FORENSIC ACCOUNTING IN INDIA: A TECHNIQUE OF FRAUD PREVENTION AND DETECTION

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ABSTRACT

Indian economy touches the economy of the world. By doing so Indian markets expand their operations through different mode like joint venture, amalgamation and consolidation etc. At the same time many complexities arise due to growth in business trade. Many white-collar crimes and financial scandals in the beginning of the twenty-first century questioned the credibility of the financial structures. Due to these, a great demand of Forensic Accounting has been introduced for fraud prevention and detection. The main objective of the paper is to gauge financial scams and white collar crimes in India. This paper also examines the role of forensic accounting in minimizing such financial scandals. Forensic Accountants will also help the Government in the enforcement of regulatory requirements.

Keywords: Forensic Accounting, Frauds, Financial Scams, Auditing, Investigative functions

JEL Classification: M40, M41, M42, M49

INTRODUCTION

The blooming economy and rapid changes across all levels of businesses and society not only offer plethora of opportunities but also brings multiple evils. Financial frauds are the byproduct of economic growth. There is no economy in the world, whether it is developing or developed which is not infected by the virus of fraud. Number of financial frauds happened in all the sectors of the world economy. Starting in the late 1990s, a wave of corporate and white-color frauds started globally like Waste Management Scandal (1998), Enron Scandal (2001), WorldCom (2002), Tyco Scandal (2009), Health South Scandal (2003), Freddie Mc Scandal (2003), American Insurance Group Scandal (2005), Lehman Brothers Scandal (2008) and Bernie Madoff Scandal (2008), Satyam(2009), Olympus (2011), Toshiba (2014) etc. This rise in financial scandals at the beginning of the twenty-first century questioned the credibility of the financial structures of the organizations and the role of audit in fraud prevention and detection. Hence, earlier notion that "Auditor is a watchdog not a bloodhound," has changed. Auditors should not only check the books and accounts of the company with compliance to GAAPs, auditing standards and company policies, but also, like a bloodhound, should attempt to sniff out frauds, scams out of financial records of organization. Accountants look at numbers while forensic accountants look behind the numbers. "Forensic accountants go beyond the numbers and try to analyze 100 per cent of the data as against the sampling procedures used by auditors. When the extended procedures are invoked, cases like the overvaluation of the sales or debtors become easy to investigate," So the combination of accounting, auditing and investigative skills forms the specialty known as Forensic Accounting. Forensic accounting is the special area of accounting which is concerned with the detection and prevention of financial fraud and white-collar criminal activities.

Maurice E. Peloubet is known for developing the term forensic accounting in 1946. Forensic accounting comprises two words – forensic and accounting. The word forensic means the application of scientific methods and techniques to the investigation of crime, as much as it is concerned with courts of law and the term accounting is defined by AICPA as "the art of recording, classifying, and summarizing in a significant manner and in terms of money, transactions and events which are, in part at least, of financial character, and interpreting the results thereof." According to AICPA, "Forensic Accounting is the application of accounting principles, theories and discipline to facts or hypothesis at issues in a legal dispute and encompasses every branch of accounting knowledge," Forensic Accounting borrows knowledge from accounting, finance, law, computerization, ethics, criminology etc. Forensic accountants, also referred to as forensic auditors or investigative auditors, often have to give expert evidence at the eventual trial. Thus Forensic accounting is very important tool to detect, investigate and prevent the frauds. It has been growing rapidly as a profession in the world and has been accepted as a profession in countries such as Canada, Australia, the USA, and the UK, is beginning to gain the importance that it deserves.

OBJECTIVES OF STUDY

The study is basically exploratory in nature and depends exclusively on secondary data which are collected from websites, periodicals, accounting journals, related books, various reports published by Govt. of India, RBI, KPMG and different associated agencies. The main objectives of study are:

1. To know the various types of frauds.
2. To understand the role of Forensic Accounting (techniques) in fraud examination.
3. To examines the major scams in India
4. To understand the different services rendered by Forensic Accountants.
5. To know the prospects of Forensic accounting in India in the context of growing of multiple frauds.

