, fraud will always persist.

ROLE OF FORENSIC ACCOUNTING IN DETECTING FINANCIAL FRAUDS

The Forensic accounting process has a large separate set of concerns based on a different role that calls for different tools, different thought processes and different attitudes. The reporting under forensic accounting does not end with reaching at general opinion on financial statements taken as a whole, derived from reasonable efforts within materiality boundary, instead the forensic investigator involves at a much more granular level, with the detailed development of factual information derived from both documentary evidence and testimonial evidence about the who, what, when, where, how and why of a suspected or known impropriety. The forensic accounting investigator's findings and recommendation may form basis of testimony in litigation proceedings or criminal actions against the perpetrators.

Statement on Auditing Standards (SAS) no.99 issued by the AICPA in 2002 significantly expanded the information gathering phase beyond the traditional audit. The standard requires the auditor to assess the entity's programs and controls that address identified fraud risks. The most important qualities the accounting professional can bring to any fraud investigation are an investigative mindset and skepticism. The skepticism mindset is something that long has been inherent in forensic accountants and other internal investigators when looking for evidence of fraud. The investigator historically has asked a set of questions different from those of the conventional auditor, who is monitoring the financial statements to see whether they are in compliance with GAAP and thereby fairly represent the financial condition of the company.

With the emergence of SAS 99 and under scrutiny, the external auditor is now being pushed to think like forensic accountant – to think like both a thief and detective and be constantly looking for the weak links in the accounting system and among the people who staff it. In the course of investigation the forensic accountant must be prepared to reach far beyond the company's books to industry and government information, proprietary databases, court records and to any source that might throw light on the case. The forensic accountant should bring independence and objectivity. Since fraud is breach of standards and honesty the investigator must be of irreproachable personal integrity and without allegiance to anyone or anything but the truth. Everyone encountered in the course of the investigation must be dealt with impartially and evenhandedly. Any fraud investigation is part art and part science. The science element comes, of course, from academic training in accounting theory, especially the audit side, and from knowledge of business practices and legal processes acquired through experience. This serves as the foundation for the investigators task.

Accounting professionals play two important roles in any forensic investigation:

1) lead financial investigators and, potentially,

2) Expert witnesses in any subsequent civil or criminal trials.

In the first instance, they are the key people in any fraud investigation because they understand accounting systems and internal controls and know how to trace the flow of funds into, through, and out of the company. They are also in a position to provide an independent, objective critique of the corporate organization. This critique should not only cover the problems in the accounting system that permitted the fraud to occur in the first place but also address the integrity of the people at the heart of the process. As experts assisting in case strategy and testimony, accounting professionals know the rules of evidence, what documents to request, whom they should interview, and, in civil cases, how to do any associated damage quantification arising out of a particular situation.

The good financial investigator must be knowledgeable about fraudulent practices both in general and for a specific industry. A wide experience of how frauds are committed enables the investigator to act quickly in deciding which classes of documents will be most useful and who needs to be interviewed. Because some industries such as insurance, construction, and banking are especially prone to fraud, some investigators may specialize in those fields. Since so much information is now created and stored electronically, a good knowledge of computers and information technology is an essential part of the Investigator's tool-kit. Computer forensics techniques are now also commonplace as part of financial investigations. These techniques can assist in recovering "deleted" information such as e-mails and proprietary information transferred to unauthorized computers. Then, when the evidence has been gathered and the suspects have been identified, good communication skills are needed to write a report that ties the whole story together and makes a well supported argument in clear language.

The ability to translate complex accounting issues into language the layperson understands is especially important when giving expert testimony. A judge or jury not familiar with accounting concepts and terminology must receive the information in clear, understandable form.

When fraud is suspected, the first job of the investigative accountant is to discover and review the evidence to prove or disprove the allegations. Since the reputations of the suspected principals are at stake, the evidence-gathering process must be extremely discrete. In criminal cases, the evidence must establish guilt beyond a reasonable doubt; in civil cases, liability is established by the less rigorous standard of the balance of probabilities. Non judicial regulatory authorities, boards, and tribunals have yet other standards with which the investigator should be familiar.

Evidence will typically come from two primary sources. **The first** is the accounting records and any underlying documentation that may exist. In many cases, evidence found in these records might suggest additional research in external databases such as public records and court documents, as mentioned above. The investigator's experience should indicate what issues are well supported, which ones need additional evidence, and which are merely circumstantial. **The second** source of evidence is gained through the interview process. Interviews may be conducted with key internal personnel, outside sources, and, ultimately, the suspects and any outside parties such as vendors or contractors who have done business with the individuals in question. The financial investigator must also be a good psychologist and be able to assess the greater or lesser likelihood that any given suspectis a fraudster. The paper and electronic evidence may show that accounting irregularities exist, but unless the evidence is connected to individuals, no fraud can be established.The investigator must be able to pick up on the motivational and behavioral clues that define a suspect. A winter tan, a better car, an affair, domestic financial worries, and a thousand other clues can all raise suspicions that might develop into a picture of criminal activity.

Forensic Accountants play a vital role in detecting the frauds in the following areas:

1) **Fraud Committed by Employees:** Where the employee indulges in fraudulent activities and are caught to have committed fraud the forensic accountant tries to locate any assets created by them out of the funds defalcated, then try interrogating them and find out the hidden truth.

2) **Criminal Investigation:** In the matters related to financial implications the services of Forensic accountants are called for. The report of forensic accountant is considered for preparation and presentation as evidence.

3) **Cases Relating to Professional Negligence:** Professional negligence cases are taken up by the Forensic Accountants. Non-conformation to Generally Accepted Accounting Standards (GAAS) or non compliance to auditing practices or ethical codes of any profession are required to measure the loss due to such professional negligence or on account shortage in services.

4) **Arbitration Service:** Forensic Accountants render arbitration and mediation services for the business community, since they undergo special training in the area of alternative dispute resolution.

5) **Settlement of Insurance Claims:** Insurance companies engage Forensic Accountants to have an accurate assessment of claims to be settled. Similarly, policyholders seek the help of forensic Accountants when they need to challenge the claim settlement as worked out by the insurance companies. A forensic Accountant also handles the claims relating to consequential loss policy, property loss due to various risks, fidelity insurance and other types of insurance claims.

6) **Dispute Settlement:** Business firms engage Forensic Accountants to handle contract disputes, construction claims, product liability claims, and infringement of patent and trademarks cases, liability arising from breach of contracts and so on.

7) **Engagement by Regulators:** Regulators of businesses like the Ministry of Corporate Affairs, the SEBI or the stock exchanges engage Forensic Investigators to gather evidence in the cases where they are of an opinion that a fraud or misrepresentation of accounts has been resorted to by the company and detailed investigation in its functioning is necessary for the overall benefit of the stakeholders.

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FORENSIC AUDITING

MEANING OF AUDITING

The origin of auditing may be traced back to the 18th century when the practice of large- scale production was developed as a result of Industrial Revolution. It is found that some systems of checks and counter checks were applied for maintaining accounts of public institutions, as early as the days of the ancient Egyptians, the Greek and the Romans. The growth of Auditing profession in India is of a quite recent origin. It was an outcome of the Indian companies Act, 1913 which prescribed for the first time the qualifications of an auditor. Due to rapid growth in the size of business firms, it has become necessary that the accounts must be checked and audited by an independent person, known as auditor especially in case of joint-stock companies where the shareholders are drawn from far off places. That is why it becomes necessary to assure them that their investment is safe and that the directors and the managing directors etc. handling capital and accounts, have presented true and correct accounts.

Definition of Auditing

The word "audit" is derived from the Latin word "audire" which means "to hear". In olden times, whenever the owners of, a business suspected fraud they appointed certain persons to check the accounts. Such persons sent for the accountants and "heard" whatever they had to say in connection with the accounts. Since then there have been lotof changes in the scope and definition of audit. The following are some of the definitionsof audit given by some writers:

According to **Spicer and Pegler,** "An audit may be said to be such an examination of the books, accounts and vouchers of a business as will enable the auditor to satisfy himself that the balance sheet is properly drawn-up, so as to give a true and fair view of the state of the affairs of the business, and whether the profit and Loss Accounts gives a true and fair view of profit or loss for the financial period, according to the best of his information and the explanations given to him and as shown by the books and if not, in what respect he is not satisfied"

R.B. Bose has defined as audit as "the verification of the accuracy and correctness of the books of account by independent person qualified for the job and not in any way connected with the preparation of such accounts." **M.L. Shandily** has defined auditing as "inspecting, comparing, checking, reviewing, vouching ascertaining scrutinising, examining and verifying the books of account of a business concern with a view to have a correct and true idea of its financial state of affairs".

From a closer scrutiny of the definitions given by various writers, it would be evidentthat these are different methods of saying a particular thing but still there is a lot of similarity therein. However, audit may be defined as:

1. an intelligent and a critical examination of the books of account of a business which,
2. is done by an independent person or body of persons qualified for the job,
3. With the help of vouchers, documents, information and explanations received from theauthorities, so that,
4. the auditor may satisfy himself with the authenticity of financial accounts prepared fora fixed term and ultimately report that,
   - (i) The Balance Sheet exhibits a true and fair view of the state of affairs of theconcern,
   - (ii) The Profit and Loss Account reveals the true and fair view of the profit or lossfor the financial period, and
   - (iii) The accounts have been prepared in conformity with th. e law. In short, an auditimplies an investigation and a report.

Nature of Auditing

The basic purpose of auditing is to confirm the authenticity of books of accounts prepared by an accountant. It is well known saying that “where the function of accountant ends, audit begins to determine the true and fair picture of such accounts

Audit is performed to ascertain the validity and reliability of information. Examination of books of accounts with supporting vouchers and documents in order to detect and prevent error and fraud is the main function of auditing. Auditor has to check effectiveness of internal control system for determining the extent of checking to be done for carrying out the audit. The following aspects are to be covered in auditing.

- Review of system and procedures
- Review of internal control system
- Routine checking /Arithmetical accuracy
- Following of proper accounting principles
- To ensure that the financial statement matches with the books of accounts
- Verification of assets and Liabilities
- True and fair view of state of affairs of the financial statements
- Statutory compliance
- Reporting

Importance of Auditing

- Satisfaction of owner:- It is because of audit that the owner will be satisfied about the business operations and working of its various departments.
- Helps in the detection and prevention of Errors and Frauds.
- Verification of books of accounts will help in maintaining the records up to all the times
- Helps in getting independent opinion on the profitability and true and fair view on the financial position of the audited concern.
- Helps in keeping Moral check on the staff and avoid the committing frauds
- Protect the rights and interest of shareholders
- Outsiders agents like bankers, creditors, debentures can place reliance on the books of accounts and financial statement audited by independent agencies.
- Ensures the Compliance with Legal Requirements.
- Reinforce and strengthen Internal control by removing gaps and ensuring following of the internal controls
- Money can be borrowed easily on the basis of audited financials and statements.

Objectives of Auditing

- Helps in keeping proper control over business activities helps in achieving thehigher efficiency and thereby improving performance of an entity.
- Helps in evaluation of accounting system with proper accounting records and papers
- Helps management in keeping the control on activities and thereby reduce any chance of fraud and errors.
- Review of the working of the entity and helping the management to locate weak and loose areas and providing suggestion for the betterment of operations
- Asset Protection and thereby arriving at the proper valuation, verification of assets.

- Application of internal checks and internal control measures to reduce wastage, errors and frauds
- Efficient use of scarce resources thereby improving profitability of the entity
- Following correct accounting polices
- Helps in undertaking special investigations

Advantages of Auditing

It is of great importance to get accounts audited in a proprietary concern to see that business is running efficiently, in a partnership firm to ensure healthy relations among partners and specially to decide questions like valuation of goodwill at the time of entry, retirement and death of a partner and in joint stock company in which shareholders invest their money and presume their capital intact if accounts of such a company are audited by some qualified auditor. Audit is made compulsory also under the companies Act.

