

## FORENSIC ACCOUNTING AND FRAUD INVESTIGATION

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### Introduction

The world of forensic accounting has been developing for the past 70 years. Some credit the beginning of the understanding of fraud as a subject of scientific study to the 1934 work of Donald Cressey and Edwin Southland, who co-authored *Principles of Criminology*. This authoritative text defined and described the fraud triangle, which made its way to the auditing standards with Statement on Auditing Standards (SAS) 99, *Consideration of Fraud in a Financial Statement Audit*, which makes reference to the elements of the “fraud triangle”. The concept of the fraud triangle is pervasive in the auditing standards and governs much of the work that is required of auditors.

Now-a-days, due to complex and huge size of business corporations, white collar crimes are increased on large scale at international as well as national level. There are various financial scams at central, state and district level in public sector and also in many private companies and cooperative institutions. These frauds are related with misuse of accounting techniques, policy decisions, technology etc. All these need to the serious need of forensic accounting and forensic accountant. The accounting concept goes on changing with the changing nature of business environment. Previously accountant play a role of maintaining books of accounts and preparing final accounts showing final results and auditors play a role of checking the books of accounts are maintained properly or not and verifying the accounts are prepared as per generally accepted accounting principles, auditing standards and legal provisions. But today critical financial situation emphasizes a need of special accounting called forensic accounting.

### Objectives of Study:-

The objectives of the study were-

1. To understand the concept of forensic accounting
2. To study about the various functions of forensic accountant
3. To Study about the present status of forensic accounting

### Forensic Accounting: Concept and Significance

Forensic accounting frequently uses on construction claims, financial contract disputes, environmental claims, government contract claims, and fraud investigations, among others. Professionals involved in this field are often engaged in examination and evaluation of financial evidence; the advancement and improvement of computer applications; that will aid and support the forensic accountants in analyzing and presenting financial evidence; providing services and support in legal proceedings. Also, Forensic accounting is the study of financial fraud and misconduct. Forensic accountants analyze, interpret, and summarize complex financial and business matters. They may be employed by insurance companies, banks, police forces, government agencies, or public accounting firms. Forensic accountants compile financial evidence, develop computer applications to manage the information collected, and communicate their findings in the form of reports or presentations.

Along with testifying in court, a forensic accountant may be asked to prepare visual aids to support trial evidence. For business investigations, forensic accounting entails the use of tracing funds, asset identification, asset recovery, and due diligence reviews. Forensic accountants may seek out additional training in alternative

dispute resolution (ADR) due to their high level of involvement in legal issues and familiarity with the judicial system.

### **What is Forensic Accounting?**

The application of accounting skills to provide quantitative financial information about matters before the courts. The work of a forensic accountant is generally performed by persons with financial or accounting training, who specialize in acquiring, analyzing, and reporting on financial events for the purpose of the “forum,” a decision-making body or a person. Webster’s explains “the noun forensic ... derives from the adjective forensic, whose earliest meaning in English is ‘belonging to, used in, or suitable to courts or to public discussion and debate.’ The English word was derived from a Latin word ... meaning ‘of the market place or forum, public,’ which in turn comes from the Latin word forum, meaning ‘market place, forum.’ The forum can be any decision-making authority within its context: judges, jury, public officials, insurance companies, or investors are all examples of forums for which the results of a forensic accounting analysis is delivered and decided upon.

Forensic accounting utilizes accounting, auditing, and investigative skills to conduct an examination into the finances of an individual or business. Forensic accounting provides an accounting analysis suitable to be used in legal proceedings. Forensic accountants are trained to look beyond the numbers and deal with the business reality of a situation. Forensic accounting is frequently used in fraud and embezzlement cases to explain the nature of a financial crime in court.

Forensic accounting is the specialty practice area of the accounting that describes engagements, which results from actual or anticipated disputes or litigations. According to the Webster’s Dictionary “Forensic” means ‘Suitable for use in Court’. That means a report or work done by the forensic accountant is used as evidence in a court. The different definitions of forensic accounting are as follows-

“Forensic accounting is the application of financial skill, and an investigative mentality to unresolved issues conducted within the context of rules of evidence. As a discipline, it encompassed financial expertise, fraud knowledge, and a sound knowledge and understanding of business reality and the working of the legal system.”---Bologna and Lindquist.

“The science that deals with the relation and application of finance, account, tax and auditing knowledge to analyze, investigate, inquire, test and examine matters in civil law, criminal law and jurisprudence in an attempt to obtain the truth from which to render an expert opinion.” – Horty.

“The application of accounting principles, theories and discipline to facts or hypotheses at issue in legal dispute and discipline to facts or hypotheses at issue in legal dispute and encompasses every branch of accounting knowledge.” --- American Institute of Certified Public Accountants (AICPA)

“Forensic accounting draws its name from association with a court of record. Forensic accounting and auditing are performed to accomplish an objective that involves a judicial determination.” --- Felix Pomeranz

Forensic accounting is a broad concept. It includes expert knowledge of all branches of accounting and its application to find out frauds, collect evidences and prove it into the court. It is the science of applying finance, accounting, tax, auditing and legal knowledge to examine the matters which are unresolved.

### **Key Takeaways :-**

- Forensic accounting is a combination of accounting and investigative techniques used to discover financial crimes.
- One of the key functions of forensic accounting is to explain the nature of a financial crime to the courts.
- Forensic accounting entails the use of tracing funds, asset identification, asset recovery, and due diligence reviews
- Forensic accounting is used by the insurance industry to establish damages from claims.

