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Forensic Accounting: An Insight into Its Needs, Techniques and Significance

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Abstract:
The term fraud is a concept not novel to a common man. For a person to lose confidence and develop a feeling of terror, this word works with full synergies. The number of fraud cases have gone skyrocketed in the present era giving impetus to raised demand to curb these. Conventionally, traditional auditors were supposed to identify and prevent any fraudulent activities from occurring, but due to failure of the traditional auditors in this area, a new area of accounting was used to identify and prevent frauds, which was termed 'forensic accounting'. This paper provides an insight into an abstract idea of Forensic accounting and enumerates about its origin and growing need and significance after huge fraud cases at the global as well as national level. This paper also attempts to throw light on the techniques used by a forensic auditor.

Key Words: frauds, forensic accounting, Techniques, Benford's law, Relative Size factor

"What the use of fingerprints was to the 19th century and DNA analysis was to the 20th, Forensic Accounting will be to the 21st century."

-Gordon Brown, former Chancellor of the Exchequer

Introduction

In this age of constant progress and innovation, the term "fraud" is not unfamiliar to the average person. The occurrence of frauds has increased round the clock, contributing to the erosion of people's trust in the financial system. As per the Association of Certified Fraud Examiner's (ACFE) report (2020), every organization loses 5% of their revenues to fraud. As per a survey by Deloitte India, 69.23% respondents believed that forensic investigators are the ones to turn to for fraud investigations. The worldwide increase in financial trouble signifies the shortcomings of traditional audit in avoiding the situation. This research work elucidates the concept of forensic accounting, a technique, to curb this severe menace. The term forensics refers to legal dimension, while accounting points onto the dimension of accounting work that arises as an outcome of economic activities. This technique, combining accounting, auditing and legal aspects is valuable to both industry and scholars, and provides an assured contribution to the continuing struggle against financial crime.

Research Objective:

The researcher attempts to give an abstract idea of the term, 'forensic accounting' and its acceptability in India. The researcher aims to throw light onto the its origin, significance and need.

Research Methodology:

The present research has been done by using secondary data through previous works of research including research papers and thesis. Journals, articles, newspapers and many websites have been refereed to accumulate the data.

What is Forensic Accounting?

As per the conventional practice, the auditors were expected to ensure sound financial reporting keeping an eye out for any financial gimmick during their regular audits. But it has been acknowledged today that auditor can only assess the conformity with generally accepted accounting principles, auditing standards, and company regulations. As a result, a new accounting area was utilized to monitor the financial frauds in enterprises that feared fraud suspicious transactions. 'Forensic accounting' is the term coined for this branch of accounting.

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."

According to Bologna and Lindquist (1995) "Forensic and investigative accounting is the application of financial skills and an investigative mentality to unresolved issues, conducted within the context of the rules of evidence."

Forensic accounting describes how various methods and approaches are used to detect accounting gimmicks or fraudulent deeds in financial reporting. The concept also puts light on the accounting and non-accounting practices performed by the forensic accountant or investigator as a part of his attempt to detect financial misconduct.

Legal Assistance and Investigative Accounting are both subsets of Forensic Accounting. For performing an investigation, Forensic Accountants employ accounting, auditing, as well as investigative skills. Forensic accountants are equipped to go far beyond the data that appears and handle the financially difficult situations. Owing to an expeditious rise in financial frauds in the contemporary world, the practice of combining forensic techniques with that of accounting has gained prominence.

Origin of Forensic Accounting:

In the 1930s, Frank Wilson was asked to examine the transactions of an iconic criminal while working for the US Internal Revenue Service. The criminal was well-known for his participation in criminal operations. Wilson's meticulous examination of the criminal's financial records led to his indictment for tax evasion leading to serious punishments. This is believed to be the initiation of the concept of forensic accounting.

With Indian reference, Kautilya, an age-old Indian economist, pioneered to identify the significance of forensic accounting and accountants. In his exemplary text, Arthshastra, Kautilya enumerated many tactics of misappropriating public monies through deception, for which auditors of the royal treasury must constantly be vigilant. In addition, Emperor Akbar's devoted Scholar Birbal had cunning tactics under his wraps to detect financial irregularities in a manner similar to modern era's Forensic Accounting.

The above incidents signified the usage of forensic accounting, but it was not up till 1946 when Maurice E. Peloubet of New York, pioneered to introduce the terminology of "Forensic Accounting" in his article "Forensic Accounting - Its Place in Today's Economy."

Need of Forensic Accounting:

Amid the incidents of multiple large corporate scams in India such as Satyam scam of ₹7800 crores (known as India's Enron scam) and numerous banking scams such as The Punjab National Bank (PNB) scandal of ₹11,356.84 crores, the need for forensic accountants has skyrocketed in the nation.

Organizations want to discover early signs and prevent any chance of occurrence of fraudulent activities, which is why many enterprises conduct periodic forensic audits. Enron, World. COM, Daewoo Motors Korea, Xerox, and others are examples of global scams that resulted in commercial losses for its Indian associates. In India, too, major financial scams involving large sums of state funding have accelerated in recent years.