The advantages of audit can be grouped into the following categories:

A. for Business itself

1. The accounts of a business and its financial position can be examined by anindependent and qualified auditor.
2. Quick discovery of errors and frauds: Errors and frauds are located very easily and atearly stage. Therefore, chances of their repetition are reduced to the minimum.
3. Moral check on the Employees: Through auditing, the staff maintaining accounts become more alert and careful in keeping future accounts up-to-date.
4. Loans and credit can easily be obtained from banks and other money lenders on thebasis of properly audited accounts.
5. The business itself enjoys better reputation due to audited accounts.
6. In case of Advice to the management, regular audit, the auditor can come into close touch with the working of the business & thus, can give suggestions the managementto improve it in case he is asked to do so.
7. Audit is useful in case of a business managed by some agent or representative of its owner.
8. Uniformity in accounts if the accounts have been prepared on a uniform basis, accounts of one year can be compared with other years and if there is any discrepancy,the cause may be enquired into.

B. For the owners of Business

1. If the business is owned by a sale trader, he can rely well on the audited and on his accounts clerks who are responsible for maintaining accounts.
2. In case of partnership firm, its partners can utilize the audited accounts to settle their disputes in regard to adjustment of capital and valuation of goodwill at the time ofadmission, retirement and death of a partner.

3. In case of a joint stock company. Shareholders living at distant places can rely on audited accounts and can be sure of their investment being sage with the company.
4. In case of a trust, its trustees can easily make their position clear before others by getting the accounts audited by an outside auditor.

C. For others

1. Filling of Income Tax Return: Income Tax authorities generally accept the profit & loss account that has been prepared by a qualified auditor and they do not go into detailsof accounts.
2. Settlement of Insurance claim: In case of fire, flood and the like unexpected happenings, the insurance company may settle the claim for loss or damages on the basisof audited accounts of the previous year.
3. Sales Tax payments: The audited books of accounts may generally be accepted bythe sales tax authorities.
4. Payment of wealth-tax, expenditure-tax etc.: The taxation authorities can also rely on audited accounts for the purpose of imposing wealth tax, expenditure-tax etc.
5. Actions against Bankruptcy and insolvency: The audited accounts of a business canbe produced in support of a legal case before the court. It forms a basis to determine action in bankruptcy and insolvency cases.
6. Future trends of the business: The future trends of the business can be assessed with certainty from the audited books of accounts.

Limitations of Auditing

Truly speaking an audit should have no limitation of its own. It is designed to protect the interest of all parties who are interested in the affairs of the business. If these is any short coming arising there from, it may be due to its narrow scope of application in its related field of operations and un-extended designation of the concept. The audit has following limitations.

1. **Lack of complete picture:** The audit may not give complete picture. If the accounts are prepared with the intention to defraud others, auditor may not be able to detect them.
2. **Problem of Dependence:** Sometimes the auditor has to depend on explanations, clarification and information from staff and the client. He may or may not get correct or complete information.
3. **Existence of error in the audited accounts:** Due to time and cost constraints, the auditor cannot examine all the transactions. He uses sampling to check the transactions. As a result, there may be errors & frauds in the audited accounts even after the checking by the auditor.

4. **Exercise of judgement:** The nature, timing and extent of audit procedures to be performed is a matter of professional judgement of the auditor. The same audit work can be done by two different auditors with difference in sincerity & personal judgement.
5. **Diversified situations:** Auditing is considered to be a mechanical work. Auditors may not be in a position to frame audit programme which can be followed in all situations.
6. **Lack of Expertise:** In some situations, an auditor has to take opinion of experts on certain matters on which he may not have expert's knowledge. The auditor has to depend upon such reports which may not be always correct.
7. **Limitations of internal control:** The auditor can only report on the truth and fairness of the financial statements. But other problems relating the management and control may not be possible to be covered by the auditor. Examples of such problems or limitations of internal control are cast-ineffectiveness, manipulations by management, etc.
8. **Influence of management on the auditor:** This is also come of the limitations of the audit that the auditor is influenced by the doings of those in management. The reason isthat he is appointed by the shareholders and directors who pay him remuneration or fee.

CLASSES OF AUDITING

Broadly, audit can be divided into 2 categories i.e. audit required under law and voluntary audit. Audit which is prescribed by a statute / legislation includes Audit of companies governed by the Companies Act, 1956 .Banking companies, Electricity supplies companies Cooperative Societies, Public and Charitable Trusts, Corporation set up under Act of Parliament etc. Whereas the voluntary audit includes Audit of Partnership firm, Sole Proprietorship, Hindu Undivided Families.

Further audit can also be classified on the basis of methods used or scope of work defined under the audit. These types of audit include internal audit, Management Audit, Process Audit. I.e. ISO Audit, Functional audit, System Audit, Propriety audit Efficiency audit.

The various classes of audit are mentioned as under:

- Internal Audit
- Financial Audit
- Secretarial Audit
- Cost Audit
- Tax Audit
- Bank Audit
- Co-operatve Societies Audit

- Trust Audit
- Insurance Audit
- Partnership Audit
- Sole Proprietorship Audit
- Government Audit
- Management Audit
- Functional Audit
- Propriety Audit
- Efficiency Audit

AUDIT PROGRAMME

It is a written scheme of the exact details of the work done by the auditor and his staff in connection with the particular work. All the work which is assigned to each member ofthe audit team is written in the audit programme. Audit programme guides the audit personal in work to audit be done. Following are the methods by which the programme is carried out:

1. **Complete Programme:** Complete programme is on the file. Completed items are ticked off by the particular assistant. Assistant knows what he has to do. He also knowsthat by which date each item is to be completed.
2. **Individual Programme:-**According to the nature of the business auditor prepares the programme for each assistant in such cases.
3. **No Any Advance Programme:-**In this case auditor never prepares the programme in advance but according the progress of the work he allows to go.

Advantages of Audit Programme

1. **Supervision of Work:** The auditor can judge the efficiency of his audit team by holding of an audit programme. He is in a position to know the progress of the work. He can see at any time that what part of the work has been completed and what remains to be done.
2. **Distribution of Work:** Audit programme is very useful in distributing the audit work properly among the members f the audit team according to their talent.
3. **Uniformity of Work:** Audit programme helps in settling all the things in advance, so the uniformity of work can be achieved.
4. **Basic Instrument for Training:** Audit programme is very useful for the new auditor. It provides training and guidance to him. So it is rightly called the basic instrument for training.
5. **Legal Evidence:** Audit programme is a legal evidence of work done by every assistant of the audit team. It can be presented in the court of law if any client is taken against the auditor for negligence.

6. **Fixation of Responsibility:** If any error or fraud remains undetected the responsibility of negligence will fall on the particular assistant who has performed that job.
7. **Several Audits may Be Controlled:** The auditor controls the audit of various companies at the same time. In the absence of audit programme he cannot supervise them effectively.
8. **Easy Transfer:** If one assistant is unable to continue the work given to him, it can be given to another person. Audit programme guides him that what is done and what is remaining.
9. **Final Review:** Before signing the report, final review is made and for this purpose also auditing programme is very useful.
10. **Useful for Future:** On completion of an audit, it serves the purpose of audit recordwhich may be useful for future reference.

Disadvantages of Audit Programme

1. **Not Comprehensive:** Auditors may have covered the whole field but it cannot be saidwith certainty that all the necessary work have been done.
2. **Rigidness:** Audit programme looses its flexibility. While each business have a separate problems. So audit programme cannot be laid down for each type of business.
3. **No Initiative:** It kills the initiative of capable persons assistant cannot suggest anyimprovement in the plan.
4. **Too mechanical:** Such audit programme is mechanical that it ignores many other aspects like internal control.
5. **Not Suitable for Small Audit:** It has been proved that audit programme is not suitablefor sail audits.
6. **New Problems over Looked:** With the passage of time new problems arise whichmay be over looked.

INTERNAL CHECK AND INTERNAL AUDIT

Internal Audit is an evaluation and analysis of the business operation conducted by the internal audit staff. It is a part of overall system of internal control system established inan organization

Internal check is a part of Internal control which means establishing the control in an organization where by the work of one person is checked by another person. This reduces chances of any errors or frauds in an organization.

In the internal audit there is study of processes and controls which are operational in an organization and also helps in establishing internal check and measures which helps inthe reduction of errors and frauds. The internal check is a part of the audit and is subsetof the internal control system.

Internal Control

Internal control is broadly defined as a process, effected by an entity's board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives

Definition of Internal Control

Internal control is the process, effected by an entity's Board of Trustees, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

a. Reliability of financial reporting,

b. Effectiveness and efficiency of operations, and

c. Compliance with applicable laws and regulations.

Types of Internal Controls

1. **Detective:** Designed to detect errors or irregularities that may have occurred.
2. **Corrective:** Designed to correct errors or irregularities that have been detected.
3. **Preventive**: Designed to keep errors or irregularities from occurring in the first place.

Limitations of Internal Controls

No matter how well internal controls are designed, they can only provide reasonable assurance that objectives have been achieved. Some limitations are inherent in all internal control systems. These include:

1. **Judgment:** The effectiveness of controls will be limited by decisions made with human judgment under pressures to conduct business based on the information at hand.
2. **Breakdowns:** Even well designed internal controls can break down. Employees sometimes misunderstand instructions or simply make mistakes. Errors may also result from new technology and the complexity of computerized information systems.
3. **Management Override:** High level personnel may be able to override prescribed policies and procedures for personal gain or advantage. This should not be confused with management intervention, which represents management actions to depart from prescribed policies and procedures for legitimate purposes.
4. **Collusion:** Control systems can be circumvented by employee collusion. Individuals acting collectively can alter financial data or other management information in a manner that cannot be identified by control systems.

Internal Control Objectives

Internal Control objectives are desired goals or conditions for a specific event cycle which, if achieved, minimize the potential that waste, loss, unauthorized use or misappropriation will occur. They are conditions which we want the system of internal control to satisfy. For a control objective to be effective, compliance with it must be measurable and observable. Internal Audit evaluates Mercer's system of internal control by accessing the ability of individual process controls to achieve seven pre-defined control objectives. The control objectives include authorization, completeness, accuracy, validity, physical safeguardsand security, error handling and segregation of duties.

- **Authorization:** The objective is to ensure that all transactions are approved by responsible personnel in accordance with specific or general authority before the transaction is recorded.
- **Completeness:** The objective is to ensure that no valid transactions have been omitted from the accounting records.
- **Accuracy:** The objective is to ensure that all valid transactions are accurate, consistent with the originating transaction data and information is recorded in a timely manner.
- **Validity:** The objective is to ensure that all recorded transactions fairly represent the economic events that actually occurred, are lawful in nature, and have been executed in accordance with management's general authorization.
- **Physical Safeguards & Security:** The objective is to ensure that access to physical assets and information systems are controlled and properly restricted to authorized personnel.
- **Error Handling:** The objective is to ensure that errors detected at any stage of processing receive prompt corrective action and are reported to the appropriate level of management.
- **Segregation of Duties:** The objective is to ensure that duties are assigned to individuals in a manner that ensures that no one individual can control both the recording function and the procedures relative to processing the transaction.

A well designed process with appropriate internal controls should meet most, if not all of these control objectives.

Major Components

1. **Control Environment**: Factors that set the tone of the organization, influencing the control consciousness of its people. The seven factors are (ICHAMPBO):
   - I - Integrity and ethical values,
   - C - Commitment to competence,
   - H - Human resource policies and practices,
   - A - Assignment of authority and responsibility,
   - M - Management's philosophy and operating style,
   - B - Board of Director's or Audit Committee participation, and
   - O - Organizational structure.