MEANING AND TYPES OF FRAUDS

Fraud is a worldwide phenomenon that affects all sectors of the economy. The dictionary meaning of fraud is "deceit, impersonation with intent to deceive, criminal deception done with the intention of gaining an advantage."According to the Association of Certified Fraud Examiners (ACFE), fraud is "a deception or misrepresentation that an individual or entity makes knowing that misrepresentation could result in some unauthorized benefit to the individual or to the entity or some other party". Fraud can be committed with the Objectives of:
1. Increasing the market value of the business
2. Making financial statements consistent with budgets
3. Obtaining unfair earnings by presenting falsely the value of the business

Types of Fraud: Frauds are usually not exhaustive as fraudsters use new methods each time. As technology is advancing fraudsters are able to find ways to use it and perpetrate a fraud in a variety of ways. Corporate fraud can be classified as:

- **Financial Statement Fraud**: Such types of frauds are committed intentionally by misstatements or omissions of amounts or in disclosures of financial statements. These frauds involve manipulation, falsification, or alteration of accounting records or supporting documents from which financial statements are prepared. According to a study conducted by the Association of Certified Fraud Examiners, fraudulent financial statements, as compared with the other forms of fraud perpetrated by corporate employees, usually have a higher dollar impact on the victimized entity as well as a more negative impact on shareholders and the investing public (THOMAS W. GOLDEN,2006).
- **Banking and insurance Fraud**: These types of frauds are also popular. It's illegal means to receive money or assets from any bank or financial institution. It considered being a white collar crime. Bogus health, insurance claims, business insurance claims and fraudulent bankruptcies are common types of frauds in this area.
- **Employee Fraud**:-This type of fraud involves the theft of cash or inventory, skimming revenues, payroll fraud, and embezzlement etc. Some examples of frauds that employees commit to benefit themselves may be as:

• Embezzlement of the money during its collection but before it is recorded in accounts

- Stealing the cheques of business
- Making payments which should not be made or previously made
- Creating fictitious debts and having payments done in favor of oneself
- Inventory and scrap theft
- Office supplies and fixed asset theft
- Creating fictitious expenses and obtaining disbursements
- Padding expense items
- Creating ghost employees and embezzling their wages/salaries
- Accepting bribes from the customers and suppliers of the business with various reasons
- Using credit cards of the business for personal objectives
- Manipulating the overtime periods and obtaining extra payment
- Selling business assets under the market value.

- **Cyber Frauds**: These are the frauds committed using the Internet and electronic transactions. Tech-savvy fraudsters are using technology in a variety of ways to commit frauds. These may be creation of false or misleading information in accounting records. Most accounting software systems allow users to have specific access to only certain aspects of the system. However, unauthorized access and password sharing is another area by which fraudsters have access on company's sensitive information. This is a potential threat to organizations.

THE TECHNIQUES OF FORENSIC ACCOUNTING

Besides the various conventional techniques of auditing, forensic auditor used some special techniques which are as follows:

i) Interview Technique: This is the most common technique which is used in any enquiry. Forensic accounting investigators generally use this technique which is designed to obtain an admission of guilt by the person involved in fraud scheme. These results form an integral part to be used in court and adjudication process.

(ii) Benford's Law: It is a statistical tool to determine whether variable under study is a case of unintentional errors or any pattern signifying suspicious movement. Benford suggested the probabilities for the occurrence of each digit at various places in the number whereby if the data is manipulated; the said digit would not appear at the same place. Benford's Law does not detect the frauds but only indicates the probable area of fraud.

(iii) Theory of Relative Size Factor (RSF): RSF technique is used to identify the number in the data but in some relation with the second highest data in the number. In this method the records that fall outside the prescribed range are taken into the books of account and it calls for further investigation. It highlights all unusual fluctuations, which may be routed from fraud to genuine errors.

