CHAPTER 3

FORENSIC ACCOUNTING A NEW DIMENSION OF MODERN ACCOUNTING
### CHAPTER 3

**FORENSIC ACCOUNTING A NEW DIMENSION OF MODERN ACCOUNTING**

<table>
<thead>
<tr>
<th>SR. NO.</th>
<th>TITLE</th>
<th>PAGE NO</th>
</tr>
</thead>
<tbody>
<tr>
<td>3.1</td>
<td>OVERVIEW ON FORENSIC ACCOUNTING</td>
<td>59</td>
</tr>
<tr>
<td>3.2</td>
<td>CHARACTERISTICS OF FORENSIC ACCOUNTING</td>
<td>60</td>
</tr>
<tr>
<td>3.3</td>
<td>VARIOUS TOOLS USED BY FORENSIC ACCOUNTANT</td>
<td>63</td>
</tr>
<tr>
<td>3.4</td>
<td>VARIOUS PROCEDURES USED BY FORENSIC ACCOUNTANT</td>
<td>67</td>
</tr>
<tr>
<td>3.5</td>
<td>REASON OF AUDIT FAILURE TO IDENTIFY FRAUD</td>
<td>69</td>
</tr>
<tr>
<td>3.6</td>
<td>INTERNATIONAL STUDIES ON FORENSIC ACCOUNTING</td>
<td>72</td>
</tr>
<tr>
<td>3.7</td>
<td>CONCLUSION</td>
<td>75</td>
</tr>
</tbody>
</table>
CHAPTER 3

FORENSIC ACCOUNTING A NEW DIMENSION OF MODERN ACCOUNTING

3.1 OVERVIEW ON FORENSIC ACCOUNTING:

Forensic Accounting concept is introduced as part of examining fraud. Forensic accounting gained more importance after the collapse of companies like WorldCom and Enron in USA. In simple term Forensic Accounting is the blend book keeping, verification and examination. Currently in the inflated economy frauds has risen vigorously which has led to a high demand of investigator in the industries. Forensic accountant takes assignment as an investigating officer and litigating officer in examining these frauds. Skills and professionalism of the forensic accountant are different from the auditor, they investigate each case considering as fraud involvement. They have expert knowledge on accounting, law, computer forensic and hence accountability to establish these frauds becomes necessary on them. There finding on these frauds is considered as evidence in the court of law. They required a great professionalism, transparency in completing their assignments.

Their assignment consists of just like an audit, but not the audit which you schedule on a bi-yearly or yearly basis. Frauds are unpredictable, they can occur anytime and anywhere and hence role of forensic accountant becomes important to control such fraud. As forensic accountant has knowledge of legal as well as accounting, it becomes easy for them to calculated the damages and prove the quantum of fraud incurred in the court of law. They not only detect frauds but also prevent occurrence of fraud. A new avenue has increased because of demand by various regulatory bodies for preventing and regulating the fraud. Professional especially Chartered Accountants has good scope to extend their services as Forensic accounting professional. In India many Big Chartered Accounting Firms are rendering services such as consultation, legal proceeding, expert representation, arbitrator, mediator expert appointed by court and any other litigation support required by Client. Forensic services goes beyond the organization level to personal level. They play important role in divorce cases, personal damages in form of insurance or detecting terrorism finance activity.
With the current trends in the business world primarily making a high dynamic and volatile market place, frauds are also increasing day by day which has led to need of a forensic accountant requirement in the industries. Forensic accountants not only take up the organization cases but sometimes they need to take the cases of some other professional so as to identify their cases on professional negligence. Professional negligence can be understood that where the auditor has not performed his duties to identify fraud. The gravity of professionalism is based upon the analysis done by the forensic accountant. They also provide the services to personal grounds which involves financial impacts such as alimony or calculating revenue available for child support and equal distribution of money within the family in case of legal heirs. They are hired only after frauds take place in the organization. They are expert with sound knowledge on accounting and law. Hence they involve themselves and understand the internal accounting systems of the organization.