2. **Risk Assessment**: Risks that may affect an entity's ability to properly record, process, summarize and report financial data:
   - Changes in the Operating Environment (e.g. Increased Competition)
   - New Personnel
   - New Information Systems
   - Rapid Growth
   - New Technology
   - New Lines, Products, or Activities
   - Corporate Restructuring
   - Foreign Operations
   - Accounting Pronouncements
3. **Control Activities**: Various policies and procedures that help ensure those necessary actions are taken to address risks affecting achievement of entity's objectives (PIPS):
   - P - Performance reviews (review of actual against budgets, forecasts)
   - I- Information processing (checks for accuracy, completeness,authorization)
   - P - Physical controls (physical security)
   - S - Segregation of duties
4. **Information and Communication**: Methods and records established to record, process, summarize, and report transactions and to maintain accountability of related assets and liabilities. Must accomplish:
   a. Identify and record all valid transactions.
   b. Describe on a timely basis.
   c. Measure the value properly.
   d. Record in the proper time period.
   e. Properly present and disclose.
   f. Communicate responsibilities to employees.
5. **Monitoring**: Assessment of the quality of internal control performance over time. The following are the reasons or causes which further makes the internal control weak and more prone to Errors and fraud in an organization:
   1. There is not enough staff to have adequate segregation of duties.
   2. It is too expensive.
   3. The employees are trusted and controls are not necessary.

These arguments represent pitfalls to unsuspecting management. Each argument is in itself a problem that needs to be resolved.

1. The problem of not having enough staff or other resources should be discussed with your supervisor. In most cases, compensating controls can be implemented in situations where one person has to do all of the business-related transactions fora department.

2. If implementing a recommended control seems too expensive, be sure to consider the full cost of a fraud that could occur because of the missing control. In addition to any funds that may be lost, consider the cost of time that would have been spent by the department during the time of an investigation of the matter, and the cost of hiring a new employee. Fraud is always expensive and the prevention of fraud is worth the cost.
3. Finally consider the issue of trust. Most employees are trustworthy and responsible, which is an important factor in employee relations and departmental operations. However, it is also the responsibility of administrators to remain objective. Experience shows that it is often the most trusted employees who are involved in committing frauds.

Departments conducting research are good examples of areas where sound internal controls are needed. Research departments that have grants and contracts with outside sponsors are at risk that inappropriate charges will be posted to the project account, perhaps affecting current or future funding. Each department not only has the responsibility to ensure that all of their transactions are have been processed properly, but also to ensure that other researchers are not "hiding" improper transactions in the department's accounts.

CHECKING AND VOUCHING

The act of examining documentary evidence in order to ascertain the accuracy and authenticity of entries in the books of account is called "Vouching". In other words, vouching means a careful examination of all original evidences that is invoices, statements, receipts, correspondence, minutes, contracts etc. With a view to ascertain the accuracy of the entries in the books of accounts and also to find out, as far as possible that no entries have been omitted in the books of accounts. According to Dicksee. "Vouching consists of comparing entries in books of account with documentary evidence in support thereof.

According to R. B. Bose, "By vouching is meant the verification of the authority and authenticity of transactions as recorded in the books of account".

From these definitions it is clear that vouching means testing the truth of entries appearing in the primary books of account, vouching includes routine checking of carry forwards, extensions, posting into the ledgers, casts, sub-casts and other calculations in the books of original entry. Vouching may be lengthy process in a big organization unless there is efficient internal control system in existence.

The vouching is an important tool in the hands of auditor provided he handles this work with intelligence, observation and commonsense. Vouching is a sort of preliminary work which forms an important part of audit work. Since accounts of a business begin with the passing of entries, hence it becomes a basis for further scrutiny to be made at a later stage. The auditor, after satisfying himself with regard to the authority and authenticity of transactions, can only then say specifically that the books of account are correct and the Balance sheet and Profit and Loss Account exhibit the true and fair state of the financial affairs of business. This is why vouching is said to be the backbone of auditing.

But all this depends upon the efficiency of the auditor. He, besides checking the arithmetical accuracy of the books or comparing the entries with the available documentary evidence, should also go to the source of a transaction. He should also see that the transaction has been properly authorised. Frauds can be detected only by proper vouching conducted in an intelligent and searching manner. The importance of proper vouching was emphasised in the case of "Armitage Vs. Brewer and Knott. In this case auditors were found guilty of negligence because of their failure to detect defalcations committed by manipulating wage records and petty cash book.

Objects of Vouching

1. To see that all transactions connected with the business have been recorded in thebooks of account.
2. To establish that no transaction which is not connected with the business has beenrecorded.
3. To verify that all recorded entries are genuine.

Vouchers

A voucher is a written paper or document in support of an entry in the books of account.They may be of two types:

1. **Primary:** Written evidence in original is said to be the primary voucher, for example, invoice for a purchase.
2. **Collateral:** When the original voucher is not available, copies thereof are produced in support or subsidiary evidence in order to remove doubt from the mind of auditor. Such a voucher is usually known as a collateral voucher.

A voucher may be a receipt, invoice wage-sheet, an agreement, correspondence, bank paying-in-slip, minute books recording resolutions of directors or share holders, and soon.

While examining vouchers the following points should be noted by the auditor:

1. All vouchers have been properly filed, serially numbered and arranged in order as it saves time in finding out a particular voucher in checking.
2. The voucher is properly stamped as normally every receipt for more than five hundred rupees requires a revenue stamp unless legally exempted.
3. The date and the year of the receipt or the voucher corresponding with the cash book. The name of the party to whom the voucher is issued, the name of the party issuing voucher and the amount etc. are correct.
4. Those vouchers which have been inspected by him are stamped so as to avoid the possibility of their being produced again.

5. Every voucher is passed "as in order" by some responsible person whose signature should be noted.
6. Amount paid appears both in words and figures. If they differ, the matter should be investigated.
7. For missing vouchers, the auditor should satisfy himself with regard to the reasons of their being lost. If he is not satisfied with the explanations, he should state this fact in his report.
8. No help from any member of the staff of the client has been taken while vouching the entries and checking the vouchers.
9. Any alteration in the voucher is duly signed by the invoice clerk.
10. In case of vouchers for insurance, rent, rates and taxes etc., the period for which the payment has been made should be noted.
11. Special attention should be paid to those vouchers which are in the personal name of one of the partners, Directors, manager, Secretary or any other official of a business and which may or may not relate to the business itself. In case of purchase, original invoice, inward book and order book etc. should be examined to ensure that the goods were purchased for the business only.

Vouching of Cash Transactions

Vouching of cash transactions is by far the most important job in every business irrespective of its size and type of business etc. Before setting the programme for vouching the cash book, an auditor should examine carefully the whole system of internal check in operation in respect of cash transactions. (Internal check has already been explained in detail previously).

Vouching of receipts of the debit side of the cash book

It is rather very difficult to vouch the receipt of cash than to vouch payments as some entries might have been omitted altogether and therefore only an indirect evidence like counterfoils of receipts issued, carbon copies of receipts, contracts and letter from debtors etc. are available. He should check a few items at random and if he finds them to be in order, he may assume that the others will be correct but he must not forget to compare the rough cash book or the diary with the cash book. If he fails to do so and later on a fraud is detected, he might be held responsible. If he finds that there is a time gap between the two dates, he should go deeper into the matter as it is possible that money might havebeen received in between the two dates and misappropriated.

Some of the important items which usually appear on the debit side of the cash book and the duty of an auditor in that connection are given below:

1. **Opening Balance:** This can be vouched by comparing it with the balance shown in the duly audited balance sheet of the previous year. By doing this, it is verified that the actual balance has been brought down.

2. **Cash Sales:** Under this head, the chances of fraud are comparatively greater, for example the salesman may sell goods but may not record the same in the cash book thus misappropriating the money. Therefore the auditor should examine the effectiveness ofthe internal control system in operation in regard to cash sales. Assuming an effective internal check system in operation, the auditor should take the following steps to verifythe correctness of the amount of cash sales.
   (a) Check the counterfoils of the cash sales books with the salesman's summariesor abstracts.
   (b) Note that each salesman's abstracts agrees with the analysis of the cash received bythe receiving cashier.
   (c) Check the details of cash received with the cash sales counterfoils.
   (d) Compare the daily totals of the receiving cashier's memorandum cash books with their corresponding entries in the main cash book. If the auditor fails to do so and later on fraud is discovered, he will be held liable.

Cash Received from Debtors

The cash received fro m customers to whom good have been sold on credit in the past can be vouched with the help of the counterfoils of the receipts issued to them. But it is often noted that a smaller amount than actually received is shown on the counterfoils or receipts are issued to the debtors from old but unused counterfoil receipt books, the auditor should take the following steps in vouching receipts from debtors:

1. Check the internal check system with regard to the sales as a whole.
2. Ensure that the unused counterfoil receipts are kept in safe custody.
3. See that all spoiled receipts are attached to the counterfoils and he has cancelled them.
4. Verify the dates on the counterfoils with those in the cash book.
5. The practice being followed with regard to receipts through cheques should be notedand if no official receipts are being issued, he should verify the daily lists of such receipts with the entries in the cash book.
6. In respect of discount allowed to debtors, the auditor should ascertain the terms on which discount is allowed and test check a certain number of entries to ascertain whether the discount allowed is in order.
7. Special attention should also be paid to the amount shown as bad debts written off as cash can be misappropriated by writing off the whole or a part of the debit balance asbad. He has to ascertain as to who is responsible for writing off debts as bad. He should, with the permission of the client, establish direct contracts with the debtors by sending them the statements or verification slips from time to time and asking them to send their confirmation directly to him.

With regard to receipts from debtors fraud may be committed by the process of "teeming and lading", that is not entering cash in the cash book received from a debtor and entering it only when a similar amount is received from another debtor and so on. Of course, no misappropriation is committed but the practice should be checked because there is the loss of interest for the period money is misappropriated and the cashier may be tempted to commit such a fraud of bigger amount and may not be able to replace the same. To detect such a fraud the auditor should:

1. Examine the accounts of those debtors which show part payments from time to time.
2. Check the amount and date on the counterfoil receipts to compare it with the date and amount deposited in the bank.
3. Should send verification slips to the debtor requesting them to send the confirmation directly to him.
4. **Bills Receivables**: All details about bills receivable can be made available in the Bills receivable book. The auditor should take the following steps:
   (i) Ascertain the due dates of the various bills.
   (ii) Note that the amount due on bills was received on maturity. This can be ascertained by comparing the bills receivable book with the cash book and the pass book.
   (iii) Special attention should be given to those bills which have been matured but the amount in respect thereof has not been received. Such bills might have been dishonored or retired. But there is a possibility of their proceeds being misappropriated by the cashier.
   (iv) In case of discounted bills, the cash received should be properly entered in the cash- book and the discount deducted should be separately shown in the discount account.
   (v) He should note that in case of bills discounted but not matured at the date of the balance sheet, contingent liability has been shown in the balance sheet.
5. **Rents Receivable:** The auditor should proceed keeping in view following points:
   (i) Examine the leases agreement with the tenants and ascertain the exact amount receivable.
   (ii) Check the amounts due with the rent-foil.
   (iii) Compare the amounts as per rent roll with the cash book.
   (iv) Check the counterfoils of rent receipt issued to tenants. If agents are appointed to collect rent, the accounts or statements submitted by them should be carefully checked.
6. **Interest and Dividends**: Interest and dividends received from investments should be vouched in the following manner:

(i) receipts on this account should be checked with the counterparts of the interest anddividend warrants or the letters along with the cheques.

(ii) in case of bearer bonds the bonds themselves should be inspected along with the torn off coupons to note as to what interest should have been received.

(iii) If the banker is authorized to collect interests or dividends the entries in the bankpass book or statement should be inspected.

(iv) In case of interest on fixed deposits, the bank pass book has to be checked.

(v) In case of interest received on a loan granted to a borrower, the agreement betweenthe borrower and the business should be referred to for the rate of interest, date ofpayment etc.

(vi) The auditor should ensure that all dividends or interest in respect of investments, deposits or lending's etc. have been received and accounted for.

7. **Sale of Fixed Assets:** The points to be considered are given below :

(i) It is possible in case of sale of fixed assets, the sale deed is not executed for the full purchase consideration. To detect such a fraud, the auditor should examine the correspondence made with the parties willing to purchase them.