(iv)Computer Assisted Auditing Tools (CAATs): CAATs are computer programs developed for the auditors. Forensic accounting software comes into two varieties- data extraction software and financial analysis software. Data extraction software is designed to conduct spreadsheet analysis on all the company's data base records, such as billing, accounts receivable, payroll, purchasing etc which helps in detecting anomalies. Financial analysis software analyses the financial statements and benchmarks the ratios between different accounts such as billing by revenues or supply costs as a percentage of revenue.

(v) Data Mining Techniques: It is a set of computer-assisted techniques designed to automatically mine large volumes of data for new, hidden or unexpected information or patterns. Data mining techniques are categorized in three ways: Discovery, Predictive modeling and Deviation and Link analysis. It discovers the usual knowledge or patterns in data, without a predefined idea or hypothesis about what the pattern may be, i.e. without any prior knowledge of fraud. In predictive modeling, patterns discovered from the database are used to predict the outcome and to guess data for new value items. In Deviation analysis the norm is found first, and then those items are detected that deviate from the usual within a given threshold (to find anomalies by extracted patterns). Link discovery has emerged recently for detecting a suspicious pattern. It mostly uses deterministic graphical techniques, Bayesian probabilistic casual networks. This method involves “pattern matching” algorithm to „extract‟ any rare or suspicious cases.

(vi) Ratio Analysis: Data analysis ratios are used for detecting fraud. Numerous ratios are used by various analysts including financial ratios, data analysis ratios and utility ratios. However, the use of data analysis ratios are prominently used by forensic accountant is identifying possible symptoms of fraud. Ratio helps in estimating costs, identifying deviations etc.

SCAMS IN INDIA

India has witnessed hundreds of scams since independence like–Haridas Mundhra (1957), Nagarwala (1971), Antulay and cement (1982), Bofors (1989), Harshad Mehta (1992), palmolein oil imports in Kerala (1992), Telgi (1995), SNC Lavalin in Kerala (1995), Sukhram and telecom (1996), fodder in Bihar (1996), Jain hawala (1997), Ketan Parekh (2001), the Barak missile (2001), Kargil coffins (2002), the Taj corridor (2003), the PDS scam in Arunachal (2004), oil for food (2005), Scorpene submarine deal (2006), stamp papers (2005), cash for votes (2008), Satyam (2008), Madhu Koda and mining (2009), 2GSpectrum Scam (2010), Commonwealth Games (2010), Adarsh Housing Society (2010), housing loans by banking and financial institutions (2010), Belekiri port in Karnataka (2010), foodgrains in Uttar Pradesh (2010) and Bellary mines (2011), Coal Allocation Scam (Coalgate), Chopper deal Scam (2012), Sharadha Group Financial Scam (2013) which have adversely affected development of the corporate and non corporate sectors. For the purpose of the study, some scams are tabulated as below:

Sr No	Scams and Fraud	Loss suffered/ Amount involved in Fraud	Detail of Case/ Modus operandi
1.	Harshad Mehta Securities Market sScam (1991)	5000 Crores	Harshad Mehta managed to procure huge amounts of money using the so called “Ready Forward” deals, and used this money to purchase large amounts of shares at hugely inflated price
2.	Fodders Scam (1992)	950 Crores	An unholy nexus was traced by the office of CAG, involved in fabrication of “vast herds of fictitious livestock” for which fodder, medicine and animal husbandry equipment was supposedly procured in the Bihar. This theft spanned for many years, and allegedly involved numerous Bihar state's administrative and elected officials resulting in Rs 950 Crore embezzlement.
3.	Telgi-Fake Stamp Papers Scam (1995)	200 Crores	Mr Abdul Karim Telgi, the scam kingpin, paid bribes to get access to the security press in Nasik, where stamps papers and currency notes are printed. He later used this knowledge to print fake stamp papers. Telgi’s network spanned 14 states, 125 banks and more than 1,000 employees.
4.	CRB Scam (1995)	1200 Crores	CR Bhansali floated more than 100 companies, such as CRB Mutual Funds and CRB Capital Markets to attract huge funds from the public by promising high rates of interest and this interest was later paid form further borrowings, and so on.
5.	The UTI Scam (2001)	4800 Crores	The UTI scam involved US-64 scheme which was meant to channel the funds of small investors into instruments bearing high returns. UTI Chairman, P.S. Subramanyam along with a couple of executive directors, acted wrongly and duped the lakhs of small investors through false propaganda, while allowing windfall profits to the handful of big corporate who had invested in UTI.
6.	Ketan Parekh Securities	1250 Crores	Ketan Parekh, a Pentafour Bull, create a trading ring of his own and identified a number of stocks (popularly called the K-10), and

