



Forensic Accounting: Innovative Tool for Corporate Sector

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Abstract:

In the present scenario, there has been tremendous increase in the Financial Frauds, White Collar Crimes, and Professional Negligence etc. due to flourishing businesses and diversified operations. Recent Accounting frauds and requirement of transparency as well as governance gives the rise to the need of Forensic Accounting in the Corporate Sector. Internal and External auditors can only check the arithmetical accuracy and the compliance with the Accounting Standards, Auditing Standards and Policies in the preparation of Books of Accounts. The new arena of accounting world be helpful to detect the suspected business transactions, frauds and other criminal offences.

The Concept of Forensic Accounting has emerged since long time back. Kautaliya was the economist who had discovered the methods of detecting frauds. Similarly on the same line Birbal has worked out. Forensic Accounting is basically the application of accounting knowledge, principles, methods, interpersonal skills and analytical skills to look beyond the numbers to detect the various offences and frauds in the books of accounts.

Forensic accounting is the functional area of accountancy that analyzes actual or anticipated disputes or litigation. "Forensic" means "suitable for use in a court of law", Forensic accountants, also referred to as forensic auditors or investigative auditors specialize in insurance claims, personal injury claims, fraud, construction, or royalty audits (www.wikipedia.com). Forensic Accounting resorts to accounting, auditing, and analytical skills to conduct an inspection into a company's financial statements.

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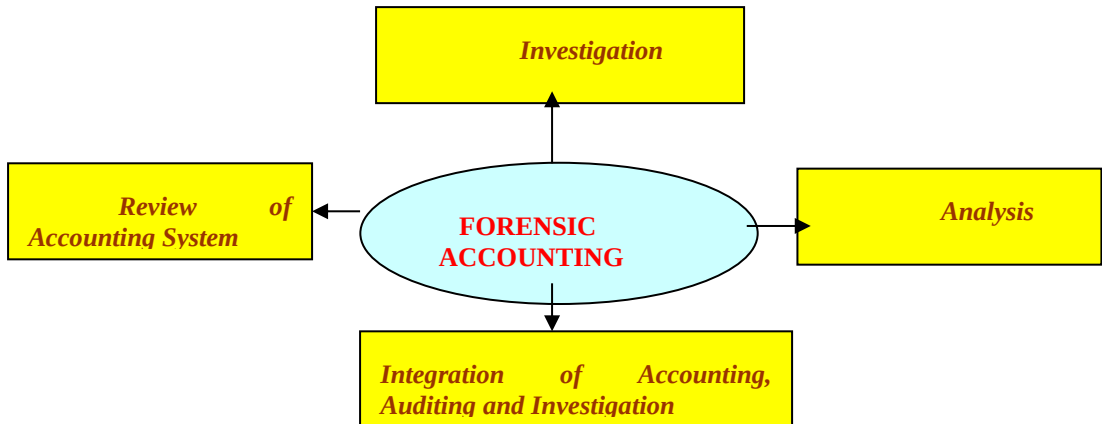


Source: U.S. Dept. of Justice, Education and Training in Fraud and Forensic Accounting: A Guide for Educational Institutions, Stakeholder Organizations, Faculty and Students, Draft Copy, December 23, 2005

Forensic Accounting Global Experience

Bolgna and Linquist (1995) defined the Forensic Accounting as the application of financial skills and an investigative mentality to unresolved issues. White Collar crimes cost the United States more than \$300 billion (KPMG Forensic, 2003). Forensic Accountants assess a company's true worth during a merger and ensure that purchaser is acquainted with the target firm's financial position (Harris and Brown, 2000). Fraudulent misrepresentations associated with the company's financial records may range from overvaluation of inventory and improper capitalization of expenses to misstatement of earnings and embezzlement (Harris and Brown 2000; Messmer 2004). Forensic Accounting Primarily focuses on quantifying damages in case of personal injury , product liability, contract disputes , intellectual property etc.(Durtschi 2003; Messmer 2004; Peterson and Reider 2001; Ramaswamy 2005). Ramaswamy (2005) believed that (Source: James A. Digabriele; Montclair State University, Montclair, New Jersey, "An Empirical Investigation of the Relevant Skills of Forensic Accountants", Journal of Education for Business, 2008 Heldref Publications)

Forensic Accounting basically includes: Forensic accounting is the combination of various Functions. The following flowchart would explain the same:



It encompasses two main areas:

1. Litigation Support----

Arbitration assistance, Business valuation, stockholder disputes, and Investigative services related to fraud and other illegal acts

2. Investigation Support---

Determining criminal matters such as employee theft, securities fraud (including falsification of financial statements), and insurance fraud, searching for irregularities associated with civil matters