(ii) In case, sale has been made through a broker, the broker's sold note should be examined,

(iii) He should see that the sale has been duly sanctioned.

(iv) He should note that the profit earned on the sale of fixed assets should be credited to the capital reserve account and not to the general profit & loss account.

8. **Insurance Claims**: Amounts received under an insurance policy should be verified by means of the correspondence with and accounts rendered by the insurance companies.

9. **Sale of investments**: In this connection, the auditor should consider the following points:

(i) As investments are usually sold through brokers, so the broker's sold note should be examined to note the date of sale, the amount received and the commission changed.

(ii) In case the sale has been made through the bank, the bank advice should be examined.

(iii) He should note as to whether the sale has been cum-dividend and if so, the dividend has subsequently been received and the sale proceeds have been proportioned between capital and revenue. If investments are sold ex-dividend, he has to see that the dividendhas been received if declared.

10. **Subscriptions:** Subscriptions received by a club or society should be checked with counter-foils of receipt books and with the published list of subscribers.

11. **Commission received**: For this, the agreements between the client and the parties from when it is receivable should be examined to verify the terms of commission, its rate etc. Counter-foils of receipts should be compared with the particulars entered in the cash bank. In case of goods received on consignment, the amount of commission should be vouched with reference to the copy of the account sent to the consignor or the auditor should calculatethe amount himself, if necessary.

12. **Receipts from Hire Purchase:** The hire purchase agreement should be checked in order to ascertain the duration of the agreement, the amount of installments, total number of installments, and payment by the closeof period the accounts of which are under audit. He should also note that the installment includes interest also and also the whole amount of an installment is properly apportioned between sales and interest.

Vouching of Cash Payments

The object of vouching the credit side of cash or bank of cash payments is not merely to ascertain that money has been paid away but to ensure that the payments have been made:

(a) to the proper and right party,
(b) on behalf of the business for a proper purpose,
(c) for the accounting period under audit,
(d) after proper authorization,
(e) against a proper voucher, and
(f) correctly recorded in the books of account.

Some of the important items on the credit side of the cash book and the duty of an auditor in that connection are given below:

(A) Capital Expenditure

According to Spicer and Pegler "Capital expenditure is all expenditure incurred for the purpose of acquiring, extending or improving assets of a permanent nature, by means of which the business may be carried on or for the purpose of increasing the earning capacity of the business". Such expenditure is normally heavy and therefore requires special attention. The type of documents required depends upon the nature of the payment. Some of the items of capital nature and the duties of an auditor in each case are given below:

1. **Land & Building**: The auditor should take the following steps :
   (i) The documents of title of the property purchased should be examined.
   (ii) The auditor should find out as to whether land or buildings purchased are on freeholdor leasehold basis. In latter case, he should examine the terms of the lease.

(iii) If the properties are purchased through an auctioneer, the account submitted by the auctioneer should be checked.

(iv) In case the property has been purchased through the broker, the broker's note should be examined.

(v) Where the property is got erected through a contractor, he should examine the receipts issued by the contractor, for payments made. If the buildings have been constructed by engaging labour, he should vouch the expenditure on building materials purchased, cartage paid, wages paid to the workers etc. and also see that the expenditure has been properly capitalised.

(vi) The expenses incurred, for example, auctioneer's commission, brokerage, architect's fee, registration fee etc. can be vouched with the help of the receipts obtained and it should be seen that they are capitalised.

2. **Plant, Machinery, Furniture, Fixtures etc.**: In this connection, the auditor should take the following steps:

(i) Examine the invoices and the receipts obtained from the supplier and see that the items have been properly authorized.

(ii) In case, machinery has been purchased on hire-purchase basis the auditor should examine the contract of hire-purchase with the vendors to find out the purchase price, the amount of installment and interest. Here, he should note that only the principal amounthas been capitalized.

3. **Investments:** Investments should be vouched in the following manner

(i) In case, these have been purchased though a stock-broker, payments should be vouched with reference to the brokers sold note.

(ii) In case of a new issue for which application has been made and if the share certificates have not yet been received, the allotment letter and banker's receipts for the installments paid should be inspected. But if share certificates or debentures have been received, they should be examined.

(iii) The actual investments should be examined.

(iv) In case of cum-dividend purchase, he should see that the expenditure has been properly apportioned between capital and revenue.

(v) He should see that the investments have been made in accordance with the provisions of the Companies Act and Investments are registered in the name of the company required under section 49 of the Companies Act.

4. **Patents:** The auditor should take the steps as given below

(i) Examine the patent.

(ii) if the patent has been purchased, the assignment should be inspected together with the receipt for the purchase consideration.

(iii) In case patent has been purchased through some agent, the agent's receipted amounts should be examined to note the agent's fees and verify the amount so included in the asset account.

(iv) He should note that the patent renewal fees has not been charged to the patent account, as these fees represent revenue expenditure.

5. **Loans:** In order to vouch the figure of loans, the auditor should

(i) Inspect the loan agreement, the security held if any, receipt given by the borrower etc.

(ii) Examine that the loan has been properly authorized.

(iii) If the loan has been advanced against mortgage he should examine the receipt mortgage, the receipt from the borrower, the mortgage, deed, title deeds and other documents.

(iv) In case of loans to directors, the managing directors and other officials of a company, he must see that the provisions of the companies act are followed.

(B) Revenue Expenditure

1. **Wages:** In case of concerns employing a considerable number of workers, vouching of wages forms a very important part of the auditor's job. He should first of all satisfyhimself in regard to the efficiency of internal check system so far as it relates to the maintaining of wage records, preparation of wages sheets and payment of wages. Besides this, he should note the following points:

(i) the totals and calculations involved in the wage sheets should be checked.

(ii) He should check a few items, for example, deductions in the form of rent, fire insurance, provident fund, etc. and the method of deducting them should also be examined.

(iii) He should see that the amount of the cheque drawn for payment of wages tallies with the net amount as shown in the wages sheets.

(iv) Names of workers given in the wages sheets should be well compared with thosegiven in the wages record like job cards, foremen's register, etc.

(v) He should see that the wages sheets have been properly initialed by those responsible for their preparation.

(vi) He should carefully check the payments made to the casual labour.

2. Salaries: For this, salaries book containing the details of the employee's salary should bemaintained. The auditor should take the following steps:

(i) He should compare the cheques drawn with the salaries book.

(ii) Any change in the salary list should be verified with an official source.

(iii) Special attention should be paid to the deductions in respect of provident fund, life insurance premium, income tax, etc.

(iv) Independent information as regards employees leaving the service of the concern should be obtained from the staff departments and compared with the salaries book to find out persons already left being included in the salaries book.

(v) He should ensure that the payment has been made to the correct person. This he can do by comparing the signature on the salaries book with the specimen signature of the employees.

3. **Petty Cash:** Vouching petty cash is another problem for the auditor as normally there are no proper vouchers and therefore chances of misappropriation of cash exist. As a first step, the auditor should examine the soundness of internal check system in this regard and in case he finds it to be satisfactory, he should take the following steps

(i) He should see that imprest system is being followed and if not he should recommendthe same to the client.

(ii) He should check the payments made to the petty cashier with the entries in the cashbook.

(iii) For that expense for which vouchers are not available he should ask the pettycashier to give a summary which should be duly signed by a responsible officer.

(iv) He should examine the totals and balances of the petty cash book.

(v) He should see that the petty cash book is periodically checked and initialed by someresponsible official.

(vi) The auditor should, without notice and occasionally, count the cash in hand and agreeit with the balances shown by the petty cash book.

4. **Travelling Expenses:** These are paid for the travel in connection with the business. Where a fixed amount is payable, there is no difficulty in checking it. But in other cases, the auditor has to check very carefully. His duty in vouching such payments shall consist of:

(i) Vouching the cheque drawn according to the cash-book with the traveller's receipts.

(ii) Checking the figures in some of the traveller's accounts with the vouchers submittedby them.

(iii) Seeing that all unpaid commissions and expenses have been brought into account atthe end of the financial period.

5. **Insurance Premiums:** In case of new policies, the auditor should inspect the cover note or the receipt from the insurance company and in case the policy has been received, it should be examined. In case of renewals, the renewal receipt should be checked. If the number of policies is large, he should require a schedule of various particulars like number of the policy, the amount, the date of maturity, the amount of the premium payable etc. He should examine these particulars. In case some policy has lapsed, he should find out as to under whose authority it has been allowed to lapse.

6. **Bank Charges:** In order to vouch this item as shown in the cash book the auditor should tally the figures with the bank pass book and if necessary he should check their calculations.

7. **Postage:** The auditor should compare the postage book with the cash book and petty cash book and count the stamps in hand. He should see that postage includes only the postal expenses connected with the business and not with any private account.

8. **Director's Fee:** The auditor should take the following steps in vouching the payments under this head,

(i) Examine the articles to find out the fee payable to the directors.

(ii) The director's minute book, the attendance register should be examined to ascertainthe number of meetings attended by them.

(iii) Examine the receipts obtained from directors for this payment.

(iv) Examine the resolutions of the shareholders to calculate the amount payable asdirector's fee and compare this figure with the amount actually paid.

9. **Cash Purchases:** In vouching this item, the auditor should take the following steps:

(i) Test the entries in the cash book with the cash memos.

(ii) See that the goods paid for have actually been received which can be done bychecking the entries in the goods inward book or purchases book.

(iii) See that only net amounts, that is, purchases minus trade discount, has been carriedto the books of account.

10. Payments to Creditors

(i) The receipts issued by the creditors acknowledging the receipt of money should bechecked.

(ii) The money paid should be compared with the money due as per the accounts of thecreditors and the invoices received from them.

(iii) He should scrutinize the method of comparing the statement of accounts with theiractual accounts.

(iv) Before passing an entry in this regard, he should refer to minutes, contracts and otherdocumentary evidence in support of it.

11. Bills Payable

In this connection, the auditor should:

(i) Examine the duly cancelled returned bills as an evidence of the amount having beenpaid.

(ii) Inspect the bills payable book.

(iii) See the bank pass book and the banker's advice in case the payments on certain billshave been made through the bank.

12. **Freight and Carriage:** The auditor should vouch the payment on this account with the help of the statements rendered by the shippers or carriers together with the receipts. He should also see that allowances in respect of rebates have been properly accounted for.
13. **Rents Payable:** The agreement with the landlords and receipts from them should be examined.
14. **Payment of taxes:** In order to vouch this item, the auditor should refer to the copy of the assessment order, assessment form, notice of demand and the receipted challan etc. The advance payment of income tax and interest allowed on it should also be verified. Payment of sales tax can be vouched by reference to the return submitted by the dealer and Treasury or bank receipt every month or quarter.
15. **Commission:** The conditions relating to the payment of commission should be examined with reference to the agreements between the client and the agents. The statements of account submitted by the agents should also be seen.

Vouching of Trading Transactions

Here, the auditor is concerned with the checking of the Purchases Book and Sales Bookin order to prevent misappropriation of goods.

1. **Purchase Book or Bought Day Book:** This book is used for recording the credit purchases of the business only. First of all, an auditor should satisfy with the internal check system in operation with regard to purchases. If the system of internal check is efficient and effective, the auditor can conveniently proceed with the vouching of purchases book in the following manner:

(A) He should check the invoices and compare them with entries in the day book. When examining an invoice, special attention should be paid to the following points:

(a) The name of the creditor agrees with the entry in the day book.

(b) The invoices are made cut in the name of the auditor's client and appear to be of a nature relating to the business carried on.

(c) Each invoice relating to goods has a memorandum, signed by the gate keeper acknowledging receipt of the goods attached to it. Alternatively, it may bear a referenceto a goods inward book. The auditor should examine this order to see that the goodsstated in the invoice have actually been received.

(d) The date agrees with that in the day book and falls within the period under audit.

(e) The trade discount has been deducted from the amount of the invoice, and then only netamount has been entered.