	Market Scam (2001)		took up huge positions in these. For this purpose, he used a large number of Benami accounts and traded in smaller stock exchanges. He also borrowed heavily from banks by pledging shares as collateral security when their prices were high.
7.	UP Food Grains Scam (2003)	35,000 Crores	Food which the government purchased to give to the poor for the public distribution system and other special schemes for those below poverty line (BPL) was sold off by nearly 150 government officials to private entities in open market, while in the government records, the stocks were shown as distributed among the target population.
8**.**	IPO Scam (2004)		A number of key operators, including corporate stock brokers such as Karvy and Indiabulls, were involved in the IPO scam. The operators opened thousands of fake DEMAT accounts to purchase shares in IPOs, in the hope of selling later at huge profits. Many provisions according to SEBI guidelines were not followed by depository. This obviously has bought the role of Depository System in question.
9.	Satyam Scam (2008)	10000 Crores	Ramalinga Raju, chairman of Satyam Computer Services, claimed that he has overstated income nearly every quarter over the course of several years in order to meet analyst expectations, assets on Satyam's balance sheet was overstated by $1.47 billion and nearly $1.04 billion in bank loans, names of employees and cash that the company claimed to own was non-existent which led to a scam that suffered a loss of more than 10000 Crore.
10	2G Spectrum (2010)	1,75,000 Crores	This scam shows the gross use of power, as a collusion of businessmen, journalists and political leaders. While awarding 2G spectrum licenses, License were issued on first cum first serve basis instead of auction resulting heavy loss to government. Then telecom minister A. Raja was accused of conniving with telecom companies, extending cutoff date and issuing licenses with irregularities at 2001 prices in 2008, but CBI failed to prove the allegation against A.Raja and others on dated 21.12.17
11.	Common-wealth Games (2010)	35000 Crores	During the Commonwealth Suresh Kalmadi who was the chairman of the Organizing Committee of the Commonwealth Games committed number of corrupt deals involving overstated contracts. Kalmadi also handed out a Rs 141 crore contract to Swiss Timing for its timing equipment; the deal was inflated by Rs 95 crore and athletes were asked to move into apartments that were shabby and dilapidated. It was estimated that only half of the allotted amount was spent on Indian sportspersons. Suresh Kalmadi, organizing committee. members, 2 private companies & Govt officials were the key players
12	Coal gate (2012)	1,86,600 Crores	Govt of India alloced coal blocks in an inefficient manner without competitive bidding process leading to windfall gain to allottees who were the politicians and big corporate.
13	Saradha Group Financial Scam (2013)	20,000 – 30,000 Crores	Saradha Financial Scam caused by the collapse of a Ponzi scheme being run by Saradha Group, a consortium of over 200 private companies that was believed to be running collective investment schemes popularly but incorrectly referred to as Chit funds.

