

## FORENSIC ACCOUNTING AND FRAUDS

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### ABSTRACT

India is leading its way towards attainment, progress and growth with global recognition as one of the fastest growing economies of the contemporary world. This emerging face of India is indeed a capture of spirited government's reform and initiatives under the realm of Good Governance. The contemporary lead of good governance, which revolves around five 'E's being 'Effective, Efficient, Easy, Empower, and Equity' calls for an accountable, transparent and developed face of a globally recognized welfare state. In this direction, we are adopting a highly collaborative approach and addressing challenges like fraud, deceit, financial misplacement and alike, which are hindering the inclusive growth of India. Inter-alia, where fraud is considered as one of the critical ailments, which not only holdup the corporate organizations where it has been conducted, rather it shakes the entire economy sometimes with temporary effects and sometimes with permanent ones, it has always been the priority of growing economies including India to detect, prevent and regulate the menace of fraud in the larger interest of the nation. Due to many white-collar scam and crime in India has questioned the credibility of the financial institutions. In this selection of timely detection, prevention and regulation over corporate fraud and reference to due investigation, Forensic Audit is having an imperative role in assisting the corporates for maintaining efficiency and merit. On the larger parameters, Forensic audit as tool-mix of accounting and investigation is serving all the five E's of good governance and make the corporates to grow and develop on the parameters of being Effective, Efficient, Easy, Empower, and Equity'. The methodology employed in the study was purely exploratory library-based research. This is based on an in-depth review of relevant and current literature on fact in issues. The findings reveal that forensic auditing is so relevant in today's corporate world. The relationship that exists between them is linking financial accounting and auditing. Forensic accounting academics emphasize the need for forensic accounting education. However, little is known about whether forensic accounting education has unintended consequences and the literature is quiet on this issue. This gap in the forensic accounting literature is addressed in this article. Further, this review addresses a thought-provoking issue on whether all fraud cases should be given equal investigative priority.

**Key words:** Forensic audit, Forensic accounting, Fraud, Financial audit, Investigation, Financial scam

### INTRODUCTION

A forensic audit is an examination and evaluation of Individual's or a company's financial information for use as evidence in court. A forensic audit can be conducted to prosecute a party for fraud, embezzlement or other financial claims. In addition, a forensic audit may be conducted to determine negligence, misuse of powers or even to determine undue benefits given to any other company or individual. Forensic audit is also conducted on behalf of the banks and financial institutions, insolvency professional agency, SEBI or Management of the company. It is the process used to examine an individual's or company's financial information for use as evidence in court. It helps detect diversion of funds, wilful defaults and window dressing of financial statements. A forensic audit is therefore an independent and comprehensive process of reviewing a person's or the company financial statements to determine if they are accurate and whether any financial benefit has been attained by way of presenting an unrealistic picture or any illegal activity.

1. 'Fraud', in general, refers to a wrongful or criminal deception practiced which is intended to result in financial or personal gain to oneself and a financial or personal loss to the other.

As per Business Dictionary, 'Fraud' is an act or course of deception, an intentional concealment, omission, or perversion of truth, to:

- (1) Gain unlawful or unfair advantage,
- (2) Induce another to part with some valuable item or surrender a legal right, or
- (3) Inflict injury in some manner.

2 'Wilful fraud' is a criminal offence which calls for severe penalties, and its prosecution and punishment (like that of a murder) is not bound by the statute of limitation. However, incompetence or negligence in managing a business or even a reckless waste of firm's assets (by speculating on the stock-market, for example) does not constitute an act of fraud, but yes, invites legal liabilities. In such cases, if the act of causing financial loss to the business or manipulating the stock market is attempted with the clear intention of deceit, this would tantamount to financial frauds. In law, fraud is a deliberate deception to secure unfair or unlawful gain, or to deprive a victim of a legal right.

3 Fraud can also be a civil wrong (i.e., a fraud victim may sue the fraud perpetrator to avoid the fraud or recover monetary compensation), a criminal wrong (i.e., a fraud perpetrator may be prosecuted and imprisoned by governmental authorities) or it may cause no loss of money, property or legal right but still be an element of another civil or criminal wrong. The

ultimate object of practising fraud may be some monetary gain or other benefit, such as, obtaining a passport or travel document, driver's license or qualifying for a mortgage by way of false statements.<sup>4</sup> As per Black Law Dictionary, 'Fraud' refers to 'All multifarious means which human ingenuity can devise, and which are resorted to by one individual to get an advantage over another by false suggestions or suppression of the truth. It includes all surprises, tricks, cunning or dissembling, and any unfair way which another is cheated.'