(f) Any invoice charged to capital is a proper capital charge and is debited to the correctaccount.

(g) In case the staff member's accounts are passed through the day book, they are chargedto their personal accounts.

(B) At the end of the financial period, the auditor should compare the goods inward book and the stock sheets with the purchases book in order to ensure that all goods taken into stock have been entered in the purchases book. In case there is no goods inward book, he should check the suppliers advice notes received with the goods as it is possible that towards the close of the financial year, goods have been received and included in that closing stock but not recorded in the purchases books which will inflate profits.

(C) The auditor should ask his clients to send notice to every supplier requesting him to furnish a statement showing the balance due on the balance sheet date. Then he should examine these statements and compare them with the ledger accounts. If they agree, it will mean that no invoices with regard to these accounts have been omitted.

(D) The auditor should see that no invoice has been entered twice in the books as fraud may be committed by such a practice. In order to prevent it, he must compare invoicesand the goods inward book in few cases as test checking.

(E) As invoice may be postdated to provide a fictitious period of credit to the purchaser the auditor must see that entries are made in the purchases book only if the goods have been actually received during the financial year under audit.

(F) In case of duplicate invoices, the auditor should satisfy himself that they were obtained in respect of only these invoices which have been actually lost.

(G) He should check totals, sub-totals, carry-forwards, calculations in the purchase books and postings from the purchases book to the ledger accounts.

2. **Purchases Returns Book:** Sometimes goods purchased are rejected or returned to the supplier or seller for various reasons. In this connection the auditor should satisfy himself with the efficiency of internal check system and if satisfied should proceed in the following manner.

(A) He should compare the credit notes sent by the creditors with the entries in the purchases returns book and the goods outward book.

(B) He should see that proper deduction has been made on account of goods returned before the payment is made. In case the payment has already been made, he should ensure that full credit has been received subsequently.

(C) He should pay particular attention to the heavy returns made at the close of the year and in the beginning of the year as the entries might have been passed to adjust fictitious purchases of the previous months.

(D) He should check castings and postings of the purchases returns book to the ledger accounts.

3. **Sales Book (Credit Sales):** The vouching of the sales book is a much more difficult task then that of the purchase book because the only documentary evidence available is in the form of duplicates or invoices which are not

completely reliable. Therefore the auditor has to be very careful in this regard. Firstly, he should examine the system of internal check in this respect and if satisfied with the system, proceed as follow:

(A) He should compare the various particulars like the name, date, amount etc. on the copy of the invoice with those given in the sales book.

(B) In case some distinction is made in granting trade discount to two different customers, he should enquire into the reasons for the same.

(C) The sales book should be vouched with the help of the orders received book and the goods outward book to ensure that no sales have been omitted from recording.

(D) Where goods have been supplied on `approval' or `goods on sale or return' basis, he should see that they are not treated as sales till the letter of acceptance has been received. At the same time he should ensure that the goods with customers are included in the stock.

(E) The auditor should specially examine the sales relating the sales relating to the periods in the beginning or at the close of the financial year in order to ensure that no manipulation has been made in accounts. He may check such sales with the goods outward book.

(F) He should see that capital sales have not been treated as revenue sales.

(G) He should check the castings of the sales book and the posting to the ledger accounts.

(H) He should set that the goods sent on consignment are not included in the figure ofsales.

They shall be treated as sales only when they have been actually sold by the consignee and the `Account Sale' is received by the consignor. Till then, such goods are to be treated as stock with the agent. So he should check such entries with the consignment note, account sale, vouchers for the expenses and cash-book. Entries for sale-proceeds, expenses incurred by the consignee, his commission, etc. should be vouched with the help of account sale as sent by the consignee. He should also see that the stock remaining unsold with the consignee is shown in the balance sheet at cost or market price whichever in lower.

4. **Sales under Hire Purchase Agreements:** Such sales can be recorded in the account books under two methods. One is to credit the sales account with the total cash selling price in the year of sale and to treat the buyer as debtor for the installments not yet due at the date of the balance sheet. The other is to credit the sales account with each installment payable under the contract as and when it becomes due. When the first method is followed the auditor should see that a provisionfor unrealized profits is made at the date of the balance-sheet and credit is taken in each year only for such interest as has actually accrued during

the accounting period. In case the second method is adopted, the auditor should see that the amount of the unpaid installments less unearned profit included therein, is credited to the trading account and shown in the balance sheet as stock-on-hire.

5. **Packages and Empties:** There are some cases in which customers are supplied with packages like bags, cans and jars etc. which they have to return to the suppliers or dealers. The auditor shall see that an effective system should exist to record such packages and empties. Generally a memorandum system is adopted under which the customer is debited with the cost of such empties. The cost of empties is not included in the sales. They are entered in the sales return book under a separate column for this and also in the empties returns inward book by the gatekeeper. So the auditor must examine these books. At the date of the balance sheet a list of empties `not returned' by the customer should be prepared and the value of such empties should be recorded in separate book to be known as "Empties and Packages on hand" at cost price less depreciation. So the auditor should ensure a proper valuation of empties for the purpose of balance sheet and see that correct depreciation has been provided for those packages and empties which are still in the hands of the customers.

6. **Bills Receivable Book:** Entries for bills receivable are passed in this book. Auditor's duty in regard to different types of bills is as follows:

   (a) In case of bills matured for which payments have been received, the receipt of money may be checked by reference to the cash book or bank pass book as the case may be.

   (b) For bills discounted, the cash book and the pass book entries should be checked.

   (c) There may be bills in-hand which are not matured. If such bills are with the client,, personal verification should be done by the auditor. If they are deposited with the bank, the auditor should check the certificate to that effect obtained from the bank.

   (d) In case of bills dishonored, he should see that the proper entries have been passed in the financial books. He should also check the castings of the bills receivable book and their postings to the ledger accounts. The liability for bills discounted should be properly shown on the liability side of the balance sheet.

7. **Bills Payable Book:** The auditor's duty in connection with bills accepted and entered in this book is as follows:

   (a) In case of those bills for which payment has been made by the client on maturity, the auditor should vouch them with the entries in the cash book or bank pass book and the returned bills.

(b) For those bills which have not yet mature, he should vouch them with the help of counterfoils or copies of such bills, bills payable book and if necessary, the statements of account submitted by creditors.

(c) He should also examine the castings of this book and their postings into the ledger accounts.

8. **Journal:** Journal is used to record all extra ordinary transactions for which there are no special books of original entry. The entries appearing in the Journal will be such as all opening entries, say, for the acquisition of various assets, the issue and allotment of shares etc., closing entries which are passed" for closing and transferring balance from the nominal accounts in the Profit and Loss account; adjusting entries such as provision for outstanding, depreciation and bad debts etc., and miscellaneous items like writing off profits or losses on the sale of assets. In order to vouch the journal the auditor should take the following steps:

(a) In order to vouch opening entries, the auditor should examine them with reference to last year's audited balance sheet. In case of new business he should verify them with reference to minutes of the board's meetings, documents of title, purchase agreement, correspondence with the vendors, receipts issued by the payee, etc.

(b) For vouching closing entries, he should see that balances were correctly arrived at and they have been carried to proper accounts.

(c) In case of adjusting entries the auditor should check all the available evidence, for instance, bad and doubtful debts can be inspected with the help of accounts contained in the sales ledger.

(d) He should check the postings to the respective ledger accounts to as certain that they are in order.

8. **Bought Ledger or Purchase Ledger:** This ledger contains accounts relating to creditors. The auditor should take the following steps:

(a) He should check the opening balances of different accounts with the audited balance sheet of the previous year.

(b) He should examine all supporting books like purchases book, goods inwards book, cash book, discount register, goods outward book etc.

(c) If the self- balancing system is in use, he should ask his client for a schedule of creditors and total of the schedule should be tallied with the creditor's ledger adjustment account.

(d) The auditor should examine all the creditors' statements and with their help, the purchase ledger balances should be checked.

(e) He should see that the balances in the purchases ledger whether debit or credit are shown on the proper side of the balance sheet.

(f) He should ensure that provision for reserve for discount on creditors, if made, is not excessive.

9. **Sales Ledger or Debtors Ledger:** This contains accounts relating to debtors. The following points should be noted while vouching sales ledger:

(a) The auditor should check the opening balances with the audited balance-sheet of the previous year.

(b) He should examine supporting book like bills receivable book, cash-book, goods out ward book, sales returns book etc.

(c) Where self-balancing system is in use, the total of the balance as per the schedule of debtors should be verified with the total of the balance shown in the debtors ledger adjustment account.

(d) He should test check postings to this ledger from various books of first entry. He should give special attention to credit postings, as any attempt to conceal defalcations will more usually take the form of fictitious credit entries.

(e) He should also check the castings and balances with the list of debtors. If there is any credit balance in the sales ledger, he should see that it is shown on the liabilities side of the balance sheet alongwith sundry creditors.

(f) While examining the accounts the auditor should ascertain the composition of each balance. In particular he should note whether it represents specific items of goods or is an accumulated balance. In the latter case, he should ensure that it does not represent doubtful for bad debt.

(g) He should call for a list of bad and doubtful debts and verify them thoroughly as there is quite possibility of the figure being understated and misappropriated.

10. **Vouching of Impersonal Ledger:** It is an important part of the auditor's, duty to vouch the impersonal ledger which contains accounts from which trading and profit and loss accounts and the balance sheet are prepared. The impersonal ledger has two kinds of accounts -Nominal accounts & real accounts. Nominal accounts relate to the trading, profit account and real accounts record assets. Here, the transactions appearing in the impersonal ledger but relating to profit & loss account and the auditor's duty in connection with only those items is to be considered. Whole vouching these transactions, the auditor should consider the following points:

(a) He should check the totals of the various books of original entry with the accounts in the impersonal ledger.

(b) He should vouch the Journal carefully and should see that each entry is supported by sufficient evidence. He should also check their postings to impersonal ledger.

(c) He should test the postings from the cash book to the impersonal ledger in order to ensure that the entries have been posted to the correct accounts.

(d) In those cases where direct entries are passed from one account to another in the impersonal ledger, he must proceed in the same manner as if they had been passed though the journal. Such items are as follows:

11. Outstanding assets: Under this head, there may been an expenditure already incurred for which the corresponding benefit could not be made available for the business during the period or some portion of this relates to the period subsequent to the date of balance sheet. Such items are usually named payments in advance or pre-payments and should be shown in the balance sheet.

Beside this, there may be some items accruing or due which may not have been recordedin the books, for example, prepaid expenses, accrued income items and deferred revenue expenditure. In case of prepaid expenses like advance payment of rates and commission etc; the auditor should see that such amount has been excluded from the profit & loss account and be shown on the asset side of the balance sheet. He should vouch such expenses with the help of nominal accounts, demand notes, receipts and the actual inspection of the original documents. He should also see that the correct amount has been proportioned between the two periods on the date of the balance sheet. In case of other items also, same procedure can be following by the auditor.

12. Outstanding liabilities: It is the duty of an auditor to ascertain that all outstanding liabilities are brought into account before calculating the net profit or loss for the year under audit. But in practice, it may not be easy for an auditor, therefore it is better if he obtains a certificate from a responsible official that there are no expenses incurred in the current year which have not been recorded in the books of account. In spite of this, he should scrutinize the nominal accounts like interest, rent and salaries and discount etc, to verify that all expenses accrued up to the date of the balance sheet have been accounted for.

For example, in case of unearned income, the auditor should examine the necessary vouchers to ascertain how much amount of such income is to the credited in the current year's profit and loss account and how much is to be carried forward to the following year. Another example of outstanding liabilities is unpaid expenses such as audit fee wages and salaries, freight & carriage, rent, rates, taxes & electricity etc. traveler's& agent's commission, interest on loan & debts etc. In order to vouch these expenses, the auditor should examine nominal accounts demand notes, receipts, invoices & other relevant vouchers & note the period covered by such payment. He should also ascertain with their help that the expenses unpaid have been debited to the profit & loss account of the current year and shown separately on the liability side of the balance sheet.