Basically Forensic Accounting includes the following

- ✓ *Investigation of Financial Statements*
- ✓ *Investigation of Financial Evidences*
- ✓ *Analysis of Financial Statements*
- ✓ *Analysis of Financial evidences*
- ✓ *Integration of Accounting, Auditing and Investigation to assist in the Tax matters and Legal matters etc.*
- ✓ *Expert Consultancy for Litigation Operations*
- ✓ *Internal Check of Operations*
- ✓ *Internal Control of Activities*
- ✓ *Review of Accounting System and Process*
- ✓ *Verification of assets and Liabilities*
- ✓ *Detecting of Defalcation of Corporate Affairs*
- ✓ *Investigation of Theft*
- ✓ *Default minimization*
- ✓ *Investigation of Malpractices*

- ✓ *Quantifying and Analyzing the lost earnings*
- ✓ *Investigation of loss of Profits and sales*
- ✓ *Investigation of Damages and Insolvency*
- ✓ *Communication of Information in the form of Reports*
- ✓ *Review of businesses processes*
- ✓ *Review of interdepartmental Operation*

Data of Fraud Commitment level:

- *Frauds against organizations 40% by employees , 41% by management and 19% by owners*
- *Males - 61%, Females-39%*
- *High school - 33%*
- *College - 55%*
- *Postgraduate - 12%*

Source: 2006, ACFE Report to the Nation on Occupational Fraud & Abuse, pp.42-43

Application of Forensic Accounting in the Corporate Sector: Corporate Accounting Frauds, failure of the authorities to track the scams, White Collar Crimes creates the need to implement the Forensic Accounting. Forensic Accountants can utilize the business information, knowledge of accounting policies, procedures, standards and reporting systems to detect the frauds and crimes. Working in this capacity they would help the Corporate to protect themselves from the forthcoming risks. Forensic Accounting helps the Corporates in the following ways:

1. **Assessment of Loss:** Forensic Accountant can investigate and find out the reasons as well as extent of loss incurred to an organization due to Professional negligence.
2. **Asset Value Computation:** Forensic Accountant can help to estimate the asset value in the case of Liquidation to settle the claims of various secured and unsecured creditors.
3. **Claims and Dispute Settlement:** Forensic Accounting would help to find out as well as analyze the evidences and thus helps to settle the disputes of various contracts, products & services and furthermore even the cases of infringement of law can be taken care of.
4. **Detection of Fraud:** Forensic Accountant can find out any fraud either relating to fund embezzlement or manipulation of Books of Accounts.

Thus it would be an initiative to determine the extent of fraud and reasons of fraud.

5. **Professional and Ethical Negligence:** Premeditated negligence of the Accounting Standards and Compliance of Companies Act, 1956 would cause the loss to the organization and this sort of circumstances can be detected using Forensic Accounting.
6. **Crime Investigation:** Forensic Accounting can be used in the cases where the Crimes have Financial Repercussions. Thus forensic accountant can analyze the evidences and check the reasons of crime along with the responsible person.
7. **Alternative Dispute Resolution:** Forensic Accountants can work as an arbitrator to settle the various disputes among employees, organization etc.
8. **Loss of Goodwill, Sales and Profit:** Forensic Accountant can investigate the reasons for the losses and thus help to determine the quantity of loss also.
9. **Corporate Governance:** Forensic Accounting would help to make a transparent corporate governance system by making an integration of Accounting, Auditing and Investigation Skills.

Role of CEO as Forensic Auditor: TIPS for CEO

CEO of the Corporates can identify the suspected events and causes behind it. CEO can work in the capacity of the Forensic Auditor by taking care of the following footmarks:

1. **Take the assessment of respective departments and functions.**
2. **Determine the area of risks and operations.**
3. **Determine the availability of information relating to suspicious transactions and frauds/ white collar crimes.**
4. **Undergo for the analysis of information protocols.**
5. **Perform simulated intelligence to correlate the information with the events.**
6. **Analyze the results of simulated intelligence.**
7. **Use the results of above mentioned analysis in the context of operating environment.**
8. **Sharing of experiences.**
9. **Do the above mentioned steps as a circular process.**

Pre- Requisites for useful Forensic Accounting in Corporate Sector:
Corporate Sector is required to have the Forensic Accountant with professional skills and expertise to deal with the frauds and crimes. Furthermore, they are required to get the expertise in the following areas:

- ✓ Understanding of Company's Governance Policies
- ✓ Ability to analyze the Financial Statements
- ✓ Knowledge of Accounting Policies, Standards and Financial Statements
- ✓ Interpersonal Skills to communicate with the persons
- ✓ Knowledge of perception of employees
- ✓ Knowledge and expertise in networking system
- ✓ Proficiency in management control and information system
- ✓ Ability to look beyond numbers
- ✓ Non reactive to the subjectivity
- ✓ Ability to correlate and memorize the facts and events
- ✓ Sagacity

