

FORENSIC ACCOUNTING : AN ACCOUNTANT'S VISION

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ABSTRACT

Just as forensic science has been helping catch the criminals for long, forensic accounting is fast emerging in the arena of corporate accounting frauds to play a similar role. The article discusses the role of accountants in the field of forensics and considers the areas where forensic accounting can be of immense help.

Keywords : Forensic Accounting, Financial crime, Third World Economies, Fraud, Corruption

Introduction

Forensic Accounting is a rapidly developing area of specialization in the field of accounting. It is the area of specialization that is primarily concerned with the detection and prevention of financial fraud and other forms of economic crime.

Forensic accountants are becoming the rising stars of the accounting profession as more and more companies seek them out in order to avoid becoming the next Enron.

Until the recent times, the public, management officials, directors and even regulators, everybody's perception was that detecting fraud was part of the accounting and auditing functions. Fraud, according to these groups' thought, was something internal and external auditors were supposed to provide safeguard against the same through their periodic audits. Now, they realize that auditors can only check a company's accounting reports in order to check the compliance to generally accepted accounting principles and company policy. Thus, more and more people are realizing that a new category of accountants is needed to substantiate fraud for companies that suspect fraudulent transactions. This area of accounting is known as forensic accounting. Essentially, forensic accounting marries the skills of an auditor with the skills of an investigator.

Forensic Accounting - Conceptual aspects

The integration of accounting, auditing and investigative skills yields the speciality known as Forensic Accounting.

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The term "Forensic", according to the Webster's Dictionary means, "Belonging to, used in or suitable to courts of judicature or to public discussion and debate."

According to AICPA, "Forensic Accounting is the application of accounting principles, theories and discipline to facts or hypotheses at issues in a legal dispute and encompasses every branch of accounting knowledge"

"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, we utilize accounting, auditing and investigative skills when conducting an investigation. Equally critical is our ability to respond immediately and to communicate financial information clearly and concisely in a courtroom setting.

Forensic Accountants are trained to look beyond the numbers and deal with the business reality of the situation.

Literature Review in the Relevant field

Joshi (2003) ascribed the origination of forensic accounting to Kautilya, the first economist to openly recognize the need for the forensic accountant who mentioned 40 ways of embezzlement centuries ago. He, however, stated that the term "forensic accounting was coined by Peloubet in 1946. Crumbley (2001) wrote on same when he stated that a form of forensic accounting can be traced back to an 1817 court decision. He stated also that a "young Scottish accountant issued a circular advertising his expertise in arbitration support in 1824" but that Peloubet was probably the first to publish the phrase forensic accounting. Investigation of fraud and corruption is confirmed thus, not to be new, even in Nigeria. It is only gaining prominence because of the growing wave of the crime under the seemingly new nomenclature the last five years (Coenen 2005). Forensic accounting, also called investigative accounting or fraud audit, is a merger of forensic science and accounting. Forensic science according to Crumbley(2003) "may be defined as application of the laws of nature to the laws of man". He refers to forensic scientists as examiners and interpreters of evidence and facts in legal cases that also offers expert opinions regarding their findings in court of law. The science in question here is accounting science, meaning that the examination and interpretation will be of economic information. Joshi (2003) defined Forensic accounting as the application of specialized knowledge and specific skill to stumble up on the evidence of economic transactions. Zysman(2001) put Forensic accounting as the integration of accounting, auditing, and investigative skills. Simply put, forensic accounting is accounting that is suitable for legal review offering the highest level of assurance and including the now generally accepted connotation of having been arrived at

in a scientific fashion (Crumbley, 2006) Coenen (2005) stated that forensic accounting involves the application of accounting concepts and techniques to legal problem. It demands reporting, where the accountability of the fraud is established and the report is considered as evidence in the court of law or in the administrative proceeding (Joshi). It provides an accounting analysis that is suitable to the court, which will form the basis of discussion, debate and ultimately dispute resolution (Zysman, 2001). These suggest that forensic accounting is a field of specialization that has to do with provision of information that is meant to be used as evidence especially for legal purposes. The persons practicing in this field (i.e. forensic accounting) investigate and document financial fraud and white-collar crimes such as embezzlement and investigate allegations of fraud, estimate losses damages and assets and analyse complex financial transaction. They provide those services for corporation, attorneys, criminal investigators and the Government (Coenen, 2005). Their engagements are usually geared towards finding where money went, how it got there, and who was responsible. They are trained to look beyond the numbers and deal with business reality of the situation (Zysman2001).