3.2 CHARACTERISTICS OF FORENSIC ACCOUNTING

Forensic accounting and financial audit are similar in nature, however the analysis done by the forensic accountant has more weighted in court of law and on that basis debate is conducted and disputes are resolved. Following aspects helps us to understand the role of forensic accountant as compare to auditor.

i. **Role:**

   One of the most important of Forensic accountant is that its role is not only restricted as an investigation but also as an expert witness assisting in litigation.

ii. **Better Control:**

   Forensic accounting has better control on all possible frauds. It covers both approaches, top down approach and down top approach.
iii. **Basis for principle:**
Auditor follows Basic principles of auditing conducting an audit on the other hand a forensic accountant should possess’ quality such as detail oriented, persistent, ambitious and highly organized (Mukoro, Yamusa, & Faboyede, 2013).

iv. **Focus on work:**
Forensic accountant are trained to prevent and detect fraud as compare to auditor as his main object is to prove the financial statement true and fair. To check whether fraud has taken place is the incidental object of auditing whereas Forensic accountants are hired to investigate fraud has occurred or not and if it has occurred than calculation of damages need to be done.

v. **Quality required:**
Forensic accountant not only should posses’s excellent knowledge on accounting but also on other areas such as economics, market estimation and valuation appraisal report. He should also well verse with prevailing Law of the country as he also had to handle cases on breach of contract.

vi. **Cost effective:**
Traditionally Internal audit function was used to detect fraud in the organization therefore was an expensive for the companies. However the auditors were not trained professional to detect fraud and hence there was chances that most of the frauds remain undetected. Similarly if the internal auditor possess expertise like forensic accountant that the chances to detect fraud increases and hence the professional fees paid to them becomes cost effective and management do not find pain to pay them.

vii. **Better role performance as a member of Audit committees:**
Role of audit committee is important to prevent and detect fraud in the organization. If a qualified accountant possess quality and expertise of forensic accountant will be an added advantage to their professional ethics and creates a better image in front of committee.

viii. **Challenges:**

Detecting fraud is much more difficult as compare to detecting error. Forensic accountant must be discreet when conducting their investigation. They have to be impartial, taking into account both the financial records and the conduct of employees. They have to be meticulous in searching the data base as people who had hidden the evidence of their crimes need to prove that fraud has occurred.

ix. **Common techniques:**

Forensic accountant apply same techniques of application irrespective of whether it’s criminal or civil case. With this technique all possible and hidden frauds are identified by the experts. As now computer and internet are used by the organization, computer forensic techniques are important to apply.

x. **Wider Coverage:**

The coverage of Forensic accounting is not restricted to only accounting but it get extended to computer forensic as well. It includes Cybercrime and fraud done through technology. Here Forensic accountant has to play role as a technical expert using various computer programs.

xi. **Specialization:**

Forensic accountant can specialized in specific service provided, manufacturing, or consultancy and learn the business practices to suspect fraud industry specific.
xii. **Better knowledge of Computer program:**

Forensic Accountant should have better knowledge of computer related programs and the functioning of those programs.

xiii. **Services extended to personal transaction:**

Forensic accountant services are not only restricted to organization but also they provide services to divorce case, insurance claims, personal damages, fraud claims and all other case where an individual are affected.

xiv. **Better Opportunities:**

Forensic Accountant is in great demand due to increasing fraud and also the various tools and techniques used by them to prevent and detect fraud.

### 3.3 VARIOUS TOOLS USED BY FORENSIC ACCOUNTANT:

Identify and prevention of fraud is the biggest challenge for a forensic accountant. This can be achieved only through various tools used by them which range. They cover from all the level of techniques involving simple as well as complex. Tools used by forensic accountant are complex in nature and requires lot of training to understand it. Every case is unique and hence no pre determine tools can be used. Every case brings in new experience to decide which tools can be used. Various tools used by the forensic accountant discussed are as follows (Luhar & Sharma, 2012) & (Ghosh & Banerjee, 2011):

i. **Theory on Benford’s law:**

This is a method of finding an infrequent transaction from the data. It is generally used with the help of software. With the help of excel it becomes easy to identify the uncommon numbers in the group. If the range of the number exceeds the probability of
the Benford predetermined number than this is considered that something is wrong with
the information provided.

ii. Relative size factor:

