

Forensic Accounting: An Emerging Approach to Deal with Corporate Frauds in India

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Abstract

Corporate sector across the globe is facing challenge from frauds these days. Existing rules and regulations were not sufficient to curb the trend of frauds and a new concept called Forensic Accounting has taken over to fill the void. Few countries like initiated and adopted forensic accounting and other countries like India are yet to follow the suite. This paper discusses the importance of Forensic accounting in Indian scenario and need for India to promote it in the corporate sector. Secondary data was used for writing this paper.

Keywords: Accounting, Auditing, Corporate Fraud, Forensic Accounting

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1. Introduction

Forensic Accounting has emerged as an important discipline in accounting which can be of great importance for Corporate Sector in India. Although, this approach seems to be a new one but it has been present in Indian scenario from a long time. Kautilya, the first economist and Birbal, one of the nine gems of King Akbar have widely discussed the fraud examination methods. (Singh 2012) Recent events in the environment have triggered the rise of Forensic Accounting and focus on this concept now seems to be unavoidable.

Forensics dictionary meaning is “pertaining to, connected with, or used in courts of law or public discussion and debate”. It is dependable and eligible for use in court of law as evidence.

Accounting means “the theory and system of setting up, maintaining, and auditing the books of a firm”. Accounting is about recording, classifying, summarizing and interpretation of financial transactions of an organisation. It includes preparation of journal, ledger, P&L account, balance sheet and audit books.

Forensic accounting is a method of investigating financial transactions and business situations in order to obtain the truth and develop an expert opinion regarding possible fraudulent activity. Two areas of expertise make up the field of forensic accounting: litigation support, and investigative or fraud accounting. Litigation support includes business valuation, revenue analysis, expert witness testimony, and future earnings evaluation. Investigative accounting is the process of gathering evidence of criminal conduct, and substantiating or disproving damages (Nunn et al. 2006). Maurice E. Peloubet 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. (Journal n.d.) Forensic Accounting as a discipline includes study of accountancy, law, psychology, communication. It is an integration of many fields. Forensic accounting has its application in below mentioned areas.

- Fraud investigation
- Fraud Prevention
- Criminal Investigation
- Mediation and arbitration
- Matrimonial Disputes
- Cases related to professional negligence
- Litigation Consultancy
- Personal Injury claims
- Outgoing partner settlement

Forensic Accounting is useful in variety of areas and it is an integration many different fields. It is in fact, considered to be a collaboration of auditing, accounting and investigation. Services of forensic accountants can be rendered to the government departments, regulatory bodies, banks, insurance companies, lawyers, police department and court.

Fraud means “wrongful or criminal deception intended to result in financial or personal gain” as per dictionary. Frauds can be of many types. It can be a Bank fraud, Corporate fraud, Bank fraud, Cyber Fraud, Securities Fraud, Identity theft or Insurance fraud. (Shaheen et al. 2011)

Corporate is “relating to large company or group”

Corporate fraud is “Activities undertaken by an individual or company that are done in a dishonest or illegal manner, and are designed to give an advantage to the perpetrating individual or company. Corporate fraud schemes go beyond the scope of an employee’s stated position, and are marked by their complexity and economic impact on the business, other employees and outside parties. (“Corporate Fraud Definition | Investopedia” n.d.) These types of frauds are difficult to prevent and have a huge impact on all the stakeholders of an organisation. Frauds can be detrimental for a particular sector and even for an economy of a country as whole. The employees in corporate sector are working under conditions of intense pressure to achieve goals, to get promoted, to maintain performance and to earn money. These pressures sometimes lead them to commit a fraud. This behaviour of an employee can be better understood with the “Fraud Triangle”. The concept of Fraud Triangle which was introduced in Statement on Auditing Standards No.99 by American Institute of Certified Public Accountants (AICPA) is of great significance to organizations as it give insights into the prevention of frauds. The Fraud Triangle talks about three conditions which are generally present in case of a fraud. These are opportunity to commit a fraud, incentive or pressure as a motivation to commit a fraud and rationalization to justify committing a fraud. Looking at fraud from this context can be of great help for organizations in preventing frauds.