Need for forensic accounting

The need for forensic accounting arises because of the failure of audit system in the organizations. A recent study by Kessler International shows that :

Table 1 : Kessler International Study

39 % of Organizations	Considered the need for forensic accounting
28 % of Organizations	Already sought help for forensic accountant
18 % of Organizations	Do not require assistance
15 % of Organizations	Unsure of whom or where they should ask for help

Source : www.ksi.org

Some of the other studies in USA pointed out that since more companies are facing bankruptcy the intense pressure with jobs and careers are at risk and employees feel pressured to maintain and support performance levels forcing many to commit corrupt acts.

US News and World Report listed Forensic Accountant as one of the “20 hot job tracks” of the future and has made this branch of accounting trendy.

A study conducted by the Price Waterhouse Coopers titled Global Economic Crime Survey 2003 suggested a need to promote a greater transparency as well as to improve crime detection.

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Tasks of a forensic accountant

A Forensic Accountant is often retained to analyze, interpret, summarize and present complex financial and business related issues in a manner which is both understandable and properly supported.

Forensic Accountants can be engaged in public practice or employed by insurance companies, banks, police forces, government agencies and other organizations for the following tasks:

- Investigating and analyzing financial evidence;
- 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; and
- Assisting in legal proceedings, including testifying in court as an expert witness and preparing visual aids to support trial evidence.

In order to properly perform these services a Forensic Accountant must be familiar with legal concepts and procedures. In addition, a Forensic Accountant must be able to identify substance over form when dealing with any issue.

Thus, the services rendered by forensic accounting specialists can be divided into two broad categories :

- Investigative Services, concerned with determining whether criminal activities or financial irregularities have actually taken place. In this context Forensic Accountant can be of assistance in various ways, including:
- Review of the factual situation and provision of suggestions regarding possible courses of action.
- Assistance with the protection and recovery of assets.
- Co-ordination of other experts, including:
 - o Private investigators;
 - o Forensic document examiners;
 - o Consulting engineers
- Assistance with the recovery of assets by way of civil action or criminal prosecution.
- Litigative Services are those services that are provided in the context of legal or regulatory proceedings and include:
- Assistance in obtaining documentation necessary to support or refute a claim.
- Review of the relevant documentation to form an initial assessment of the case and identify areas of loss.

- Assistance with Examination for Discovery including the formulation of questions to be asked regarding the financial evidence.
- Attendance at the Examination for Discovery to review the testimony, assist with understanding the financial issues and to formulate additional questions to be asked.
- Review of the opposing expert's damages report and reporting on both the strengths and weaknesses of the positions taken.
- Assistance with settlement discussions and negotiations.
- Attendance at trial to hear the testimony of the opposing expert and to provide assistance with cross-examination.

Assignments in forensic accounting

Detailed below are the usual areas which Forensic Accounting generally encompass:

(a) Criminal Investigations

Forensic investigations often relate to criminal investigations on behalf of police forces. For example, a Forensic Accountant may be retained by the R.C.M.P., as well as by regional or local police forces and organizations such as the Law Society.

A forensic Accountant's report is prepared with the objective of presenting evidence in a professional and concise manner.

(b) Shareholders' and Partnership Disputes

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

(c) 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.

(d) Business Interruption / Other Types of Insurance Claims

Insurance policies differ significantly as to their terms and conditions. Accordingly, these assignments involve a detailed review of the policy to investigate coverage issues and the appropriate method of calculating the loss.

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A Forensic Accountant is often asked to assist from either an insured or insurer's perspective in the settlement of a case.

Examples of these types of assignments include; business interruptions, property losses and employee dishonesty (fidelity) claims.

(e) Business / Employee Fraud Investigations

Business investigations can involve funds tracing, asset identification and recovery, forensic intelligence gathering and due diligence reviews.