### OBJECTIVE OF STUDY

On this background, the main objective of this study is to examine the basic issues in forensic accounting and auditing and the specific objectives are:

1. To know the various types of fraud.
2. To know the key benefits of forensic auditing.
3. To appeal the empirical information collected from existing literature and relevant materials, this study will be of importance to shareholders, stakeholders and other researchers in the forensic accounting field.

### OBJECTIVES OF FORENSIC AUDITING

To use the forensic auditor's conclusions to facilitate a settlement, claim, or jury award by reducing the financial component as an area of continuing debate.

- To avoid fraud and theft.
- To restore the downgraded public confidence
- To formulate and establish a comprehensive Corporate Governance policy.
- To create a positive work environment.

A forensic auditor can ensure the integrity and transparency of financial statements by actively investigating for fraud, identifying areas of risk and associated fraud symptoms and a good fraud prevention program can help to create a positive working environment where employees do not indulge themselves to abuse their responsibilities.

So, by helping companies to prevent and detect frauds the forensic auditors can help to establish a comprehensive

### Corporate Governance Policy.

#### Types of fraud

The forensic accountant could be asked to investigate many different types of fraud. The most common involves theft, including cash, inventory and fraudulent payments. The three categories of frauds are corruption, asset misappropriation and financial statement fraud. They are elaborated: -

1. **Corruption:** - There are three types of corruption frauds: conflicts of interest, bribery, and extortion. Research shows that corruption is involved in around one third of all frauds. In a conflict-of-interest fraud, the fraudster exerts his/her influence to achieve a personal gain which detrimentally affects the company. The fraudster may not benefit financially, but rather receives an undisclosed personal benefit because of the situation. For example, a manager may approve the expenses of an employee who is also a friend to maintain that friendship, even if the expenses are inaccurate. Bribery is when money (or something else of value) is offered to influence a situation in one's favour. For example, Tele smith bribing an employee of Techno smith company to provide certain data to aid Tele smith in preparing a tender offer to Techno smith. Extortion is the opposite of bribery, and happens when money is demanded (rather than offered) to secure a particular outcome.
2. **Asset misappropriation:** - By far the most common frauds are those involving asset misappropriation, and there are many different types of fraud which fall into this category. The common feature is the theft of cash or other assets from the company, for example: Cash theft: Misappropriation of cash, the stealing of physical cash, for example petty cash, from the premises of a company. Fraudulent disbursements: raising fake invoices, company funds being used to make fraudulent payments. Common examples include billing schemes, where payments are made to a fictitious supplier, and payroll schemes, where payments are made to fictitious employees (often known as 'ghost employees'). Inventory frauds: the theft of inventory from the company. Misuse of assets: employees using company assets for their own personal interest.
3. **Financial statement fraud:** - This is also known as fraudulent financial reporting, and is a type of fraud that causes a material misstatement in the financial statements. It can include deliberate falsification of accounting records; omission of transactions— either revenue or expenses, non-disclosure of relevant details from the financial statements, balances or disclosures from the financial statements; or the misapplication of financial reporting standards. This is often carried out with the intention of presenting the financial statements with a particular bias, for example concealing liabilities in order to improve any analysis of liquidity and gearing. Companies get into this type of fraud to try to show the company's financial performance as better than what it is in the reality. The goal of presenting fraudulent numbers may be to improve liquidity, ensure top management continue receiving bonuses, or to deal with pressure for market performance.

Forensic audit is, in general, referred to as an examination of evidence regarding an assertion to determine its correspondence to established criteria carried out in a manner suitable to the court. As per the definition given in Investopedia, Forensic Audit is an examination and evaluation of a firm's or individual's financial information for use as evidence in court. A Forensic Audit can be conducted in order to prosecute a party for fraud, embezzlement or other

financial claims. In addition, an audit may be conducted to determine negligence or even to determine how much spousal or child support an individual will have to pay.