Crores of public money have been looted in the securities scam by Harshad Mehta and Ketan Parekh, C.R. Bhansali, Satyam Scam, failure of non-banking financial institutions, disappearing firms and enterprises, and so on. The law enforcement agencies, such as the Central Bureau of Investigation and the Enforcement Directorate, have been increasingly active in executing anti-corruption legislation, targeting both individuals and companies.

The Whistle-blower Protection Act, 2014 was passed by the Parliament of India in 2014 developing a mechanism to receive complaints of frauds and corruption. In addition, the government has also acknowledged the significance of forensic auditing in curbing fraudulent activities and established the SFIO in the year 2003 to prohibit fraudulent acts from happening.

Advantages of Forensic Accounting:

- **Solution to financial crimes:** Financial crimes have increasingly harmed the economy of a nation and has hit harsh on the sentiments of the common man. Adoption of forensic accounting techniques brings down the occurrences of financial crimes.

- **Keeps an eye on the employees:** The employees of the organization are checked for their integrity under some techniques of forensic auditing and thus they refrain from causing any deception.

- **Enhances the public confidence:** The public confidence is strong in the organizations that hire regular forensic auditors as this activity reduces any chances of financial discrepancies.

- **Regulation on business funds:** The businesses tend to lose enormous amount of funds in frauds and scams. Continuous forensic audits shall reduce this risk of capital loss to the business.

- **Raises reputation:** Those organizations adopting forensic audits will have an upper hand in terms of their reputation in the eyes of the public.

- **Minimizing losses:** The businesses face huge setbacks due to financial scandals, forensic accounting controls financial crimes, thus reducing the amount of losses.

- **Development of excellent corporate governance policies:** Forensic accounting brings to notice the fraudulent tricks so as to build a good corporate governance policy for the future.

- **Identify weakness in the control system:** The weakness in the control system is identified that earlier ignored the financial crime. Such crimes will be stopped from recurring by improved control systems in the organization.

Techniques of Forensic Accounting:

- **Benford's Law:** The law is named after physicist Frank Benford. He stated it in 1938 in his paper titled "The Law of Anomalous Numbers". Benford has given a technique to identify any fraudulent activity, although the way to investigate that activity has not been clarified. After much research, Benford found that among naturally occurring numbers, the probability of occurrence of 1 as the leading number is as high as 30% rather than that of beginning with 9 is just 4.5%. Any undue variance with the actual and these Benford's given probabilities is a sign of alert.

- **Theory of Relative Size factor:** The RSF test is discussed in the book "Forensic Analytics: Methods and Techniques for Forensic Accounting Investigations" by Mark J. Nigrini. The ratio of the greatest figure in the data set to the second largest figure is calculated to uncover suspected fraudulent activity in the given accounting data.

- **Computer assisted Auditing Tools:** CAATs equip auditors with technologies for detecting unusual or unexpected data patterns that may signify fraud. CAATs can help auditors uncover fraud by doing analytical tests such as ratios and Benford's Law tests. It generates data summaries and aids curb stoning in surveys.

- **Ratio Analysis:** Accounting ratios are analysed for any discrepancy by the forensic accountant. Suspicious patterns shown are investigated further.

- **Analysis of financial statements:** The financial statements are analysed not only for mathematical calculations, but for handwriting styles, ink usages, deleted or erased information etc. It is also verified that no accounting entry has been made on the day of holiday.

- **Surveillance and informants:** Forensic accountant hire secret informants and also perform physical surveillance in order to ensure correct information about fraudulent activity.

- **Verifying existence of stakeholders:** The stakeholders such as creditors and investors are checked for their existence. Also, the organization with whom mergers/acquisitions have been done or proposed, are verified by the forensic auditor.

- **Having discussions with the staff members:** Forensic accountants call for discussion with staff members of the organization and attempt to bring out the truth.

- **Interviewing suspicious employees:** The suspicious candidates are interviewed and tend to be subject to different kinds of analysis by the forensic auditor including analysis of their body language, historical background etc.

The list is exhaustive and subject to the auditor's working methodologies.

Conclusion:

For those who have yet to work on it, forensic accounting is a fresh concept. Despite its novelty, forensic accounting must not be considered as a substitute, but instead as a critical and important component for the maintenance of a healthy financial system. On researching it is found that in spite of high frauds in the country, the implementation of forensic accounting is at its infancy in India.

Unlike in the west, with the establishment of Serious Fraud Investigation Office (SFIO) in America, forensic accounting became a widely renowned specialty and has also provided a significant source of employment. There is no shortage of opportunity for the development of forensic accounting in India. In fact, the sector is anticipated to rise in the coming years. Although, Forensic Accountants' current job is confined to dealing with the financial ramifications of the cases they are assigned with rather than auditing, they will eventually be more effective in performing fraud control activities. So as to avoid frauds and unethical actions and bring about a transparency in the system, forensic accounting should be promoted in India with all its feathers. Moreover, necessary changes in legislations should be brought about in order to comprehend the significance and importance of forensic accounting in the common man.

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