13. Contingent Liabilities: Contingent Liabilities are those liabilities which are not definite or certain as they may or may not arise after the preparation of the balance sheet. So it is the duty of an auditor tosee that the necessary provision has been made for contingent liabilities. In order to ascertain the existence of such liabilities, he should examine the minutes of the meetings of the board of directors and other concerned correspondence. He should also enquire from the legal officer of the client about possible losses from pending law suits. He should write to the bank to supply a list of all the bills discounted, also the number ofbills which have not matured as yet. He should also find out the amount of dividend payable to cumulative shareholders. The auditor should divide the contingent liabilities into two main groups according to Part - I of schedule IV of the companies Act. Firstcome those liabilities in respect of which a provision has been made in the balance sheet. So in such a case, he should see that they appear under the heading "current liabilities and provisions". Then there are liabilities in respect of which no provision has been made in the balance sheet. In this respect, the auditor has to see that these are appearing by way of foot note in the balance sheet.

14. **Contingent Assets:** There is no practice of showing these in the balance sheet either as a foot note or any other manner and in Companies Act also there is no provision to show them. It is but fair that if a contingent liability is shown, a contingent asset must also be shown at the same time.

AUDIT REPORT

An **audit report** is a written opinion of an **auditor** regarding an entity's financial statements. The **report** is written in a standard format, as mandated by generally accepted **auditing** standards (GAAS). The **auditor's report** is a disclaimer thereof, issued by either an internal **auditor** or an independent external **auditor** as a result of an internal or external **audit**, as an assurance service in order for the user to make decisions based on the results of the **audit**.

When financial statements are finalized, they usually must contain an evaluation – an auditor's report - from a licensed accountant or auditor. This report provides an overview of the evaluation of the validity and reliability of a company or organization’s financial statements. The goal of an auditor's report is to document reasonable assurance that a company’s financial statements are free from error.

Preparation of the Report

An audit of a company’s financial statements should result in a report wherein the accountant or auditor is free to share their opinion about the validity and reliability of a company’s financial statements. In this report, the auditor should provide an accurate picture of the company and their financial statements. The auditor should also state whether they are externally or internally connected to the company.

Within the report, the auditor can share any reservations about the condition of the company’s finances or relevant additional information. Reservations could arise if the auditor disagrees with something found in the financial statements, e.g. if the auditor disagrees with management about the valuation of an asset because they believe that this has a more significant impact on the financial statements.

There are rules concerning what an auditor's report should include and the order in which various items should be reported.

Auditor's reports must adhere to accepted standards established by governing bodies. Standards such as those set by the UK Generally Accepted Accounting Practice (UK GAAP) help to assure external users that the auditor's opinion on the fairness of financial statements is based on a commonly accepted framework.

A typical auditor's report will state:

1. The company that has been audited and what their accounting method is
2. The responsibility of the auditor and their report
3. Reservations (if any)
4. Conclusion
5. Any additional information
6. A management report
7. The date and auditor’s signature

Types of Audit Report

There are 4 types of Audit Reports. They are:

1. **Clean Report:** If the auditor has no reservation in respect of matters presented in the financial statements, he gives a clean report. He states that the financial statements give a true and fair view of the state of affairs and profit and loss account during the period.
2. **Qualified Report:** If the auditor has any reservation in respect of the certain matters mentioned in the financial statements, he may qualify his report. The auditor may qualify his report only when the subject matter of qualification affects the truthfulness and fairness of the financial statement materially.
3. **Disclaimer:** While conducting the audit, the auditor may fail to obtain the required information and explanation or the books of accounts may not be available due to various reasons, or there may arise various situations, which shall restrict the scope of the duties of the auditor. Under such situations, he may not be in a position to form an opinion, then the auditor shall disclaim to give an opinion.
4. **Negative Report:** If the auditor is of the opinion that the financial statement does not show the true and fair view of the state of affairs of the business, he shall give an adverse or Negative Report.

AUDITS IN COMPUTERIZED SYSTEMCOMPUTER-ASSISTED AUDIT TECHNIQUES

Computer-assisted audit techniques (CAATs) are those featuring the ‘application of auditing procedures using the computer as an audit tool’. CAATs are normally placed in three main categories:

(i) **Audit software:** Computer programs used by the auditor to interrogate a client’s computer files; used mainly for substantive testing. They can be further categorised into:

- **Package programs (Generalized audit software):** pre-prepared programs for which the auditor will specify detailed requirements; written to be used on different types of computer systems.
- **Purpose-written programs:** Perform specific functions of the auditor's choosing; the auditor may have no option but to have this software developed, since package programs cannot be adapted to the client's system (however, this can be costly).
- **Enquiry Programs:** Those that are part of the client's system, often used to sort and print data, and which can be adapted for audit purposes, e g accounting software may have search facilities on some modules, that could be used for audit purposes to search for all customers with credit balances (on the customers' module) or all inventory items exceeding a specified value (on the inventory module). Using audit software, the auditor can scrutinise large volumes of data and present results that can then be investigated further. The software consists of program logic needed to perform most of the functions required by the auditor, such as:
  - Select a sample
  - Report exceptional items
  - Compare files
  - Analyse, summarise and stratify data.

The auditor needs to determine which of these functions they wish to use, and the selection criteria. The following is an example of how this could be applied to the auditof wages:

- Select a random sample of employees from the payroll master file; the auditor could then trace the sample back to contracts of employment in the HR department to confirm existence.
- Report all employees earning more than a certain amount per month as audit sample.
- Compare the wages master file at the start and end of the year to identify starters and leavers during the year; the auditor would then trace the items identified back to evidence, such as starters' and leavers' forms (in the HR department) to ensure they were valid employees and had been added or deleted from the payroll at the appropriate time (the auditor would need to request that the client retain a copy of the master file at the start of the year to perform this test)
- Check that the total of gross wages minus deductions equates to net pay.

(ii) **Test data:** Test data consists of data submitted by the auditor for processing by the client's computer system. The principle objective is to test the operation of application controls. For this reason, the auditor will arrange for dummy data to be processed that includes many error conditions, to ensure that the client's application controls can identify problems.

Examples of errors that might be included:

- supplier account codes that do not exist
- employees earning in excess of a certain limit
- sales invoices that contain addition errors
- Submitting data with incorrect batch control totals.

Data without errors will also be included to ensure 'correct' transactions are processed properly. Test data can be used 'live', ie during the client's normal production run. The obvious disadvantage with this choice is the danger of corrupting the client's master files. To avoid this, an integrated test facility will be used . The alternative (dead test data) is to perform a special run outside normal processing, using copies of the client's master files. In this case, the danger of corrupting the client's files is avoided –but there is less assurance that the normal production programs have been used.

(iii) **Other techniques:** There are increasing numbers of other techniques that can be used; the main two are:

- **Integrated Test Facility:** used when test data is run live; involves the establishment of dummy records, such as departments or customer accounts to which the dummy data can be processed. They can then be ignored when client records are printed out, and reversed out later.
- **Embedded Audit Facilities (Embedded Audit Monitor):** also known as resident audit software; requires the auditor's own program code to be embedded into the client's application software. The embedded code is designed to perform audit functions and can be switched on at selected times or activated each time the application program is used. Embedded facilities can be used to: – Gather and store information relating to transactions at the time of processing for subsequent audit review; the selected transactions are written to audit files for subsequent examination, often called system control and review file (SCARF) Spot and record (for subsequent audit attention) any items that are unusual; the transactions are marked by the audit code when selection conditions (specified by the auditor) are satisfied. This technique is also referred to as tagging.

The attraction of embedded audit facilities is obvious, as it equates to having a perpetual audit of transactions. However, the set-up is costly and may require the auditor to have an input at the system development stage. Embedded audit facilities are often used in real time and database environments.

Impact of Computer-based Systems on the Audit Approach

The fact that systems are computer-based does not alter the key stages of the audit process; this explains why references to the audit of computer-based systems have been subsumed into ISAs 300, 315 and 330.

(i) **Planning:** The Appendix to ISA 300 (Redrafted) states 'the effect of information technology on the audit procedures, including the availability of data and the expected use of computer - assisted audit techniques' as one of the characteristics of the audit that needs to be considered in developing the overall audit strategy.

(ii) **Risk assessment:** 'The auditor shall obtain an understanding of the internal control relevant to the audit.' (ISA 315 (Redrafted)). The application notes to ISA 315 identify the information system as one of the five components of internal control. It requires the auditor to obtain an understanding of the information system, including the procedures within both IT and manual systems. In other words, if the auditor relies on internal control in assessing risk at an assertion level, s/he needs to understand and test the controls, whether they are manual or automated. Auditors often use internal control evaluation (ICE) questions to identify strengths and weaknesses in internal control. These questions remain the same – but in answering them, the auditor considers both manual and automated controls. For instance, when answering the ICE question, 'Can liabilities be incurred but not recorded?', the auditor needs to consider manual controls, such as matching goods received notes to purchase invoices – but will also consider application controls, such as programmed sequence checks on purchase invoices. The operation of batch control totals, whether programmed or performed manually, would also be relevant to this question.

(iii) **Testing:** 'The auditor shall design and perform further audit procedures whose nature, timing and extent are based on and are responsive to the assessed risks of material misstatement atthe assertion level.' (ISA 330 (Redrafted)) This statement holds true irrespective of the accounting system, and the auditor will design compliance and substantive tests that reflect the strengths and weaknesses of the system. When testing a computer information system, the auditor is likely to use a mix of manual and computer-assisted audit tests.

'Round the machine (computer)' vs 'through the machine (computer)' approaches to testing Many students will have no experience of the use of CAATs, as auditors of clients using small computer systems will often audit 'round the machine'. This means that the auditor reconciles input to output and hopes that the processing of transactions was error-free.The reason for the popularity of this approach used to be the lack of audit software that was suitable for use on smaller computers. However, this is no longer true, and audit software is available that enables the auditor to interrogate copies of client files that have been downloaded on to a PC or laptop. However, cost considerations still appear to be a stumbling block. In the 'through the machine' approach, the auditor uses CAATs to ensure that computer - based application controls are operating satisfactorily.

CONCLUSION

The key objectives of an audit do not change in a computer environment. The auditor still needs to obtain an understanding of the system in order to assess control risk and plan audit work to minimise detection risk. The level of audit testing will depend on the assessment of key controls. If these are programmed controls, the auditor will need to 'audit through the computer' and use CAATs to ensure controls are operating effectively. In small computer-based systems, 'auditing round the computer' may suffice if sufficient audit evidence can be obtained by testing input and output strategy, but the strategy is additionally aligned with these outside stakeholders. The most effective due to do that is by that specialize in value creation. Human Resource shouldn't concentrate on what it does but on what it creates.

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INDIAN LEGAL SYSTEM'S RESPONSE TOWARDS FORENSIC ACCOUNTING

INTRODUCTION

This chapter initially attempts to trace the response of Indian legal system towards implementation and adoption of forensic accounting.

However in India, forensic accounting has not got its due recognition even after alarming increase in the complex financial crimes and lack of adequately trained professionals to investigate and report on the complex financial crimes. The task of Forensic Accountants is handled by Chartered Accountants who apart from handling traditional practice of auditing as required under the Companies Act, 2013 or Income Tax Act are called upon by the law enforcement agencies or the companies or private individuals to assist in investigating the financial crime or scam. The CA or CWAs in India are best suited for this profession due to their financial acumen acquired during their rigorous training which can be further honed by introducing post qualification degree or diploma in Investigating and Forensic Accounting similar to one introduced by CICA. The CA or CWA who acquire post qualification in Investigative & Forensic Accounting can use the designation CA-IFA or CWA-IFA and be legally recognized as the Forensic Accounting Experts to handle the investigation of financial crimes and give expert testimony in the Court of Law. However, no efforts has so far been made by the ICAI and ICWAI, the two leading statutory accounting professional bodies to move in this direction and set up a institute which can offer the post qualification diploma in Investigative and Forensic Accounting to its members.