According to the Association of Certified Fraud Examiner's "Report to the Nations 2016" India ranks second in terms of victim organizations reporting the cases and, India ranks 84 out of 180 countries in terms of corruption as per the report by Transparency International, a UK-based anti-corruption organization. A joint Grant Thornton and ASSOCHAM survey conducted in 2015 revealed that cases of financial fraud have risen in India over the last few years and has become one of the main factors deterring foreign companies from investing in India. Forensic Accountants played a major rule in letting the cat out of the bag in Satyam, CWG and 2G Scams etc. With the rise in money laundering and willful default cases, RBI has also made forensic audit mandatory for large advances and restructuring of accounts. Thus, it is time for organizations to build processes, procedures and controls in such a way that employee may not be in a position to commit fraud and also effectively detect fraudulent activity if it occurs. The best way to control fraud is to prevent fraud before occurring. This can be done in two ways:

• Creating the right environment in an organization by making the selection of employees and disseminating a well-understood code of conduct

• Eliminating opportunities for fraud by installing a good system of internal controls, with physical control of assets, proper authorizations, segregation of duties and proper documentation. Such proactive fraud management can help the organization spot red flags and detect instances of fraud early. However, in spite of all good intentions, fraud does occur – and then the forensic accountant is required.

SERVICES RENDERED BY FORENSIC ACCOUNTANT

- **Fraud detection when employees commit Fraud**: When employees make any fraudulent activities then it is a case of fraud committed by employees. In such situation forensic accounting need arise. The forensic accountant use their skills and trying to find out the secret truth.
- **Detect fraud in criminal matters:** Forensic Accountant render their services as an investigator in the field of criminal matters. Many criminal and white collar crimes are investigated by forensic accountant for the purpose of civil and criminal actions. Different investigation department and law society take help of forensic accountant.
- **Fraud related to professional negligence:** In India there are some principles and standards which provide a base for preparing financial statements. Mostly corporate made frauds in this area. Forensic accountants keep eye on these practice and accounting principles. They also detect frauds in auditing practices and ethical codes.
- **Detection and settlement of Insurance Claims:** Forensic Accounting engaged in settlement of Insurance claim. Forensic accountant handles different claims like loss policy matter, poverty loss due to various risks and other type of insurance claims. When the policy holder challenge the claim settlement as worked out by the insurance company then policy holder take help of forensic accountant.
- **Dispute Settlement:** Multiple problems have been introduced in growing business trade. So, business firms engage forensic accountants to handle and solve these types of matters like construction claims, contract disputes, trade mark cases etc.

PROSPECTS OF FORENSIC ACCOUNTING IN GROWING FRAUDS

It has been observed that the financial scams in India increased due to lack of stringent surveillance authority. Continuous evolution of technology is changing the way in which organizations conduct business, sometimes creating opportunities for fraudsters to commit the crime. Thus, the need of forensic accountants was realized. However, in India this branch of accounting has not got due recognition. Forensic Accounting developed as early as 1995 in USA but it put it first step in India just a few years back, when Forensic Research Foundation was formed in India for investigation of frauds. International investigation organization SFIO was also set up in India for the same purpose. Forensic accountants are trained to detect evidence of frauds in financial statements.

There was no mention of Forensic discipline in the Indian statutes prior to introduction of Companies Act 2013. The new Companies Act 2013 includes specific provisions to address the risk of fraud, alongside prescribing greater responsibility and increased accountability for independent directors and auditors. It goes beyond professional liability for fraud and extends to personal liability, prescribing penalties for directors, key management personnel, auditors and employees. This Act also introduces a new term - Internal Financial Control (IFC) - which has certain features of IC and certain features of ICFR. ICAI should also formulate an accounting standard on Forensic Accounting so that Forensic Accountant helps the law enforcement agencies and regulatory bodies in curbing white-color and financial scams. The main important law enforcement agency involved directly in combating frauds is the Police, CBI, DRI etc and Forensic auditors may help the Police, ACB and other investigating authorities in collecting evidences and other investigation purposes.

CONCLUSION

In the emerging economic scenario, given the pervasiveness of fraud and the necessity of special skills in order to uncover such fraud, it becomes important to train forensic accountants – and colleges and universities have an important role to play. International bodies like the CFA Institute have emerged forensic auditing into its curriculum. Our leading institutions ICAI and ICWAI have come up with a post qualification course such as Diploma in investigative and forensic accounting in recent years. ICAI should also formulate an accounting standard on Forensic Accounting so that Forensic Accountant helps the law enforcement agencies and regulatory bodies in curbing white-collar and financial scams.

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