Employee fraud investigations often involve procedures to determine the existence, nature and extent of fraud and may concern the identification of a perpetrator. These investigations often entail interviews of personnel who had access to the funds and a detailed review of the documentary evidence.

(f) Matrimonial Dispute

Matrimonial disputes from a Forensic Accounting point-of-view often involve the tracing, locating and evaluation of assets. The assets to be evaluated and valued may be business, property or other assets.

(g) Business Economic Losses

Examples of assignments involving business economic losses include; contract disputes, construction claims, expropriations, product liability claims, trademark and patent infringement and losses stemming from a breach of a non-competition agreement.

(h) Professional Negligence

These investigations are approached from two different but complimentary perspectives, these being:

- Technical- has a breach of Generally Accepted Accounting Principles or Generally Accepted Auditing Standards or other standards of practice occurred; and
- Loss Quantification.

If the professional in question is an accountant then a Forensic Accountant could be involved with both perspectives. If the matter involves some other profession a Forensic Accountant will normally be retained to perform only loss quantification.

(i) Mediation and Arbitration

Because of their familiarity and comfort with legal issues and procedures some Forensic Accountants have special training and become involved in alternative dispute resolution (ADR).

ADR services include both mediation and arbitration and are designed to help individuals and businesses resolve dispute with minimal disruption and in a timely fashion.

Steps in a 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 with the client

It is helpful to meet with the client to obtain an understanding of the important facts, players and issues at hand.

(b) Perform a conflict check

A conflict check should be carried out as soon as the relevant parties are identified.

(c) Perform an initial investigation

It is often useful to carry out a preliminary investigation prior to the development of a detailed plan of action. This will allow subsequent planning to be based upon a more complete understanding of the issues.

(d) Develop an Action Plan

This plan will take into account the knowledge gained by meeting with the client and carrying out the initial investigation and will set out the objectives to be achieved and the methodology to be utilized to accomplish them.

(e) Obtain the relevant evidence

Depending on the nature of the case this may involve locating documents, economic information, assets, a person or company, another expert or proof of the occurrence of an event.

(f) Perform the analysis

The actual analysis performed will be dependent upon the nature of the assignment and may involve:

- Calculating economic damages;
- Summarizing a large number of transactions;
- Performing a tracing of assets;
- Performing present value calculations utilizing appropriate discount rates;

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- Performing a regression or sensitivity analysis;
- utilizing a computerized application such as a spread sheet, data base or computer model; and
- Utilizing charts and graphics to explain the analysis.

(g) Prepare the report

Often a report will be prepared which may include sections on the nature of the assignment, scope of the investigation, approach utilized, limitations of scope and findings and / or opinions. The report will include schedules and graphics necessary to properly support and explain the findings.

Basic qualities of an ideal forensic accountant

In order to properly perform different services, a Forensic Accountant must be familiar with the legal concepts and procedures and is desired to have complete knowledge of regulations, guidelines and directions of the regulatory bodies like SEBI, DCA, ICAI, and RBI.

Thus, a capable Forensic Accountant should have the following characteristics:

1. Curiosity : to look behind the numbers
2. Creativity : to have innovative ideas in mind
3. Discretion: to the extent of variations from the specified matters as authorized by the client
4. Organization: to sum up the whole things into one single unit.

Techniques used in forensic accounting

Two most popular mathematical techniques currently used for forensic accounting are:

1. Benford's Law, and
2. Theory of Relative Size Factor

(a) Benford's Law

The object of this law is to determine whether the field under study is free from any unintentional errors or frauds. The basis of this law is that fabricated figures (an indicator of fraud) possess a different pattern from random figures.

(b) Theory of Relative Size Factor

It detects unusual data, which may be due to either simple errors or frauds. It is based on the basic concept that each field in any transaction has a normal range and any data falling outside the range is unusual or an outlier and need to be further investigated. It is

measured as the ratio of the largest number to the second largest number of a given set. Recently auditors are using Computer Assisted Auditing Tools (CAATS) to deal with huge data set and to process complex transactions thereby saving time and improving effectiveness. The tools help auditors in implementing auditing procedures such as:

- Testing details of transactions and balances
- Identifying inconsistencies and significant fluctuations
- Testing general as well as application control of computer systems

Another useful detection technique is the calculation of data analysis ratios for key numeric fields.

