

FORENSIC ACCOUNTING IN INDIAN PERSPECTIVE

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ABSTRACT

Forensic accounting is used for fraud examination and fraud examination covers fraud allegations from inception to disposition, including obtaining evidence, interviewing, writing reports, and testifying. In the current scenario the emphasis is on the forensic accounting as the public deals with financial collapses, increased white collar crime and growing occurrences of occupational fraud. Forensic accounting provides investigative functions and litigation support services to understand the depth and width of the financial scams happening in any economy. The objective of the study is to understand the significance of forensic accounting in the wake of recent financial scams in India and to highlight the problems of forensic accounting in India. This paper is conceptual in nature and information is collected from the secondary sources. In India due to the complex and traditional judicial system, political compulsion etc., forensic accountants are facing the challenge of gathering information against ‘big shots’ that is admissible in the court of law. It has been suggested that appointment of forensic accountants should be made mandatory in public sector and large scale companies.

Key words: *Forensic Accounting, Financial Scams, Investigative Functions*

INTRODUCTION

Cracking down on fraud is critical for a country that needs investment. According to KPMG Fraud Survey white-collar crime in corporate India has witnessed a 'substantial increase' over the last two years. The incidence of fraud had increased by 10% from 2010 to the same survey in 2012. It has adverse impact on international investors and entrepreneurial spirit in India.

Corruption in Indian business is endemic and greasing the palms of business associates is the norm. An estimate by CK Prahalad, a management expert at the University of Michigan, puts the cost of corruption to the Indian economy at up to 2.5 trillion rupees a year. According to the latest report by Transparency International, a UK-based anti-corruption organization, India ranks 84 out of 180 countries in terms of corruption.

Forensic accounting is the field which is called upon to address the issues of prevention and investigation of white collar crimes.

What is forensic accounting?

Forensic accounting, sometimes called investigative accounting is the application of a specialized knowledge and specific skills to identify transactions which are not authentic and gather the evidence regarding the same. The job 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.

In other words forensic accounting includes the use of accounting, auditing, and investigative skills to assist in legal matters. It consists of two major components:

- a) In case of litigation, investigative skills of forensic accountant are used in two ways, he can be called upon to give his expert opinion based on his investigation and may require possible courtroom testimony.
- b) Forensic accountant's investigative skills are required for collecting, analyzing, and evaluating financial evidence, as well as the ability to interpret and communicate findings.

Forensic accounting is used for fraud examination and fraud examination covers fraud allegations from inception to disposition, including obtaining evidence, interviewing, writing reports, and testifying. Forensic accountants are retained by law firms, corporations, banks, government agencies, insurance companies, and other organizations to analyze, interpret, summarize and present complex financial and business related issues in a simple and concise manner.

Objectives of the Study

Recent cases of frauds and financial scams in India require more professionalism in accounting and finance. Investigative audit has always been there, it is only the techniques involved that has been changing in line with sophistication of the financial fraud involved (Krancher, 2006). What is

necessary at this juncture is the need to stress that all normal statutory audit should contain some element of forensic enquiry (Enyi, 2009). As the public deals with financial collapses, increased white collar crime and growing occurrences of occupational fraud is increasing, the need for forensic accounting has become important for investigative functions and litigation support services to understand the depth and width of the financial scams happening in India. In view, the objectives of the paper are:

1. To understand the historical perspective of forensic accounting in India.
2. To understand the significance of forensic accounting in the wake of recent financial scams in India.
3. To highlight the problems of forensic accounting in India.

The present paper is of conceptual nature and purely based on information from secondary sources. For this purpose various articles on forensic accounting at national and international level, working papers, e-papers, and reports on newspapers are reviewed carefully.

Historical perspective of Forensic Accounting in India

Maurice E. Peloubet who coined the term Forensic Accountant in 1946 essay "Forensic Accounting: Its Place in Today's Economy." Archaeological findings reveal that, during 3300-3500 BC, accountants of their day in Egypt, were involved in the prevention and detection of fraud. During 1800' close relationship developed between accountancy and legal profession. Many amendments to financial statement disclosure can be attributed to frauds in corporate. In 1930's America Eliot Ness was credited to bring down gangster Al Capone, but his case was based on the investigative work done by Elmer Irey, an accountant with the Internal Revenue Service that ensured Capone's conviction for tax evasion. He was probably America's first high-profile forensic accountant.

But in Indian context history of investigative accounting goes back to ancient times of Mauryan Times. Kautilya was the first person to mention the famous forty ways of embezzlement in his famous Kautilya arthashastra.

A fraud examination is the area that is considered to be the monopoly of the Chartered accountants because of the nature of the expertise it involves in accounting. In India Chartered Accountants are called upon to take up such investigative assignments. Very few Chartered Accountant firms have fraud examination as separate practice. Chartered accountancy firms such as Sharad Joshi Chartered accountants do provide these services. A Delhi based firm S.K. Jain also investigated the world famous Xerox Fraud case. But by and large this area is dominated by the big four consultancy firms such as Deloitte, KPMG, Pricewater House Coopers and Ernst and Young.