### **Forensic Accounting for Litigation Support**

Forensic accounting is utilized in litigation when quantification of damages is needed. Parties involved in legal disputes use the quantifications to assist in resolving disputes via settlements or court decisions. For example, this may arise due to compensation and benefit disputes. The forensic accountant may be utilized as an expert witness if the dispute escalates to a court decision.

### **Forensic Accounting for Criminal Investigation**

Forensic accounting is also used to discover whether a crime occurred and assess the likelihood of criminal intent. Such crimes may include employee theft, securities fraud, falsification of financial statement information, identity theft, or insurance fraud.

Forensic accounting is often brought to bear in complex and high-profile financial crimes. For instance, the scope and mechanics of Bernie Madoff's Ponzi scheme is understood today because forensic accountants dissected the scheme and made it understandable for the court case.

Forensic accountants may also assist in searching for hidden assets in divorce cases or provide their services for other civil matters such as breach of contracts, tort, disagreements relating to company acquisitions, breaches of warranty, or business valuation disputes.

Forensic accounting assignments can include investigating construction claims, expropriations, product liability claims, or trademark or patent infringements. And, if all that wasn't enough, forensic accounting may also be used to determine the economic results of the breach of a nondisclosure or non-compete agreement.

### **Forensic Accounting in the Insurance Industry**

Forensic accounting is routinely used by the insurance industry. In this capacity, a forensic accountant may be asked to quantify the economic damages arising from a vehicle accident, a case of medical malpractice, or some other claim. One of the concerns about taking a forensic accounting approach to insurance claims as opposed to an adjuster approach is that forensic accounting is mainly concerned with historical data and may miss relevant current information that changes the assumptions around the claim.

### **Forensic Accountant**

Forensic accountants are not always certified public accountant CPAs. Internationally, they are less likely to be chartered accountants and more likely to be certified professionals such as Certified Fraud Examiners or Certified in Financial Forensics. Forensic accountants also work in fraud prevention.

Forensic accountant means an accountant having expert in forensic accounting. This means that the forensic accountant should be skilled not only in financial accounting but also in internal control systems, the law, other institutional requirements, investigative proficiency, and interpersonal skills. A forensic accountant is expected to be a specialist

in accounting and financial system. He requires an in-depth knowledge of financial statements, and the ability to critically analysis, a thorough understanding of fraud systems, the ability to comprehend the internal control systems, proficiency in computers and knowledge of network systems, knowledge of psychology, interpersonal and communication skills, thorough knowledge of a company's governance policies and the laws regulating these policies command of criminal and civil law, as well as of the legal system and court procedures.

Dr. Madan Bhasin, Professor of Accounting, SSK Business School, Seoul, Korea rightly pointed out the skills required by forensic accountant. He mentioned that In addition to the specialized knowledge about the techniques of detecting frauds, the forensic accountant needs patience and analytical mindset. He has to look beyond the numbers ad grasp the substance of the situation. It is basically the work of the intelligent accountants. There is a need for the same basic accounting skills that it takes to become a good auditor plus the ability to pay attention to the smallest detail, analyze data thoroughly, think creatively, possess common business sense, be proficient with a computer, and have excellent communication skills. A "Sixth" sense that can be used to reconstruct details of past accounting transaction is also beneficial. A photographic memory helps when trying to visualize and reconstruct these past events. The forensic accountant also needs the ability to maintain his composure when detailing these events on the witness stand. Finally, a forensic accountant should be insensitive to personal attacks on his professional credibility.

#### **Functions of Forensic Accountant**

Forensic accountants are specialized accountant. They are trained to look beyond numbers and deal with the business realities of a situation. Analysis, interpretation, summarization and the presentation of complex financial and business related issues are prominent features of the forensic accountant profession. A forensic accountant has to do different job than the ordinary accountant. The function of forensic accountants include—

- i) Investing and analyzing financial evidence
- ii) Investing fraud through a critical analysis
- iii) Develop computerized applications to assist in the analysis and presentation of financial evidence
- iv) Communicate their findings in the form of reports, exhibits and collections of documents
- v) Assisting in legal proceedings, including testifying in courts, as an expert witness
- vi) Settlement of various types of claims
- vii) Handle the cases relating to professional negligence
- viii) To help in formulating and establishing a comprehensive corporate governance policy
- ix) To prevent fraud by establishing an efficient control system

#### **Present Status of Forensic Accounting**

Forensic accounting is used in advanced countries like US, Canada etc. The practice of forensic accounting commenced in the US as early as 1995, but the seed of this specialization has yet to take off in India. The association of Certified Fraud Examiners (ACFE) in the US started a diploma forensic accounting. The Canadian Institute of Chartered Accountants (CICA) has taken initiative in this direction and issued guidelines and pronouncements regarding forensic accounting. There is a wide scope for forensic accountants. They can be engaged in public practice as consultant or

employed by insurance companies, banks, financial institutions, police forces, government agencies and other organization. The growing number of different types of scams and collapse of various companies worldwide increases the demand of services in the nature of forensic accountants. India is not exception to this. Mayur Joshi, from Indian forensic Consultancy Services, observed that, “In India the formation of Serious Fraud Investigation office is the landmark creation for forensic accounts. Growing cyber crimes, failure of regulators to track the security scams, series of cooperative banks bursting all are pointing to the need of forensic accounting, irrespective of whether we understand the need or not.

**Conclusion:**

In Indian context forensic accountants are the most required in the wake of growing frauds. So it is necessary to develop forensic accounting profession in India. Forensic accountants are specialized accountant. Forensic accounting should not become the subject of a selected few's specialization and expertise. At the undergraduate as well as at the post graduate level across the country, it should be made part of the curriculum. This will help both the corporate and government to initially keep a crime check. At the same time, required legislative amendments should be made to determine the importance of forensic accounting in general and forensic accountant in particular.

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