Three commonly employed ratios are:

- The ratio of the highest value to the lowest value (max/min)
- The ratio of the highest value to the second highest value
- The ratio of the current year to the previous year
- Redoing calculations performed by accounting systems

Forensic Accounting in Indian Context

“Auditor should be watchdog and not be the bloodhound”. It’s a good quote that every auditor should know. This quote makes the definition of Forensic accountants even simpler. 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 hunt for the conclusive evidences. External Auditors find out the deliberate misstatements only but the Forensic Accountants find out the misstatements deliberately. External auditors look at the numbers but the forensic auditors look beyond the numbers.

Forensic accountants take a more proactive, skeptical 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 possibility of fraud. The traits of the forensic Accountants could be compared to well baked Pizza. The base of forensic accounting is Accounting knowledge. Size and the extent of baking decide the quality of the Pizza. A middle layer is a dispersed knowledge of auditing, internal controls, risk assessment and fraud detection. It is like the spread of the cheese in Pizza. The topping of this Pizza is a basic understanding of the legal environment. The legal environment is essential in order to support the litigations. The Cherry on the toppings of the pizza is a strong set of communication skills, both written and oral. It is just the beautification part. Perfect combination of the Pizza base, Cheese spread and a good topping makes the pizza

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delicious and the Forensic Auditor the perfect. It's a combination that will be in demand for as long as human nature exists.

The Opportunities for the Forensic Accountants are growing at a rapid speed. Collapse of Enron and WTC twin towers have blessed the American Forensic Accountants with the opportunities.

The profession of forensic accounting has not yet gained prominence in India. Recently there are some institutions and agencies that have realized the importance of forensic accounting- like Indian Forensic Research Foundation. KPMG, the global network of professional services firm has very recently established its forensic and investigative accounting practice division in India. Network Ltd. has started working in this field. Lain Parekh Committee has recommended for setting up a separate body to investigate financial frauds. Dr. N L Mitra Committee appointed by RBI has commended the same.

Table 2 : Bank Frauds in India in Recent Years

YEAR	AMOUNT (Rs. in crores)	NUMBER OF CASE
2002	399.53	1744
2003	653.50	2207
2004	600.16	2663

Source : KPMG

In India the formation of Serious Fraud Investigation Office(SIFO) 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 in the wake of the growing frauds. The law enforcement officers are the experts of analyzing the fingerprints and the Narcotics but what about the digital evidence analysis. Very few know about it.

It's a thrill of hunt. Maurice E. Peloubet who coined the term Forensic Accountant in 1946 said that the preparation of financial statements has some but not all of the characteristics of forensic accounting. This statement is enough for the chartered accountants in India to foray in this field. It is new child on the block. Both CBI and CID cops do the forensic accounting work. Until recently there was no separate community in India. But now movement of India-

forensic community is gathering the pace. The growing number of regulator and the administrative agencies will demand the services in the nature of forensic practice. Chartered Accountants are going to find themselves more involved in what is essentially a type of forensic practice. The changing nature of the Accounting and Auditing & assurance standards also confirms this. Nearly 40 % of the top 100 American accounting firms are expanding their forensics and fraud services, according to Accounting Today. If this data is of some sense to Indian scenario then the day is not far away when forensic practice will contribute maximum to the total revenue of the Indian CA firm. Far from the humdrum stereotypic accountant your mind might have initially conjured, the forensic accounting professional is more of a private investigator with a financial sixth sense than the bookkeeper with a green eyeshade.

Conclusion

Today, forensic accounting is one of the fastest growing professions. But beyond a cursory glance one recognizes that while the title is new, what the job intends to achieve is nothing new. The job performed is not unlike what was done in the name of investigation previously. There is one version of how the name 'forensic accountant' developed. Previously Investigation Accountants assigned to analyze fraud findings found that this title made people uncomfortable. Inspiration came from a very unlikely source, a popular TV, detective serial "Columbo". To some viewers Columbo's most memorable attribute was the crumpled raincoat and ability to quickly solicit the co-operation of defendants and solve cases using a gentle approach styled "forensic evidence". The rest, as they say is "history".

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