
Forensic Accounting in India

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ABSTRACT

The ever-increasing use of technology in every sphere of business, is inadvertently leading to more sophisticated and complex frauds than before. This is thereby, increasing the challenges to regulators and business heads to counter such threats. In the wake of such frauds and threats to the business, Forensic accounting helps the business to prevent frauds from occurring and detects the existence of such frauds at the right time before it is too late. Forensic accounting is the application of financial accounting and investigative skills to a standard acceptable by the courts to address issues in disputes in the context of civil and criminal litigation. The study focuses on the historical perspective of Forensic accounting in India. The study also focuses on how the Government of India, has taken steps to implement forensic accounting in India by bringing in changes in laws and making forensic accounting an integral part of the legislative system of India.

Key Words: *Forensic accounting , fraud , investigate.*

INTRODUCTION

A recent EY study based on the India Fraud Survey 2012, points out that the ever-increasing use of technology in every sphere of business, is inadvertently leading to more sophisticated and complex frauds than before. This is thereby, increasing the challenges to regulators and business heads to counter such threats. Nearly three out of five respondents had reported that their companies have suffered at least one economic crime in the past year. The incidence was particularly high in financial services, real estate, and telecommunications. The top five fraud risks that emerged from the survey, that have the potential to pose threats to businesses in India are the following: Data or information theft and IP infringement; bribery and corruption; fraud perpetrated by senior management; vendor fraud or kickbacks; and regulatory non-compliance.

Forensic accounting is defined as the application of financial accounting and investigative skills to a standard acceptable by the courts to address issues in disputes in the context of civil and criminal litigation. As a discipline, forensic accounting encompasses financial expertise, fraud knowledge and a strong understanding of business reality and the working of the legal system. Its development can be achieved usually through on-the-job training and experience with investigating officers and legal counsel. Forensic accountants thrive on detecting fraud and criminal transactions in banks, corporate entities, public sector or from any other organisation's financial records.

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.

Some forensic accountants specialize in forensic analytics which is the procurement and analysis of electronic data to reconstruct, detect, or otherwise support a claim of financial fraud. The main steps in forensic analytics are

-) Data collection
-) Data preparation
-) Data analysis and
-) Reporting.

NEED FOR THE STUDY

Poor corporate governance, mismanagement, frauds and other wrong doings which has lead to corporate failure have placed greater responsibilities on forensic accountants to equip themselves with the skills and techniques for identifying, discovering as well as preserving the evidence of all forms of financial abuses. Though accounting practices has improved tremendously, but recent electronic frauds have become complex and sophisticated to a magnitude that they could go unrecognized. The failure of statutory audit to detect, prevent and reduce misappropriation of corporate fraud and the increase in corporate crime has put pressure on the professional forensic accountants and the legal practitioners to find a better way of exposing fraud in business world.

OBJECTIVES OF THE STUDY

-) To understand the historical perspective of forensic accounting in India.
-) To understand the implementation of Forensic Accounting in India

RESEARCH METHODOLOGY

Research Design

Analytical research design is used to analyze the existing facts from the secondary data.

Sources of Information

The study takes into consideration secondary information collected through articles and magazines. Publically available data is taken into consideration for the purpose of the study.

SCOPE OF THE STUDY

The scope of the study is restricted to Forensic Accounting in India. It takes into consideration the historical perspective of forensic accounting and the implementation of Forensic Accounting in India.

LITERATURE REVIEW

Historical perspective of Forensic Accounting in India

Maurice E. Peloubet coined the term Forensic Accountant in his 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.

Present Perspective of Forensic Accounting in India

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 101 of co-operative banks bursting - all are pinpointing the need of forensic accounting, irrespective of whether we understand the need or not.

ACTIVITIES OF FORENSIC ACCOUNTANT

A Forensic Accountant is often involved in the following:

-) 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

IMPLEMENTATION OF FORENSIC ACCOUNTING IN INDIA

However in India, this branch of accounting has not got its due recognition even after alarming increase in the complex financial crimes and lack of adequately trained professionals to investigate and report on the complex financial crimes. The task of Forensic Accountants is handled by Chartered Accountants who apart from handling traditional practice of auditing under the Companies Act, 1956 or Income Tax Act are called upon by the **law enforcement agencies** or the companies or private individuals to assist in investigating the financial crime or scam. The CA or CWAs in India are best suited for this profession due to their financial acumen acquired during their rigorous training which can be further honed by introducing post qualification degree or diploma in Investigating and Forensic Accounting. The CA or CWA who acquire post qualification in Investigative & Forensic Accounting can use the designation CA-IFA or CWA-IFA and be legally recognized as the Forensic Accounting Expert to handle the investigation of financial crimes and give expert testimony in the Court of Law.

SERIOUS FRAUD INVESTIGATION OFFICER (SFIO)

However, growing financial fraud cases, recent stock market scams, failure of non financial banking companies, phenomena of vanishing companies and plantation companies and failure of the regulatory mechanism to curb it has forced the Government of India to form Serious Fraud Investigation Officer (SFIO) under the Ministry of Corporate Affairs which can be regarded the first step of Government of India to recognize the importance and advance the profession of forensic accountants. The SFIO is a multidisciplinary organization having experts from financial sector, capital market, accountancy, forensic audit, taxation, law, information technology, company law, customs and investigation. These experts have been taken from various organizations like Banks, Securities & Exchange Board of India, Comptroller and Auditor General and concerned organizations and departments of the Government. However, the main law enforcement agency

involved directly in combating white-collar crimes is the Police, CBI, DRI etc. there is a total lack on the part of these law enforcement agencies to train their investigators in this specialized part of investigating white-collar crimes involving forensic accounting. Most of the cases in India die a natural death and the criminals roam free as the IO given his lack of specialized knowledge & qualification fails to properly investigate the financial crime to its logical conclusion. On the other hand if we look at the western countries particularly USA, the law enforcement agencies like DEA, FBI, CIA has well marshaled its pool of special agents having forensic accounting backgrounds that are the backbone of the bureau's financial crimes and terrorism financing units and investigate with professional acumen, the complex financial crime like money laundering, internet crimes, financial institution fraud and economic crimes. Today, there are more than 600 FBI agents with accounting backgrounds.

Thus, it is highly imperative on the part of law enforcement agencies in India that they follow suit and engage specialist forensic accountant on its roll whose engagements relating to criminal matters typically arise in the aftermath of financial fraud.

THE INDIAN LAW WHICH REFERS TO FORENSIC ACCOUNTING:

J The Companies Act, 1956:

1. **Section 235 and 237:** There are provisions in Companies Act (Section 235 and 237) which empowers the Central Government to inspect the books of accounts of a company, to direct special audit, to order investigation into the affairs of a company and to launch prosecution for violation of the Companies Act, 1956. Books of accounts and other documents of the companies are inspected by the officers of the Directorate of Inspection and Investigation and the Registrar of Companies. These inspections are designed to find out whether the companies conduct their affairs in accordance with the provisions of the Companies Act, 1956 to see whether any unfair practices prejudicial to the public interest are being resorted to by any company or a group of companies and to examine whether there is any mismanagement which may adversely affect any interest of the shareholders, creditors, employees and others. Whether inspection reports disclose any information that may be of interest to other Departments or agencies like the Ministry of Commerce and Industry, Central Board of Direct Taxes, Enforcement Directorate, State Government or Provident Fund Authorities, such information is passed on to them. If an inspection discloses a prima facie case of fraud or cheating, action is initiated under provisions of the Companies Act, 1956 or the same is referred to the Central Bureau of Investigation.

2. **Provisions of Sick Industrial Companies Act incorporated into the Companies Act, 1956:** The Section 424A(5) of the Companies Act, 1956 empowers National Company Law Tribunal (NCLT) to examine as preliminary issue whether the company is a sick industrial company u/s. 2(46AA). Thus even before examining the viability of the scheme of revival proposed by the company, NCLT can check the genuineness of the reference made to it. Thus, inquiry by operating agency will only be to enable NCLT to decide the viability of the scheme and to assess whether the company has the ability to revive on its own. Operating agency is group of experts consisting of persons having special knowledge in banking and industry in which sick industrial company is engaged and includes public financial institution, State level institution, scheduled bank or any other person as may be specified by general or special order as its agency by the Board. Thus, Forensic Accountant can be part of operating agency and investigate whether with reference made by the company is genuine or the accounts are manipulated or fabricated to suit the scheme of reference made to NCLT to declare it as sick company and thereby siphon public funds.

J **SEBI Act, 1992:** The share market is highly volatile and the brokers indulge into various unfair and fraudulent trade practices like synchronized share trading, manipulate and fabricate the books of accounts and cheat the gullible investors. Regulation 11 C of the SEBI Act, 1992 empowers the SEBI to direct any person to investigate the affairs of intermediaries or brokers associated with the securities market whose transactions in securities are being dealt with in a manner detrimental to the investors or the securities market. Thus fraudulent and unfair trade practices of the brokers or market intermediaries are investigated by the investigator appointed by SEBI which requires the broker or market intermediary to furnish information,

books of accounts, registers, documents or records etc. which is analyzed by the investigator to find out any manipulation, fraudulent practice or otherwise of the broker. Thus, Forensic Accountant can play a lead role in assisting the SEBI to unearth the complex share related frauds perpetrated by the brokers.

)] **The Insurance Act, 1938:** Section 33 of the said Act empowers the IRDA to direct any person ('Investigating Authority') to investigate the affairs of any insurer. The investigating authority may seek assistance of the auditor (or actuary or both) who shall be the Chartered Accountant within the meaning of Chartered Accountant Act, 1949 for the purpose of assisting him in any investigation. The books of account, registers and other documents are taken by the investigating authority in its custody to analyze it to find out the manipulations or fabrication in the books of accounts. Thus, Chartered Accountants plays a front role as an Forensic Accountant and aid in the investigation conducted into the affairs of the insurer as per the provisions of Insurance Act, 1938.

)] **The Prevention of Money-Laundering Act, 2002:** Section 3 of the Prevention of Money Laundering Act, 2002 defines the offence of money laundering as involvement of a person in any process or activity connected with the proceeds of crime and projecting it as untainted property. The three important stages in the money laundering process are:

)] Placement: Physical disposal of cash acquired from illegal sources by depositing the cash in domestic banks or other kinds of financial institutions.

)] Layering: Working through complex layers of financial transactions to distance the illicit proceeds from their source and disguise the audit trail.

)] Integration: Making the wealth derived from crime appears legitimate.

Forensic Accountant can often be involved in the following antimony laundering activities:

)] Investigating and analyzing financial evidence to establish a suspicious transaction;

)] 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 that assist the banks in submission of the suspicious transaction report to the regulator; and

)] Assisting in legal proceedings, including testifying in court as an expert witness and preparing visual aids to support trial evidence.

)] **The Companies (Auditor's Report) Order, 2003:** CARO, 2003 requires the auditor to report to the effect that if a substantial part of fixed assets have been disposed off during the year, whether it has affected the going concern status. In order to carry out the duties, the auditor has to draw a corollary and reference to the section 293 of Companies Act, 1956, AS 24 ('Discontinuing Operations') and to AAS 16 (Going Concern) and thereafter make his observations on this matter. It also requires the auditor to report on Frauds.

CONCLUSION

Forensic accounting as a discipline encompasses financial expertise, fraud knowledge and a strong understanding of business reality and the working of the legal system. Its development can be achieved usually through on-the-job training and experience with investigating officers and legal counsel. Forensic accountants thrive on detecting fraud and criminal transactions in banks, corporate entities, public sector or from any other organization's financial records. With the above objectives in mind, some of the initiatives taken by regulatory bodies show a positive sign in preventing scams. The growing financial fraud cases, recent stock market scams, failure of non financial banking companies, phenomena of vanishing companies and plantation companies and failure of the regulatory mechanism to curb it has forced the Government of India to form Serious Fraud Investigation Officer (SFIO) under the Ministry of Corporate Affairs which can be regarded as a positive step from the Government of India to recognize the importance and advance the profession of forensic accountants

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