In India the formation of Serious Fraud Investigation Office 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.

Nature of Forensic Accounting

Forensic accounting is the specialty area of the accountancy profession which describes engagements that result from actual or anticipated disputes or litigation. 'Forensic' means 'suitable for use in a court of law' and it is to that standard and potential outcome that forensic accountants generally have to work (Crumbley et al. 2005). It is often said 'Accountants look at the numbers but Forensic accountants look behind the numbers (Okoye 2009). Forensic accountants are trained to look beyond the numbers and deal with the business realities of the situation. Analysis, interpretation, summarization and presentation of complex financial and business related issues are prominent features of the profession (Bhasin 2007).

The services provided by Forensic Accountants are as follows

- Business valuations
- Divorce proceedings and matrimonial disputes
- Personal injury and fatal accident claims
- Professional negligence
- Insurance claims evaluations
- Arbitration
- Partnership and corporation disputes
- Shareholder disputes (minority shareholders claiming
- Civil and criminal actions concerning fraud and financial irregularities – cross examination, formulate questions
- Fraud and white-collar crime investigations

Significance of forensic accounting and Scams in India

Forensic accounting in India has come to limelight only recently due to rapid increase in white-collar crimes and the belief that our law enforcement agencies do not have sufficient expertise or the time needed to uncover frauds. It is being used in banks, insurance companies and even police agencies (Preethi Singh, 2012). But India has witnessed hundreds of scams since independence. Some of the scams worth mentioning here are – 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), 2-G (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) (Debroy & Bhandary).

For the purpose of the study, seven alleged scams were selected which are political, financial, corporate etc. Entries are arranged in chronological order by year. The year is the one in which the alleged scam was first reported or came into knowledge of public.

Scandal	Year reported	Scope	Key Players	Summary
Stamp Paper scam	2005	Rs.600 billion	Abdul Karim Telgi & his associates, Police officers, Govt employees & politicians	Counterfeiting of stamp papers. Selling fake to bulk purchasers like banks, insurance companies & stock broking firms. Sentenced to 30 years of rigorous imprisonment.
Satyam Scam	2009	Rs.14000 crore	Ramalinga Raju & his family, CFO & other top level management, Auditors & Board of Directors	Inflated figures of cash & bank balance, operating profit artificially boosted from 61 crores to 649 crores, fictitious names of employees
2G Spectrum	2010	Rs. 1760 billion	A Raja, MK Kanimozhi, Nira Radia, Many Telecom Cos.	Irregularities in awarding spectrum licences. License issued on first cum first serve basis instead of auction. Advancing of cutoff date which is illegal.
Commonwealth games	2010	Rs. 35000 crores	Suresh Kalmadi & other organizing committee members, 2 private companies & Govt officials	Allegations of corruptions and mismanagement by the organizing committee, delay in the construction of main venue leading to misuse of funds, infrastructural compromise, hefty payments made in the name of non-existing parties
Adarsh Housing Society scam	2010	Not known yet	Top Army officials, IAS officers, politicians & legislators	Originally meant to be a six-storey structure to house Kargil war heroes and widows, got converted into a 31-storey and allotted to bureaucrats, top defence officers, a former environment minister and legislators. The market rate was 6-8.5 crores & was allotted at a throw away price of 60-85 lakhs. Violations in environment rules.
Coal gate	2012	Rs. 1.86 lakh crore	Govt of India, private & public sector companies	Govt of India allocating coal blocks in an inefficient manner leading to windfall gain to allottees (chose not to go through the competitive bidding process)
VVIP Chopper deal scam	2013	Rs. 362 crores	Augusta Westland Company, Former IAF chief SP Tyagi & his cousins, politicians, Govt officials & several middlemen.	It has been alleged that former IAF chief has accepted bribes to win contract worth Rs. 36 billion. Two Indian firms played key role in the controversy.

Source: Researchers' compilation

Forensic accounting has played a major role in all the above scams. It has been used as an investigative tool (rather than a preventive tool) where the documents pertaining to the scams are sent to the forensic laboratory. Many scams could have been detected and prevented in the early stages if forensic auditing is made mandatory in India. The cases are moving at snail pace in the trial courts due to the involvement of -

- High profile bureaucrats in scams like Common wealth games scam & Adarsh housing society scam.
- Politicians in most of the above scams like 2G spectrum, Coal gate & VVIP Chopper deal scam.
- Corporates in some of the scams like Satyam scam and 2G spectrum.

In view, forensic accountants need to be expert in (a) accounting practices, (b) auditing skills and (c) investigative skills. Along with specialized knowledge about the techniques of finding out the frauds one needs patience and analytical mindset. One has to look beyond the numbers and grasp the substance of the situation. It is basically the work of the intelligent accountants. He needs to question seemingly benign document and look for inconsistencies. He searches for evidence of criminal conduct or assists in the determination of, or rebuttal of, claimed damages. For this purpose forensic accountant involve themselves in financial investigation and reporting.