However, growing financial fraud cases, recent stock marker scams, failure of non financial banking companies, phenomena of vanishing companies and plantation companies and failure of the regulatory mechanism to curb it has forced the Government of India to form Serious Fraud Investigation Office (SFIO) under Ministry of Corporate Affairs which can be regarded the first step of Government of India to recognize the importance and advance the profession of forensic accountants. The SFIO is a multidisciplinary organization having experts from financial sector, capital market, accountancy, forensic audit, taxation, law, information technology, company law, customs and investigation. These experts have been taken from various organizations like banks, Securities & Exchange Board of India, Comptroller and Auditor General and concerned organizations and departments of the Government. However, the main important law enforcement agency involved directly in combating white-collar crimes is the Police, CBI, DRI etc. There is a total lack on the part of these law enforcement agencies to train their investigators in this specialized part of investigating white-collar crimes involving forensic accounting. The investigation of the major financial crimes is handled by ordinary investigating officers who after spending some time in investigation of conventional crimes are shunted to the economic offence wing and they are expected to handle the financial crime cases involving complex & intricate financial records whi*ch* is required to be analyzed to unearth crime or unique MO adopted by the white collar criminal. The result is obvious, the case dies its natural death and the criminals roam free as the IO given his lack of specialized knowledge & qualification fails to properly investigate the financial crime to its logical conclusion. On the other hand if we look at the western countries particularly USA, the law enforcement agencies of which like DEA, FBI, CIA has well marshalled its pool of special agents having forensic accounting backgrounds that are the backbone of the bureau‘s financial crimes and terrorism financing units and investigate with professional acumen, the complex financial crimelike money laundering, internet crimes, financial institution fraud and other economic crimes. Today, there are more than 600 FBI agents with accounting backgrounds. Thus, it is highly imperative on the part of law enforcement agencies in India that theyfollow the suit and engage specialist forensic accountant on its roll whose engagements relating to criminal matters typically arise in the aftermath of financial fraud.

However existence of white collar crime in different sectors forced Indian law makers to pass certain legislations, violations of which may lead to tremendous fillip to white collar criminals or occupational related crime in India which are:

- Essential Commodities Act, 1955,
- Industrial (Development and Regulation) Act, 1957.
- Import and Export (Control) Act, 1947,
- Companies Act, 2013 and 2013,
- Foreign Exchange (Regulation) Act, 1973,
- Central Excises and Salt Act, 1944,

- Income-tax Act, 1961,
- Customs Act, 1962.
- The Conservation of Foreign Exchange and Prevention of Smuggling Activities and Smugglers and Foreign Exchange Manipulators (Forfeiture of Property) Act, 1976.

Specifically, in Section 4 of the Prevention of Corruption Act, 1947, where there is a presumption for instance, ―that money received other than legal remuneration by a public servant is an illegal gratification‖. They laid more emphasis on the workings of the public servant as they may use their occupational capacity to exploit the mass in general.

The issue of Cyber crime & digital evidence in India is primarily dealt with by the Information Technology Act, 2000 (IT Act), the Indian Penal Code (IPC), and the Code of Criminal Procedure (CrPC). The Indian parliament considered it necessary to give effect to the resolution by which the General Assembly adopted Model Law on Electronic Commerce adopted by the United Nations Commission on Trade Law. Asa consequence of which the Information Technology Act 2000 was passed and enforced on 17^{th} May 2000. The preamble of this Act states its objective to legalize e- commerce and to regulate and control the affairs of the cyber world in a more effective manner. In IT Act, sections 43 to 45 are relating to penalty for damages to computers. Sections 65 to 74 contain provisions relating to various cyber crimes.

Subsequently on the report submitted by Santhanam committee certain legislations earlier enacted were amended as - Anti-Corruption Laws (Amendment) Act, 1964; Foreign Exchange (Amendment) Act, 1964; Prevention of Food Adulteration Act, 1954, Wealth Tax (Amendment) Act, 1964 and more powers have been conferred on the investigating officers and on the Magistrates for conducting the proceedings of the summary trials.

The Criminal Justice Act 2011 was also signed into law on 2^{nd} August 2011. The Minister for Justice and Equality has made an Order commencing various provisions of the Act with effect from 9^{th} August 2011. The main purpose of the legislation is to provide for more effective investigation of white collar crime. It sets out new procedures to facilitate free access to information and documentation including that which is held electronically. The Act provides that it is a criminal offence to fail to furnish to the guardian information which could prevent the commission of white collar crime or to assist the investigation into white collar crime. The Act includes provisions to protect whistleblowers.

The Indian Law which Refers to Forensic Accounting

The Companies Act, 2013

The Companies Act 2013 expected to facilitate business-friendly corporate regulation, improve corporate governance norms, enhance accountability on the part of corporates and auditors, raise levels of transparency and protect interests of investors, particularly small investors. The relevant provisions are as follows:

1. Prevention of Oppression and Mismanagement

(a) Class Action suits enabled: One or more members or class thereof or one or more creditors / class thereof can apply to NCLT for orders to prevent the affairs of the company being conducted in a manner prejudicial to interests of the company. They may also claim damages / compensation for fraudulent / unlawful / wrongful acts from or against the company / directors / auditors / experts / advisors etc.

(b) To prevent possible misuse, Class Action applications can be made by prescribed number of members / creditors. Banking companies are to be kept out of the purview of Class Action.

2. Inspection, Inquiry and Investigation:

(a) KMPG, auditors and practicing CS also subject to search and seizure of documents by ROC and the Inspector appointed by Central Government (CG).

(b) CG to establish SFIO for investigation of frauds relating to a company. Till the time SFIO is not established, SFIO already set up by CG in terms of directions of Government of India to be used.

(c) CG may under the specified situations including in public interest refer affairs of a company to be investigated by SFIO.

(d) Where pursuant to an investigation or a compliant, NCLT is of the opinion that there is good reason to find relevant facts about any securities and such facts cannot be found out unless certain restrictions are imposed, NCLT may provide restrictions on securities for a period not exceeding 3 years.

(e) Where it appears to NCLT in specified circumstances that there are reasonable grounds to believe that the removal, transfer or disposal of funds, assets, properties of the company is likely to take place in a manner that is prejudicial to the interests of the company or its shareholders or creditors or in public interest, NCLT may direct such transfer, assets, properties, etc. of the company shall not take place during a period not exceeding 3 years.

(f) Notwithstanding anything contained in the Code of Criminal Procedure, 1973:

- Special Court may try in a summary way any offence under 2013 Act which is punishable with imprisonment for a term not exceeding 3 years.
- Every offence under 2013 Act except certain offences shall be deemed to be non-cognizable within the meaning of the said Code. Offences under 2013 Act which are cognizable within the meaning of the said Code include:

(a) Providing misleading or false information on incorporation;

(b) Misstatement in prospectus;

(c) Fraudulently inducing person to invest money;

(d) Personation for acquisition of securities;

(e) Concealment of name of creditor entitled to object reduction in capital;

(f) Destruction of documents.

Thus the principle provisions of Companies Act 2013 focus on inspection of books of accounts, investigation of company affairs, prosecution for unfair practices and mismanagement affecting stakeholders interest. The foundation of forensic accounting can be built on the basis of the relevant provisions to ensure improved corporate governance, accountability and transparency. As forensic accounting is an emerging area of specialization, its successful adoption depends on legal compliance and the above mentioned provisions of Companies Act, can provide appropriate legislature for its implementation.

SEBI Act, 1992

The share market is highly volatile and the brokers indulge into various unfair and fraudulent trade practices like synchronized share trading, manipulate and fabricate the books of accounts and cheat the gullible investors. Regulation 11 C of the SEBI Act, 1992 empowers the SEBI to direct any person to investigate the affairs of intermediaries or brokers associated with the securities market whose transactions in securities are being dealt with in a manner detrimental to the investors or the securities market. Thus fraudulent and unfair trade practices of the brokers or market intermediaries are investigated by the investigator appointed by SEBI which require the broker or market intermediary to furnish information, books of accounts, registers, documents or records etc. which is analyzed by the investigator to find out any manipulation, fraudulent practice or otherwise of the broker.

Investigation (Section 11C)

(i) Where the Board has reasonable ground to believe that-

(a) the transactions in securities are being dealt with in a manner detrimental to the investors or the securities market; or

(b) any intermediary or any person associated with the securities market has violated any of the provisions of this Act or the rules or the regulations made or directions issued by the Board there under, it may, at any time by order in writing, direct any person (hereafter in this section referred to as the Investigating Authority) specified in the order to investigate the affairs of such intermediary or persons associated with the securities market and to report thereon to the Board.

(ii) Without prejudice to the provisions of sections 235 to 241 of the Companies Act, 2013, it shall be the duty of every manager, managing director, officer and other employee of the company and every intermediary referred to in section 12 orevery person associated with the securities market to preserve and to produce to the Investigating Authority or any person authorized by it in this behalf, all the books, registers, other documents and record of, or relating to, the company or, as the case may be, of or relating to, the intermediary or such person, which are in their custody or power.

(iii) The Investigating Authority may require any intermediary or any person associated with securities market in any manner to furnish such information to, or produce such books, or registers, or other documents, or record before him or any person authorized by it in this behalf as it may consider necessary if the furnishing of such information or the production of such books, or registers, or other documents, or record is relevant or necessary for the purposes of its investigation.

(iv) The investigating authority may keep in its custody any books, registers, other documents and record produced under sub-section (2) or sub-section (3) for six months and thereafter shall return the same to any intermediary or any person associated with securities market by whom or on whose behalf the books, registers, other documents and record are produced:

- Provided that the investigating authority may call for any book, register, other document and record if they are needed again.
- Provided further that if the person on whose behalf the books, registers, other documents and record are produced requires certified copies of the books, registers, other documents and record produced before the Investigating Authority, it shall give certified copies of such books, registers, other documents and record to such person or on whose behalf the books, registers, other documents and record were produced.

(v) Any person, directed to make an investigation under sub-section (1), may examine on oath, any manager, managing director, officer and other employee of any intermediary or any person associated with securities market in any manner, in relation to the affairs of his business and may administer an oath accordingly and for that purpose may require any of those persons to appear before it personally.

(vi) If any person fails without reasonable cause or refuses-

a) to produce to the investigating authority or any person authorized by it in this behalf any book, register, other document and record which is his duty under sub-section (2) or sub-section (3) to produce; or

b) to furnish any information which is his duty under sub-section (3) to furnish; or

c) to appear before the investigating authority personally when required to do so under sub-section (5) or to answer any question which is put to him by the investigating authority in pursuance of that sub-section; or

d) to sign the notes of any examination referred to in sub-section (7), he shall be punishable with imprisonment for a term which may extend to one year, or with fine, which may extend to one crore rupees, or with both, and also with a further fine which may extend to five lakh rupees for everyday after the first during which the failure or refusal continues.

(vii) Notes of any examination under sub-section (5) shall be taken down in writing and shall be read over to, or by, and signed by, the person examined, and may thereafter be used in evidence against him.

(viii) Where in the course of investigation, the investigating authority has reasonable ground to believe that the books, registers, other documents and record of, or relating to, any intermediary or any person associated with securities market in any manner, may be destroyed, mutilated, altered, falsified or secreted, the investigating authority may make an application to the Judicial Magistrate of the first class having jurisdiction for an order for the seizure of such books, registers, other documents and record.

(ix) After considering the application and hearing the investigating authority, if necessary, the Magistrate may, by order, authorize the investigating authority-

a) to enter with such assistance, as may be required, the place or places where such books, registers, other documents and record are kept;

b) to search that place or those places in the manner specified in the order; and

c) to seize books, registers, other documents and record, it considers necessary for the purposes of the investigation:

Provided that the Magistrate shall not authorize seizure of books, registers, other documents and records, of any listed public company or public company (not being the intermediaries specified under section 12) which intends to get its securities listed on any recognized stock exchange unless such company indulges in insider trading or market manipulation.