One of the specialized techniques helps the examiner to identify uncommon transaction
from the system. This can be done by comparing various other transactions over the
period. For example if the travelling expenses shown say Rs 45000 for financial year
2016-17, Rs 15000 for the financial year 2015-16 and for the year 2014-2015 it showed
Rs 18,000 than in such case travelling expenses are increased by three times. This
information becomes useful for the examiner to go and drill down it further. The only
expectation may be that due to expansion or increase in number of employee the expenses
have gone up. Therefore just because the numbers are high compare to last few years does
not make it fraud but it creates an opportunity to look the details in depth. It becomes easy
for the examiner to select the items from the list.

iii. Same, Same, Different:

In this kind of techniques to be followed, the examiner should understand the common
and uncommon relationship. For example there was a refund to be pay to the customer on
account of defective goods. There may be chance that the customer name and number can
be same but the bank account details can be different. Hence every time the payments are
made goes to same customer but in different accounts. So this kind of items is also need
to be check when there are more returns of goods in the same accounts.

iv. Outlier Detection:

This is the technique which is used by the examiner to differentiate between the normal
and abnormal transaction. Therefore a pattern is created on the basis of the information
generated. This pattern is observed so that a normal behavior and abnormal behavior
could be generated in the system. Than on the basis of data available the investigator can
draw his attention towards the transaction. This pattern is mostly used by banks to identify money laundering transaction. For example a customer who is a salary employee gets his salary on 1\textsuperscript{st} of every month and suddenly is bank accounts are hit by a huge amount than in such case it becomes a question of scrutiny. This kind of analysis is even used to track black money and even terrorist funding. Therefore any abnormality in the transaction or change in behavior or pattern leads to draw attention for the examiner. Using this technique it becomes easy for the investigator to look into important data rather wasting time in other normal transaction. The best part of this technique is that this can be used even by the organization to study the behavior of an employee. If an employee whose salary is not high but his standard of living is high in that case that becomes a matter of suspicion. They can start focusing on his activity on that bases to identify that if any fraud has been incurred by him.

v. **Trending:**

Trending is one of the important techniques to identify frauds. The examiner has lot of data on that even he may have documentary evidence to check on this data. He has to really focus on the transaction which is exceptional in nature. It is difficult for him to identify this transaction from the current date. If he compares the current data with the previous year data he can easily identify the fraud. For example if we compare the sales data over the year and also the same with the Bad debts taking place in the organization than it becomes easy to understand that if sales are increasing and bad debts are also increasing at the same level than this could be concluded that such bad debts are nothing but the fake sales bill entered in the system. Such fraud could not be identified unless this are compared over the period. It may sound correct for that financial year but may not be the same case for the over the period years. This technique is useful even to see the movement of inventories.
vi. Advanced Statistical Techniques:

As the fraud has been increased in the organization, simple techniques could not be helpful to identify such fraud and hence statistical tools should be used to analysis such data. Nowadays data are large in number and cannot be controlled for example in the bigger organization there may be large number of employee and hence their payroll data and other relevant data to analyses becomes difficult therefore with the help of computers this statistical tools becomes easy to analyses.

vii. Ratio Analysis:

One of the best techniques to analysis the transaction is the ratio. There are various ratios available to analyses. Some of the example of the ratio is current ratio, liquidity ratio, debt equity ratio, inventory turnover ratio, debtors and creditor turnover ratio and many other ratio as required by the management. These ratios have one of the benefits that they cover entire financial statement. They can compare between profit and loss account and balance sheet items. They can further be compared between the same kinds of companies within the industries. This will help them to assess their current position in the market. Even this analysis helps them to compare more than one year of transaction and hence can be helpful to understand and analysis the growth path as well as the uncommon increase or decrease in the data.

viii. Computer Forensic:

This is an extension version of the analysis to understand the process as well as the storage of the data. Auditors are only concern with the financial transaction on the other hand expert not only analysis the transaction but also are involved in to understand the blueprint of the software and hardware part of the concern. They want to understand the inner system of the computer hardware so that they can be sure that the system is fool proof from any fraud and damage. Therefore they are interested to know the cache memory, disabled of floppy disk and pen drive. Policies regarding the backup plan of the
organization, antivirus to protect the software and they assess more toward protection of the data of the organization.