Need of Forensic Accounting -----Normal Accounting is not adequate

Normal Accounting is just employed to make the books of Accounts following Generally Accepted Accounting Principles, Accounting Standards and Accounting Policies. Normal Accounting Procedures would not be sufficient because of the following reasons:

1. Existence of Suspected Fraudulent Transactions
2. Application of Investigative and Financial Skills to unresolved issues
3. Requirement to review the present business accounting systems
4. Requirement to look beyond numbers and deal with the business situations
5. Identifying the frauds and white collar crimes
6. Settle Professional Negligence cases
7. Critical Analysis of Financial Statements
8. Analysis of Tax Frauds
9. Analysis of Lost Profit and Earnings
10. Business Valuation

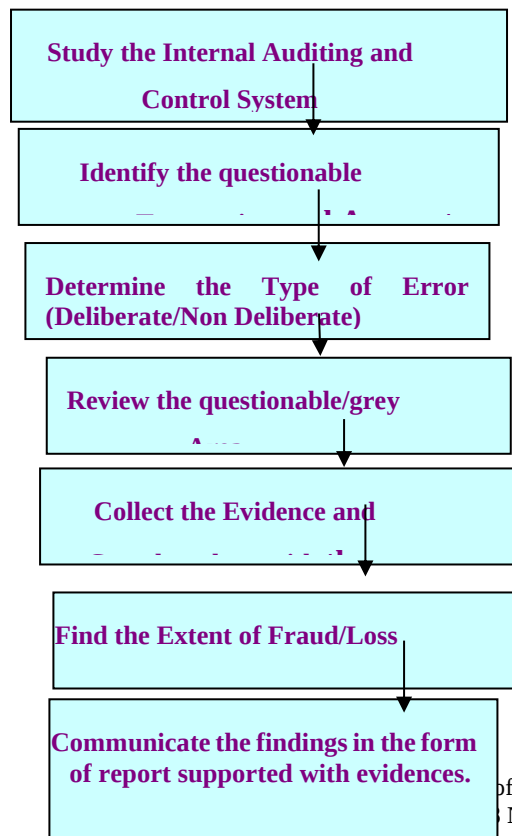
Forensic Accountant ----- Requirement of Special Training

Forensic Accountants are required to obtain a diploma given by Certified Fraud Examiners (ACFE) in the U.S. In India, ACFE offers the course based on White

Collar Crimes. Moreover the Forensic Accountant is required to have the some special training to obtain professional and analytical skills to deal with the diversity of situations. Further the special training is required because of following reasons:

1. In-depth knowledge of Evidence gathering and investigation techniques
2. Knowledge for Pro Active Risk Reduction Roles
3. Changing nature of Indian and International Accounting
4. Understanding of Financial Reporting and Business Information System
5. Specialized knowledge about the techniques of finding the frauds
6. Knowledge of determination of claimed damages
7. Dispersed knowledge of Auditing, Internal Controls, Risk Assessment and Fraud Detention.

Forensic Accounting/Auditing Steps: The Forensic Accountant has to view the backside of the internal auditors as well as external auditors. Forensic Accountant has to follow the following flow diagram as a procedure or steps in the implementation of Forensic Accounting:



Evidences for Forensic Accounting to investigate:

<i>Testimonial Evidence:</i> ✓ Interviewing ✓ Interrogatories ✓ Honesty tests (e.g., graphology, polygraph)	<i>Physical Evidence :</i> ✓ Fingerprints ✓ Tire marks ✓ Weapons ✓ Stolen property ✓ Identification numbers or markings on stolen objects
<i>Documentary Evidence:</i> ✓ Document examination ✓ Public records searches ✓ Audits ✓ Computer searches ✓ Net worth calculations ✓ Financial statement analysis	<i>Personal Observation:</i> ✓ Invigilation ✓ Surveillance ✓ Covert operations

Source: <http://www.cpafrms.com/Firmlist/usa.cfm>

Conclusion: The emergence of industrial revolution, technological development in the new millennium causes the increased instances of frauds and White Collar crimes. In this direction the Forensic Accounting has assumed its importance. CBI (Economic Office Wing) worked as Forensic Accountant and deal with the Financial Frauds. Not only financial frauds, but also Violation of IT Act, Companies Act 1956, RBI Act, and SEBI Act would also be required to be checked. TCS has also developed software to detect the telecom frauds. Thus the Forensic Accounting is a major step in the direction of Corporate Governance and Fraud minimization.

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