(x) The investigating authority shall keep in its custody the books, registers, other documents and record seized under this section for such period not later than the conclusion of the investigation as it considers necessary and thereafter shall return the same to the company or the other body corporate, or, as the case may be, to the managing director or the manager or any other person, from whose custody or power they were seized and inform the Magistrate of such return:

Provided that the investigating authority may, before returning such books, registers, other documents and record as aforesaid, place identification marks on them or any part thereof.

(xi) Save as otherwise provided in this section, every search or seizure made under this section shall be carried out in accordance with the provisions of the Code Criminal Procedure, 1973 (2 of 1974) relating to searches or seizures made under that code.

Thus, the focus is to prevent unfair trade practices of the brokers and market intermediaries by investigating and inspecting the books of account to find out manipulation or fabrication. Forensic accountants look behind the number and they possess detective and investigative mentality. So they can play a lead role in assisting the

SEBI to unearth the complex share market related frauds perpetrated by the brokers. SEBI has decided to create a forensic accounting cell to improve the quality of the financial information disclosed and to assist in detection of financial irregularities so as to serve as an effective early warning mechanism. Thus new SEBI guidelines relating to forensic accounting can be the stepping stone for its successful implementation and to strengthen investors‘protection.

The Insurance Act, 1938 and The Public Liability Insurance Act, 1991

(A) Section 33 of The Insurance Act empowers the IRDA to direct any person (–Investigating Authority‖) to investigate the affairs of any insurer. The investigating authority may seek assistance of the auditor (or actuary or both) who shall be the Chartered Accountant within the meaning of Chartered Accountant Act, 1949 for the purpose of assisting him in any investigation. The books of account, registers and other documents are taken by the investigating authority in its custody to analyze it to find out the manipulations or fabrication in the books of accounts. The provisions of the said Act are as follows:

According to Sec 33(1), the Central Government may, at any time, by order in writing, direct the Controller or any other person specified in the order to investigate the affairs of any insurer and to report to the Central Government on any investigation made by him: Provided that the Controller or the other person may, wherever necessary, employ an auditor or actuary or both for the purpose of assisting him in any investigation under this section.

According to Sec 33(1A), notwithstanding anything to the contrary contained in section 235 of the Companies Act, 2013 (1 of 1956), the Controller may, at any time,and shall, on being directed so to do by the Central Government, cause an inspection to be made by one or more of his officers of any insurer and his books and accounts;and the Controller shall supply to the insurer a copy of his report on such inspection. According to Sec 33(2), it shall be the duty of every manager, managing director or other officer of the insurer to produce before the person directed to make the investigation under sub-section (1) [or inspection under sub- section, (1A)] all such books of account, registers and other documents in his custody or power and to furnish him with any statements and information relating to the affairs of the insurer as the said person may require of him within such time as the said person may specify.

According to Sec 33(3), any person, directed to make an investigation under sub-section (1) [or inspection under sub- section (1A)], may examine on oath, any manager, managing director or other officer of the insurer in relation to his business and may administer oaths accordingly.

According to Sec33(3A), the Controller shall, if he has been directed by the Central Government to cause an inspection to be made, and may, in any other case, report to the Central Government on any inspection made under this section.

According to Sec33(4), on receipt of any report under sub- section (1) or under sub- section (3A), the Central Government may, after giving such opportunity to the insurer to make a representation in connection with the report as, in the opinion of the Central Government, seems reasonable, by order in writing,--

(a) require the insurer to take such action in respect of any matter arising out of the report as the Central Government may think fit; or

(b) direct the Controller to cancel the registration of the insurer; or

(c) direct the Controller to apply to the Court for the winding up of the insurer, ifa company, whether the registration of the insurer has been cancelled under clause (b) or not.

According to Sec 33(4A), the Central Government may, after giving reasonable noticeto the insurer, publish the report submitted by the Controller under sub- section (3A) or such portion thereof as may appear to it to be necessary.

According to Sec 33(4B), the Central Government may prescribe the minimum information to be maintained by insurers in their books, the manner in which such information should be maintained, the checks and other verifications to be adopted by insurers in that connection and all other matters incidental thereto as are, in its opinion, necessary to enable the Controller to discharge satisfactorily his functions under this section. For the purposes of this section, the expression" insurer" shall include—

(i) in the case of an insurer incorporated outside India, all his branches in India; and

(ii) in the case of an insurer incorporated in India—

(a) all his subsidiaries formed for the purpose of carrying on the business of insurance exclusively outside India; and

(b) all his branches whether situated in India or outside India.

(B) The Public Liability Insurance Act, 1991

The relevant provisions under this Act are as follows:

- Power to call for information: Any person authorised by the Central Government may, for the purposes of ascertaining whether any requirements of this Act or of any rule or of any direction given under this Act have been complied with, require any owner to submit to that person such information as that person may reasonably think necessary.

- Power of entry and inspection: Any person, authorised by the Central Government in this behalf, shall have a right to enter, at all reasonable times with such assistance as he considers necessary, any place, premises or vehicle, where hazardous substance is handled for the purpose of determining whether any provisions of this Act or of any rule or of any direction given under this Act is being or has been complied with and such owner is bound to render all assistance to such person.

Thus under both Insurance Act, 1938 and Public Liability Insurance Act, 1991 there are sufficient provisions to investigate the affairs of any insurer to find out any manipulation or fabrication in books of account. In the inspection process the investing authority requires the assistance of the auditor. Hence Chartered Accountant can play a front role as forensic accountant and aid in the investigation conducted into the affairs of the insurer as per the provisions of Insurance Act, 1938 and Public Liability Insurance Act, 1991. Thus service of forensic accountants as investigating authority has gained importance to provide better safeguard to the insured.

The Prevention of Money-Laundering Act, 2002

Section 3 of the 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 sources by depositing the cash in domestic banks or other kinds of financial institutions.
- **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.

The Prevention of Money Laundering Act, 2002 defines money laundering as 'Any act or attempted act to conceal or disguise the identity of illegally obtained proceeds so that they appear to have originated from legitimate sources'. In other words, it is the processes used by criminals through which they make –dirty‖ money appear –clean‖. The Prevention of Money Laundering Act, 2002 (PMLA 2002) forms the core of the legal framework put in place by India to combat money laundering. PMLA 2002 and the Rules notified thereunder came into force with effect from 1st July, 2005. Necessary Notifications / Rules under the said Act have been published in the Gazette of India on 1st July 2005 by the Department of Review, Ministry of Finance, Government of India. Securities and Exchange Board of India have issued a Circular No. ISD / QR / RR / AML / I/ 06 on 18th January, 2006 to all intermediaries registered with SEBI u/s 12 of the SEBI Act providing Guidelines on Anti money Laundering Standards (Guidelines). M/s. Reflection Investments, being registered as Stock Brokers, shall have to maintain a record of all the transactions; the nature & value of which has been prescribed under the Prevention of Money Laundering Act. Such transactions include:

- All cash transactions of the value more than Rs. 10 Lacks or its equivalent in foreign currency.
- All series of cash transactions integrally connected to each other which have been valued below Rs. 10 Lacks or its equivalent in foreign currency where such series of transactions take place within one calendar month.

- All suspicious transactions whether or not made in cash and including inter- alia, credits or debits into from any non monetary account such as d-mat account, security account maintained by us.
- For the purpose of suspicious transactions reporting, apart from transactions integrally connected, transactions remotely connected or related are also to be considered.

Sec.3 of PML Act, 2002 defines offence of ‗money laundering' as: ―whosoever directly or indirectly attempts to indulge or knowingly assists or knowingly is a party or is actually involved in any process or activity connected with the proceeds of crime and projecting it as untainted property shall be guilty of the offence of money-laundering‖

Financial Intelligence Unit – India (FIU-IND) was set by the Government of India vide O.M. dated 18th November 2004 as the central national agency responsible for receiving, processing, analyzing and disseminating information relating to suspect financial transactions. FIU-IND is also responsible for coordinating and strengthening efforts of national and international intelligence, investigation and enforcement agencies in pursuing the global efforts against money laundering and related crimes. FIU-IND is an independent body reporting directly to the Economic Intelligence Council (EIC) headed by the Finance Minister.

The PMLA 2002 and Rules notified there under impose an obligation on banking companies, financial institutions and intermediaries to verify identity of clients, maintain records and furnish information to FIU-IND. The PML Act imposes obligations on entities that provide financial services to sufficiently identify their clients.

According to Sec 4, the punishment for money laundering is whoever commits the offence of money-laundering shall be punishable with rigorous imprisonment for a term which shall not be less than three years but which may extend to seven years and shall also be liable to fine which may extend to five lakh rupees provided that where the proceeds of crime involved in money-laundering relates to any offence specified under paragraph 2 of Part A of the Schedule, the provisions of this section shall have effect as if for the words "which may extend to seven years", the words "which may extend to ten years" had been substituted.

However the role of forensic accountants can not be denied to prevent such money laundering activities and they can often be involved in the following antimoney laundering activities:

- Investigating and analyzing financial evidence to establish a suspicious transaction;
- 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 that assist the banks in submission of the suspicious transaction reports to the regulator; and
- Assisting in legal proceedings, including testifying in court as an expert witness and preparing visual aids to support trial evidence.

The Companies (Auditor's Report) Order, 2016

CARO, 2003 requires the auditor to report to the effect that if a substantial part of fixed assets have been disposed off during the year and whether it has affected the going concern status. In order to carry out the duties, the auditor has to draw a corollary and reference to the section 293 Companies Act, 2013, 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 i.e.; if any fraud on or by the company has been noticed or reported during the year.

CARO 2016 applies to all companies including a foreign company as defined u/s 591of the Companies Act, 2013. CARO 2016 is also applicable to the audit of Branch ofa Company, except where the Company is exempt from the applicability of the order. List of matters to be reported under CARO, 2003 that relates to forensic accountingare as follows :

(i) Internal control [4(iv)]

(a) Adequacy of internal control procedure according to the size and nature of thebusiness.

(b) Correction of major weakness if there is continuous failure in internal control system.

(ii) **Internal audit [4(vii)]:** Having regard to their nature and size of business, the auditor should report whether or not the following companied have an internal audit system:

(a) Listed companies,

(b) Companied having paid up capital and reserves exceeding Rs.5 lakhs as at the commencement of the financial year concerned,

(c) Companies having an average annual turnover exceeding Rs. 5 crores for a period of three consecutive financial years immediately preceeding the financial year concerned.

(iii) Application of funds [4(xvii)]

(a) Whether the short term funds have been applied for long term investment.

(b) If such application is made, the nature and amount involved should be indicated in the audit report.

(iv) Fraud [4(xxi)]

(a) Whether any fraud on or by the company has been noticed or reported during the year.

(b) Where any fraud is noticed and reported, the nature and the amount involved should be indicated.

Thus the main focus of CARO, 2003 is internal control, internal audit and fraud reporting. Thus the concept of forensic accounting is gaining importance as it can strengthen internal control system, conduct internal audit more effectively and detect and prevent fraud.

CONCLUSION

Its time for India to give a thought for modifying its present judicial system which is traditional and complex A regulatory body of forensic accounting needs to be set up to govern the role, duties, responsibilities and power of forensic accountant. There is also a need to make a new law for the prosecution of fraudsters, irrespective of their domicile. In order to tackle the problem of prosecution of fraudster from different domicile other than India, the issue needs to be taken up to international regulatory body. In this regard, international co- operation needs to be sought to achieve some form of legislative consistency. Appointment of forensic accountants should be made mandatory in all the companies especially in public sector companies and large scale companies to detect and prevent fraud.

After exploring the scope of Indian legal system relating to forensic accounting, let us consider the viewpoints of different focused groups regarding acceptability of forensic accounting in India. The analysis has been undertaken in the next chapter on the basis of primary data.

☯☯☯

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