3.4 DIFFERENT PROCEDURES USED BY FORENSIC ACCOUNTANT:

Following methods are used by the forensic accountant while performing their duties. These techniques cover from observation to analysis and review to investigation. They are widely used techniques such as:

i. **Document verification:**

   Auditor focuses on the documents provided by the management. They verify these document to ascertain the True and Fair view. Auditors verifies that all transaction entered have proper documentation. They focus more on accounting principles and arithmetic accuracy rather on fraud. Forensic Accountant on the other hand focuses whether the documents entered in the system are not fraudulent.

ii. **Alternative sources to verify:**

   Though auditor also does third party confirmation, but they only verify from the general ledger the accuracy of the document. Experts tries to collect data from the outside sources and hence their information are more trustful on existence on these documents from the alternative source i.e. they try to verify their truth behind the documents.

iii. **Informal information techniques:**

   Informal techniques are used to confirm the information or to investigate certain information forensic accountant try to validate the data from the informal sources.
iv. **Interviewing the employees:**

Forensic accountant try to interview the employee to understand the system critically and also to get their view on the internal system of the organization.

v. **Background verification of the employee:**

In order to control and verify the occupational fraud forensic accountant focuses and follow the procedure of background verification of the employee.

vi. **Analyzing Physical and Electronic Verification:**

Forensic accountant are not only have strong hold on accounting but also they are expert in computer hardware and software. They play an important role in identifying and controlling internet and cyber frauds. They analyses and study hardware’s and software’s used by the organization. Company uses computer for their business transaction and hence they verify hardware and software of the company to ensure their safety.

vii. **CCTV cameras:**

Forensic accountant uses CCTV camera for observing the transaction happening in the organization. For example loading and unloading of the goods. Physical property of the organization are safeguarded and verified through CCTV.

viii. **Analyzing financial transaction:**

Forensic accountant analyzes financial transaction to make sure that fraud has been occurred and if it has occurred that what is the quantum of the fraud. They explore financial transaction to draw the conclusion. They even use statistical tools to understand the complex transaction.

ix. **Observing verbal and non-verbal communication:**
Forensic accountant are good observer of the situation. They observe transaction and employee in the organization and on that basis they derived the output of the case.

x. **Surprise visits:**
Forensic accountant never plan or discuss their visit with the employee and hence they collect required and expected data from the organization.

### 3.5 REASON OF AUDIT FAILURE TO IDENTIFY FRAUDS:

Auditors follows, the Basic Principle of Auditing, he does all precautionary steps to still the fraud remains undetected by the auditors. Some of the reason is as follows:

i. **Object of Audit:**

The main object of audit is to express Detection and prevention of frauds are the incidental object and not the main object of auditing.

ii. **Responsibility fixed on Management:**

Responsibilities are fixed on Management and not on auditor as a result there is chance of Professional negligence on the part of the auditor.

iii. **Mechanical Process:**

Audit has become more mechanical process and hence auditor cannot think beyond number.

iv. **Dependence on client to provide document:**
They rely on the documents provided by the client and hence they focus on the document provided rather than searching alternative source of documents.

v. **Lack of training to detect fraud:**

Auditors do not have any training to identify frauds and hence many fraud indicators are ignored by them.

vi. **Engagement letter:**

Auditor works as per audit engagement entered with the client and hence ignore the other material element beyond his scope of audit.

vii. **Quality of support staff:**

Auditor though is a Chartered Accountant, they do not have qualified team member to detect fraud. They only verify and check arithmetic accuracy along with accounting principles.

viii. **Lack of concentration on clients:**

Auditor handles many assignments and hence it becomes difficult for him to go in details for each and every assignment.

ix. **Define Audit program:**

Auditor follows audit program well defined for client and hence cannot think beyond the limit defined.
x. **Dependence on Expert:**

Auditor has expert knowledge on the fields of accounting but he has to depend upon the technical expert to understand the technical specification. Hence it’s difficult for auditor to think from any fraud angle from it dependence Whatever certified report he gets he relied on it.

xi. **Professional negligence:**

Auditor fails to perform his duty due to professional negligence. They fail to identify frauds and errors as they have not performed their duty on professional ethics.

xii. **Lack of Computer programming and Software knowledge:**

Auditor is not well-versed to understand computer program as they are not require to undergo same for audit. They use software but they do not have in-depth knowledge of it.

xiii. **Sampling risk to determine the internal control:**

Auditors rely on the small sample and hence there is a sampling risk attached to determine the internal control and hence auditor takes risk that fraud and error remain undetected.