To make this paper more relevant, the scope has been limited from perspectives. Firstly, we will be considering only Fraud Investigation as a function of forensic accounting. Other functions of the forensic accounting will not be taken into account. Narrowing down the scope is justified as fraud investigation is one of the prime tasks of a forensic accountant. In second stage of reducing scope, Frauds in corporate sector only will be explored in this paper. Other types of frauds will not be considered in this study. In India, most of the frauds are committed by corporate sector and their impact on the society as a whole is huge. So a focussed approach will be followed in this paper and the role of forensic accounting in frauds in corporate sector will be discussed in detail.

In today’s world, the competition has increased in every aspect related to the life of a human being and same is the case with business. It’s a global world today and business face competition from national as well as international players. More competition means requirement of more organisational capability, which in turn requires more investment in business. One of the most popular ways is to raise capital from the public is by the way of shares. So our problem starts from this point where investors in business differ from the people governing the business. Companies Act is all about regulating and ensuring that public money is not misused by the people involved in business. But in spite of all the checks and regulations many fraudulent activities

happen. Forensic Accounting is a concept whose objective is to identify and prevent frauds in corporate sector.

In recent past, corporate frauds like Enron, WorldCom, Satyam has shaken the world economy. Such incidents have challenged the established systems and these are an indicator of changing ways of committing fraud in corporate sector. So there arises a need for 360 degree overhauling of the existing system. We can establish more stringent rules and regulations but who has the domain expertise to do that. New systems will again be outdated with change in the way of doing business but who will update them continuously. When something goes wrong, it needs to be investigated but who has the ability to do it. Fraudsters should stand trial of law but who has the expertise in bringing them to court of law. The rules and regulations alone will not work without human intervention but who has the capability of intervening. Answer to all these questions lies in the concept of Forensic Accounting.

2. Need for Forensic Accounting In India

India has been ranked 85th in terms of corruption in the world. (“India’s Ranking on Global Corruption Index Improves - The Times of India” n.d.) Cases of fraud are increasing from financial sector. In 2011-12, 63% of total fraud cases from India were from financial services sector.(Fazekas 2013) If we talk about the impact of corporate frauds, it’s huge. It affects economy, society and most importantly image of a country. Investors will consider it risky to put in their money in a country which has a history of such fraudulent activities in corporate sector. Corporate sector frauds involves large amount of money and affects all the stakeholders like employees, customers, shareholders, suppliers, creditors and public at large. Shareholders are duped of their money and they think twice before investing in share market and this in turn is detrimental not only for a particular company but for economy as a whole. Employees lose their jobs and customers feel cheated. It is must to have a foolproof system which can create an atmosphere of trust in corporate world and can improve the image of country as a whole.

It is the duty of regulatory bodies and investigating agencies that culprits of corporate fraud are booked by law and punished. But irony of the situation is that there are not enough experts available in India. Institutions like RBI, SEBI, IRDA, CBI, CVC & Income Tax etc don’t have specialised people to investigate economic frauds in corporate sector. It becomes very difficult to keep economic criminals behind bars if the frauds are not properly investigated and proved in the court of law. Forensic accounting provides litigation support and it is also helpful in bringing culprits of misconduct and fraud to law.

Another major obstacle which mars justice in economic offences is the changing shape of fraudulent acts. Most of the offences involve information technology and it is something which needs to be investigated by experts accustomed with both accountancy and IT. Forensic accountants are well versed with the digital evidence analysis.

Auditing of accounts is a regular feature in corporate sector and also mandatory as per Company Law Act 2013. But it seems to be losing its effectiveness when it comes to prevention of frauds. 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 mis-statements only but the Forensic Accountants find out the mis-statements deliberately. External auditors look at the numbers but the forensic auditors look beyond the numbers. (Singh 2012) Accounting in general and auditing as a function has a limited scope and their primary objective is to ensure that GAAP are followed by the organisations. On the other hand to detect frauds, there is need to identify someone whose objective is fraud detection, someone who looks at everything with suspicion, someone who goes beyond the books, someone who has the creativity to find unusual patterns. So it is a clear indication that there is need for professionals who have expertise in dealing with frauds.

Professionals responsible for managing accounting function in India are CAs, CS and CWA. They are qualified enough to achieve the objective of accounting. But when it comes to performing an important and specialised function like financial accounting, there arises a need for specialised education for that. We can expect someone to perform duties for which he has been not trained or taught. There might be some people in accounting community who out of their experience can perform the role of a forensic accountant but it is not the right way to do that. It is expected from a forensic accountant to be well versed in areas like psychology, civil & criminal laws, sociology other than accounting. But these subjects are not in the curriculum of ICAI and ICWA. So there is a clear cut need and the same should be fulfilled by the education system of the country. Moreover, accounting professionals are already dealing in wide area of knowledge and they cannot be expected to master everything. This identified gap can be filled by forensic accountants and there is ample scope of pursuing it as a full time profession.