A Ready Reference to the Significance of Forensic Audit could be rationalized as below:

- In general, forensic auditing, which is described as a specialized field of accountancy investigates fraud and analyses financial information to be used in legal proceedings.
- In Forensic Audit, a systematic and independent examination of books, accounts, statutory records, documents and vouchers of an organization is held to ascertain fraud or probability of fraud.
- Much beyond the official documents of the company, the Forensic audit involves lot of field work, trying to talk to multiple stake holders to gather information and then look for evidence to corroborate it and alike.
- It also attempts to identify or to corroborate the culprit behind the fraud.
- It arranges and collects the evidences of the fraud and the person accused of fraud.
- The collected evidences and reviewed facts are used in the legal proceedings which assist the court in granting punishment to the real accused of the fraud.
- Forensic auditing uses accounting, auditing, and investigative skills to conduct investigations into theft and fraud. It encompasses both Litigation Support and Investigative Accounting.

This makes forensic audit an apt tool in the contemporary times, ensuring financial health of the companies through aiding in the Prevention, Regulation and Penalization of financial frauds and scams.

### Key Benefits of Forensic Audit

Forensic audit submits various recompenses in ensuring commercial health of the companies through aiding in the Prevention, Regulation and Penalization of financial frauds

1. **Detection and Responsibility of Corruption:** In a Forensic Audit, while investigating fraud, an auditor would look out for: Conflicts of interest, bribery, extortion. Forensic Audit aids in detecting the corruption in the corporates and determine responsibility of the person liable for the corruption and its practices.
2. **Detection of Asset Misappropriation:** This is the most common and prevalent form of fraud. Misappropriation of cash, raising fake invoices, payments made to non-existing suppliers or employees, misuse of assets, or theft of Inventory.
3. **Detection of Financial Statement Fraud:** Companies get into this type of fraud to try to show the company's financial performance as better than what it is. The goal of presenting fraudulent numbers may be to improve liquidity, ensure top management continue receiving bonuses, or to deal with pressure for market performance.
4. **Fraud Identification and Prevention:** Fraud is quite common in big organizations where the number of daily financial transactions is huge. In such an environment, an employee can easily undertake fraudulent activities without being caught.
5. **Making Sound Investment Decisions:** As forensic accounting helps in analysing the financial standing and weaknesses of a business, it provides a path for investors to make thoughtful investment decisions. A company engaged in fraud is not a good option for investment.
6. **Formulation of Economic Policies:** Various cases of fraud that becomes evident after forensic analysis act as a reference for the government to formulate improved economic policies that would be able to curb such fraudulent activities in the future.
7. **Rewarding Career Opportunity:** As a career, forensic auditing is extremely rewarding, as it not only involves regular auditing and accounting activities, but also involves identification, analysis, and reporting of the findings during an audit. S

### Forensic service typically includes

- Financial Statement
- Computer Forensic
- Electronic Discovery
- Bankruptcies, Insolvencies, and reorganizations
- Workplace fraud investigations
- Calculation of economic losses
- Business valuations
- Professional negligence

Forensic audit is a process of resolving signs or allegations of fraud/misrepresentation from inception to disposition. Forensic audit involves efforts to resolve allegations or signs of fraud when the full facts are unknown or unclear; therefore, it seek to obtain facts and evidence to help establish what happened, identify the responsible party, and provide recommendations where applicable. When conducting the forensic audit to resolve signs or allegations of fraud, the forensic auditor should:

- Assume litigation will follow.
- Act on prediction.

- Approach cases form two perspectives.
- Move from the general to the specific.
- Use the fraud theory approach.

## CONCLUSION

The paper has examined the basic issues in forensic accounting and auditing. A forensic investigation is a very specialised and detailed type of engagement, which requires highly skilled team members who have experience not only of accounting and auditing techniques, but also of the relevant legal framework. There are numerous different types of fraud that a forensic accountant could be asked to investigate. It is important to note that while forensic accounting is gaining significant research interests among academics, progress in forensic accounting research will depend on the extent to which fraud perpetrators leave traces of fraud assuming all fraud perpetrators do leave traces after committing fraud. The investigation is likely to ultimately lead to legal proceedings against one or several suspects, and members of the investigative team must be comfortable with appearing in court to explain how the investigation was conducted, and how the evidence has been gathered. Forensic accountants must therefore receive specialist training in such matters to ensure that their credibility and professionalism cannot be undermined during the legal process.

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