The conventional accounting and auditing with the help of different accounting tools like ratio technique, cash flow technique, a standard statistical tool examination of evidences are all part of forensic accounting. In cases involving significant amounts of data, the present-day forensic accountant has technology available to obtain or source data, sort and analyze data and even quantify and stratify results through computer audit and various other techniques (Wadhwa & Pal 2012). Some of the techniques involved in Forensic Accounting to examine the frauds are:

1. Benford's Law,
2. Theory of relative size factor (RSF),
3. Computer Assisted Auditing Tools (CAATS)
4. Data mining techniques ,
5. Ratio Analysis

Problems of Forensic Accounting

Although with the current economic downturn, there is an increased demand for forensic accounting services worldwide especially in developed countries, forensic accounting in developing economies is niche field. While Forensic Accounting developed as early as 1995 in USA, it put its first step in India just few years back (Ghosh 2011). Many are of the opinion that forensic accounting is an extension of investigative auditing. In India Forensic accounting is still considered a new

inclusion into the field of fraud detection. The dearth of qualified accountants with adequate technical know-how on forensic issues is one of the major problems of forensic accounting in India.

The Indian Judiciary is partly a continuation of the British legal system established by the English in the mid-19th century based on a typical hybrid legal system in which customs, precedents and legislative law have validity of law (Wikipedia). And in most of the corruption cases in India that have been unearthed recently, politicians and/or bureaucrats are involved. Due to the complex and traditional judicial system and political compulsion, forensic accountants are facing the challenge of gathering information against such big shots that is admissible in the court of law. The admissibility, of evidence in compliance with the laws of evidence is crucial to successful prosecutions of criminal and civil claims.

Moreover, it will be quite costly if the issues were brought to court and where it involves expert witnessing. Thus, most companies prefer to settle the issue outside the court to avoid the expensive cost and the risk of bad publicity on their corporate image.

India economy has been opened up to the world and some financial scandal involve corporate from other countries. Globalization of the economy and the fact that a fraudster can be based anywhere in the world has led to the problem of inter-jurisdiction. That again aggravated the problem for forensic accountants. Forensic accountants find it difficult to prosecute fraudster from other countries in Indian jurisdiction. (e.g. VVIP Chopper deal scam)

The fast-changing world of information technology and the exponential increase in the use of computer systems threaten the forensic accounting fraternity. The technology used by criminals and fraudsters is changing constantly and forensic accounting need to stay on top of their game to prevent and detect these fraudulent practices. All Indian accountants are not information technology savvy.

Accountants with good experience may find it difficult to detect and prosecute computer related fraud. Forensic accounting is an expensive service in comparison to investigative auditing. Moreover, it is not mandatory for companies to appoint forensic accountant unlike internal/external auditors in order to prevent/detect irregularities in their financial transactions.

So far, there is no specific guideline or act on forensic accounting practices set by the authorities. All these reasons further aggravated the problems facing by forensic accountants.

Suggestions

In order to bring awareness/ make people understand the significance of forensic accounting as a preventive-detective-investigative tool to check on irregularities in financial transaction new legislation should be enacted. To develop the necessary skills to be forensic accountant one must have thorough knowledge in criminology, psychology, accounting practices, auditing practices, various laws, good communication – oral and written and litigation procedures.

Conferences, seminars and training programmes need to be organized to enhance the skills and ability of professional accountants in forensic issues. More research should be undertaken in the area of forensic accounting so that adequate information on the subject-matter could be gathered for the expansion of knowledge. Forensic accounting may be integrated into the academic curriculum of tertiary institutions as a means of increasing awareness of the subject matter.

It's time for India to give a thought for modifying its present judicial system which is traditional and complex. It has to free herself from bureaucratic and red-tapism system. In the era of fast changing information technology, India cannot afford to wait years (sometime it takes decades) to resolve a case. In the present process, by the time a case get resolved it lose all its merit. A regulatory body of forensic accounting needs to be set up to govern the role, duties, responsibilities and power of forensic accountant.

There is also a need to make a new Law for the prosecution of fraudsters, irrespective of their domicile and such Law should always be framed keeping in mind the uses of information technology in fraudulent practices.

In order to tackle the problem of prosecution of fraudster from different domicile other than India, the issue needs to be taken up to international regulatory body. In this regard, international co-operation needs to be sought to achieve some form of "legislative consistency".

For financial investigation forensic accountant uses handwritten documents or documents generated using technology. He must have good understanding of technology. It should be made mandatory to appointment of forensic accountants in all the companies especially in public sector companies and large scale companies.

Conclusions

So far forensic accounting in India is being used as an investigative tool, rather than a preventive tool. If forensic auditing is made mandatory in financial and corporate sector many of the scams involving thousands of crores can be avoided. With the above objectives in mind, some of the initiatives taken by regulatory bodies show a positive sign in preventing scams. SEBI has decided to "create a forensic accounting cell to improve the quality of the financial information disclosed and to assist in detection of financial irregularities so as to serve as an effective early warning mechanism." To prevent scams in financial sector, RBI has also asked banks to include forensic auditing practices.

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