It is a well known fact that "Prevention is better than cure". In business also, need of the hour is to follow the same policy and prevent occurrence of frauds. Preventing frauds can be a great contribution to the corporate world and it can save the society and economy from huge potential losses. Forensic accounting is not only a damage control exercise but it contributes to the systems & processes which are helpful in preventing frauds.

The present scenario of education in such specialised fields depicts a very grim picture. There is no government institute that provides degree or diploma to Forensic Accounting. Even in the professional courses like CA, CS and CWA, there is no subject that caters to this particular area. Different skill set is required for the role of forensic accountant and it can be justified only if specialised courses are offered to interested professional and students.

3. Present Scenario In India

India is one of the fastest growing economies of the world. It is at more risk of frauds as the rules and regulations prevalent in country are not able to catch up with the changing circumstances. Repetition of fraud cases where high profile and trusted people are involved has raised the demand for improving the current system of checks and controls.

Forensic Accounting is more into news these days as there is an increase in white-collar crimes and financial frauds in the world. Enron, WorldCom, Madoff, Xerox to name a few. India has contributed its own share in worldwide frauds with examples of Satyam, Commonwealth games, 2G scam etc.

Any corporate fraud is a result of many variables like poor control systems, lack of corporate governance, lack of independence to auditors and weak regulatory bodies. So there is need for an alternative to all the existing variables, which is capable of preventing frauds.

It is clear from the above data that if required measures are not taken well in time, then more such incidents at a large scale can happen. One way is to take action when something major happens and the other way is to take preventive action before any untoward incident. As one of the initiatives, Ministry of Corporate Affairs has created a new department called Serious Fraud Investigation Office (SFIO) with an objective of detecting and prevent corporate frauds. In another push, the Institute of Company Secretaries of India (ICSI) has announced awards for companies having good governance practices. But a lot more is required in a growing country like India

There are very few professionals in India who are pursuing a career in Forensic accounting. One of the reasons may be that that they are not aware about the scope and prospects of this profession in future. Other reason may be that people are not confident enough to take it as a full time occupation due to lack of formal education and training in this field. Forensic accounting has grown up as an independent area and it can be pursued as a full time profession. It is also expected that forensic accounting will be one of the top 20 most sought after jobs in the world in the next decade. ("The 20 Best Jobs for the Next Decade | The Best Schools" n.d.) Prominent education institutes which are offering courses in forensic accounting are given below

Table 1. Frauds in India

Sr No.	Name of the Scam	Nature of Industry	Year	Fraud Perpetrators	Modus operandi	Money Involved (in crores)
1	Hashad Mehta	Capital Market and Asset Management	1992	Managing Director	Harshad Mehta led to rise in Stock Market by Trading in Shares at Premium.	4000
2	C.R. Bhansali	Capital Market	1992-1996	Managing Director	Established Finance company and collected money from public and transfer money to Co. that never existed.	1200
3	Cobbler Scam	Co-operative Society	1995	Promoter	Availed loan of Crores of Rupees and created fictitious Co-Operative societies	600
4	Virendra Rastogi	Trading Company	1995-1996	CEO	Exported the bicycles by heavily invoicing the value of goods	43
5	Abdul Karim Telgi	Printing	2000	Promoter	Involved in Fake stamps Papers	171
6	UTI	Mutual Fund	2000	Chairman, Executive Director, Stockbroker	UTI issued 40000 Shares which were purchased for about Rs.3.33 Crores	32
7	Ketan Parekh	Capital Market	2001	Managing Director	Took loan of Rs. 250Crore from the Bank Whereas maximum limit was 1.5 crore	1500
8	Dinesh Dalmia	Information Technology	2001	Managing Director	Rs.1.30 crore shares are unlisted in Stock Exchange. Dalmia resorted ill legal ways to make money through partly paid up shares.	595
9	Satyam Computers	Information Technology	2009	Auditor, Director, Manager	Accounting Entries has been hugely inflated involving about Rs.100 Crores.	8000

(Gupta and Gupta 2015)

- Institute of Chartered Accountant of India (ICAI)
- International Forensic Sciences Institute
- Association of Chartered Certified Accountants (ACCA)
- India forensic Centre of Studies
- BML Munjal University

These are few of the institutes which have focussed on providing education in this highly specialised field. But the requirement is too high and a lot more such centres of excellence will be required.