xiv. **Audit report:**

Audit report is the opinion and reporting express to his best of knowledge by an auditor. Here the auditor with certain reservation can express unqualified report. Since client pay the remuneration there is a chance that the report can be manipulated.
3.6 INTERNATIONAL STUDIES ON FORENSIC ACCOUNTING:

There are various international studies which have shown that forensic accounting is different from the traditional auditor. The distinguishing feature is objective of assignment. Both Forensic accountant and auditor have different goals to achieve. Researcher has linked his research with the other international studies so as to provide better insight of forensic accounting.

i. Study on Role of Forensic Accountants In Nigeria (Mukoro, Yamusa & Faboyede, 2013):

The authors focus to understand the part of forensic accounting to decrease monetary crimes and corruption in the country of Nigeria. The skills possess by forensic accountants can be used in investigation of crime and corrupt practices. The researcher has also identified that documentation and reporting is one of the important activities of forensic accountant during the litigation support. The researcher has taken data from primary source; targeting the respondent from Federal Inland Revenue Services (FIRS). Researchers in his study have highlighted the key features of Forensic accountant that they have mechanism to hold manager accountable or responsible for frauds. Survey method was conducted to study following:

a. Relevance of forensic accounting in examining criminality and dishonesty in public sector.

b. Role in administrative proceedings.

c. Forensic accountant role in documentation and reporting.

Key Observation of the study:

a. Forensic accounting review truthful condition and provides recommendations regarding probable course of action.

b. Forensic accounting provides assistances with the protection and recovery of assets.

c. Forensic accounting plays as a coordinator between other investigator, consulting engineer and other technical expert.
d. Forensic accountant understand the financial issues and to formulate additional questions to be asked.
e. Forensic auditor leaves audit trail in carrying out the investigation.

ii. A Tool for Fraud Detection and Prevention in the public sector in Kogi state (Okoye & Gbegi, 2013):
The auditor needs to be trained so that occupational fraud such as misappropriation of goods and cash can be prevented. Forensic accounting has skilled of investigation and litigation support. The study is based on the public sector in Kogi state of Nigeria. It also has skill such as analyze and evaluate financial evidence and able to report the findings.
The study was conducted focusing on the following:
   a. Forensic accounting helps to reduce fraud
   b. Comparison between Forensic Accounting and Traditional Auditor.

The population of study was comprise of five Ministries i.e. Finance, Justice, Local Government, Budget - Planning & Commerce Industry. The respondent of the survey were top management, senior staff, graduate and Diploma holders.

Following were the emphasis of the study:
   a. Understanding the concept of Forensic Accounting.
   b. Need of Forensic Accounting in Public Sector of Kogi State.
   c. Services of investigator will reduce and avoid the fraud of the public sector.
   d. Distinguish features of Traditional Auditor and Forensic Accountant.

Key observation of the study was:
   a. Forensic Accounting service are not employ by the public sector of Kogi state.
   b. Respondent have sufficient information regarding forensic accounting.
   c. Technical and skills of forensic accounting are different from those of Traditional auditor.
   d. Use of Forensic accounting will be reduce and prevent the fraud.

iii. To understand the difference between auditing and forensic accounting
Survey is conducted by Charles Davis, Ramon Farrell, Suzanne Ogilby FVS Section (AICPA) : “Characteristic and Skills of the Forensic Accountant” (2009).

a. Surveyed have agreed on Essential Traits and Characteristics following skills required what traditional auditor do not have such as , Analytical (attorney 78%, Academic 90%, CPA 86%). Detail Oriented (attorney 64%, Academic 35%, CPA 49%). Ethical (attorney 60%, Academic 65%, CPA 49%), Responsive (attorney 41%, Academic 2%, CPA 10%), Insightful (attorney 39%, Academic 29%, CPA 24%), Inquisitive (attorney 22%, Academic 48%, CPA 52%), Intuitive (attorney 26%, Academic 40%, CPA 38%), Persistent (attorney 19%, Academic 46%, CPA 30%), Skepticism (attorney 12%, Academic 54%, CPA 43%), Evaluative (attorney 30%, Academic 15%, CPA 16%), Function well under pressure (attorney 28%, Academic 23%, CPA 35%), Generate new ideas (attorney 27%, Academic 10%, CPA 16%).