In a recent study conducted in China, it has been concluded that Forensic Accounting as a profession is bound to grow in present scenario and there is need for system to reduce the gap between demand and supply of professionals. Forensic Accounting should be introduced as a subject in education institutions at various levels.(Rezaee, Lo, and Ha 2014) To fulfil the gap in supply of forensic accountants through education and training, it is required to identify the skill set required in a competent forensic accountant.

4. Skills required in a Forensic Accountant

- Ability to understand and critically analyse the Financial Statements. Unusual patterns in recording of the transactions should be identified.
- Thorough understanding of Fraud techniques usually employed by the fraudsters but it should not be limited to the past experience alone. Recent developments in the way of doing business have made the systems prone to new ways of committing fraud. Logical tracking of the system is must for a thorough investigation.
- Proficiency in Information Technology is a must as it is critical part of all organisations and source of frauds these days. Even the techniques we employ these days to detect frauds are based on IT.
- Good understanding of Control systems and Processes followed by organisations. One should be able to find out the lacunas in the systems and processes, which is very important for preventing an untoward incident.

- Good communication skills are must as a person will have to interact with people throughout the hierarchy in the organisation. Communication is of great help when you plan to go beyond the books in an organisation.
- Creativity is the desirable trait of an investigator. No book can teach to identify frauds in corporate sector. It is the work of you creative self which helps in unfolding the truth. It is the creativity which define your pattern and scope of thinking.
- In depth knowledge of laws of land is another minimum requirement for a successful Forensic Accountant. Legal complications are a routine and have to be dealt deftly.
- Understanding of Psychology is another important requirement for performing duty. Things are always about going beyond books and being suspicious about everything. Your interactions with people will be more meaningful if you better understand the psychology of the people.
- Element of Curiosity and suspicion are also mandatory for a successful Forensic Accountant. Without these traits it is difficult to find the hidden or suppressed facts. More curious you are, more are the chances that you will get to the answers of difficult questions.

The above mentioned details also reinforce the idea that services of a forensic accountant are required in varied fields in India. If the opportunity is not grabbed at the right time, it will cause great loss in future.

5. Suggestions

Based on this research, certain suggestions are given. These can be helpful in achieving our main aim of preventing frauds in corporate sector. These suggestions are an extension of our research and talks about the extended role of forensic accounting.

- Professional education scenario should include forensic accounting as a new discipline and specialised courses should be offered to both professionals and students. This initiative will go a long way in producing required talent in this field.
- Collaborations should be initiated with International agencies and institutes working in the area of forensic accounting. It is a good way to contribute to the body of knowledge and learn from the experience of others.
- Some important forensic accounting subjects should be mandatorily offered to accounting professionals like CA, CS and CFA. These professionals are most suited to fill the existing gap in required talent immediately.
- Amendment should be made in the Companies Act to enforce certification of company accounts by forensic

accountant. Reports of forensic accountant should also be available for consultation for public at large. It will enhance the confidence of stakeholders in the books of company.

- All business organizations should be compulsorily instructed to float a fraud prevention policy. This policy should have some common points across industries and can be a great tool in sensitizing people against frauds. Forensic accountants can contribute greatly in formation of these policies.
- Special departments for forensic accountants should be created in agencies and institutions like RBI, SEBI, IRDA, CBI, CVC, banks & insurance companies. Efficiency and effectiveness of these departments will increase while performing their duties.

6. Conclusion

Economy and business are changing at a fast pace presently. In case of laws and regulations, it is equally required that the change happening in the environment should be matched, which of course is not happening. So, there comes in picture concepts like Forensic Accounting, which play pivotal role in filling this gap. Challenge today is the rising number of frauds in corporate sector. There are many causes and types of frauds. Accounting branch of knowledge today is not able to handle all the accounting issues and this situation has given rise to a new discipline of forensic accounting across the world. India is lagging behind in following the trend but has lately started feeling need for forensic accountants. These Forensic professionals will play crucial roles and will be contributor in investigating and preventing frauds. There are institutions in the country, which have started imparting education and training in this field. India should promote forensic accounting discipline and should make necessary legal changes to make it effective for the betterment of economy, society and corporate sector.

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