b. Surveyed agrees on skills should be enhanced to detect fraud such as Testifying (attorney 74%, Academic 30%, CPA 49%), Knowledge of relevant professional standards (attorney 70%, Academic 36%, CPA 38%), Audit evidence (attorney 53%, Academic 34%, CPA 26%), Fraud detection (attorney 53%, Academic 79%, CPA 56%), Electronic discovery (attorney 19%, Academic 43%, CPA 18%), Interviewing Skill (attorney 13%, Academic 70%, CPA 63%), Internal control (attorney 26%, Academic 32%, CPA 25%).

c. Surveyed agreed on Core Skilled require such as to detect fraud Effective oral communicator (attorney 61%, Academic 28%, CPA 43%) Critical / strategic thinker (attorney 49%, Academic 62%, CPA 50%), Synthesize results of discovery and analysis (attorney 37%, Academic 43%, CPA 36%), solve unstructured problems (attorney 7%, Academic 30%, CPA 31%) Investigative intuitiveness (attorney 24%, Academic 36%, CPA 36%).

Conclusion of the study:
Overall result suggests that as compared to auditors, forensic accountants are more capable in terms of skill and qualification to identify and control frauds. Hence their services should be used for both private and public sectors.

iv. **A case study on Forensic Accounting of Iran (Zadeh & Ramazani, 2012):**

The researcher has defined that they are a mixture of bookkeeping, verification, and law profession. They are experts who identify frauds and the quantum of frauds. Other services offered by them include divorce, insurance claims, personal damage, and any other illicit method of transaction need to be proved. The researcher focuses on two areas:

a. Insight and information of discussion services related to forensic accounting.

b. Accountant awareness of the source and procedures of forensic accounting.

The respondents are graduate, Master, diploma qualified with an experience of one to fourteen years in the field of accounting.

**Key observation from the research:**

a. Training will enhance the performance of the accountant.

b. Legal rules of financial crimes will help their application.

c. Seminar session to make awareness regarding forensic accounting.

### 3.7 CONCLUSION:

Hence from the above, it is clear that as the world is changing dynamically, it has led to an increase in frauds. Now the methodology of frauds has been redefine and are taking place easily in a complex environment. Traditional auditors are not trained enough to identify and report such frauds. However, the complexity of the frauds can be identifying if the skills and quality of the forensic accountant can be acquired by the auditor. The another limitation of the auditor is that they are limited only to the sound knowledge of accounting, whereas forensic accountants have gone beyond accounting and covered areas like local laws regulations, cyber laws, and technical
information and therefore has wide coverage to identify upgraded and updated method of committing frauds. The most important point is that forensic accountant assignment is to identify frauds and submit report, the court will decided on the basis of evidence collected that frauds has occurred. They not only play active role in identifying frauds but also gives various suggestion to the management to prevent the frauds taking place at all levels of management. Auditor role are restricted on to the books of financial accounting whereas forensic accountant role goes beyond to the personal level liability taking place on any dispute relating to the family matters, insurance or any kind of claims taking place and having involvement of financial impact. Now the organization has understood the relevance of forensic accountant as cost effective department. On the basis of survey done by the researcher following is the outcome from the above chapter:

a. That the services provided by the Forensic Accountant are different from the Traditional Auditor.

b. The use of Forensic application tools and techniques can help internal auditor, statutory auditor, Audit committee members etc.; to perform their duties in better manner.

c. Increase in the fraud has created a new careers opportunity in the field of professional are in excessive demand.

d. Forensic Accountant has better accounting skill, investigative and analytical skills to identify fraud than traditional auditor.

e. Methodology applied by forensic accountant is much wider and different from traditional auditor and hence detection of fraud becomes easy.

f. Failure of Audit to prevent and detect frauds has increased the demand of Forensic Accounting.

g. Forensic accounting control all possible fraud and mismanagement what traditional audit fails to do.
h. Forensic Accounting direction to planning the accounting process which in turn help in identify possible fraud.

i. Risk calculation process in organization will help professional to identify areas of frauds.

j. Forensic accounting is stronger than audit to control fraud.

k. Forensic accounting engagement can be specifically tailored to deter fraud and potentially prevent it what audit fails to do.

l. Investigation report under forensic accounting is the good evidence and accepted under court of law.

m. Forensic accountant takes a more active, uncertain method in investigation of books of accounts.

n. Forensic accounting is more dynamic than Audit.
REFERENCES:


