

Forensic Accounting – Role in Corporate Fraud Investigation in India

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Abstract: Fraud is any activity that is undertaken to deceive a party. In India, fraud in public and private sectors of the economy has been seen as one of the major factors of the dwindling economy. Forensic Accounting is an area of study which specializes on financial fraud investigation. A number of financial experts agree that there is an inverse relationship between economic development and fraud & because of the mindless obsession with profit maximization when carried to any extreme level can lead to failures like WORLDCOM, SATYAM has extreme negative impact on the survival and growth of any economic entity. A vast research work is needed for the implementation of the forensic accounting and auditing in India. There are many hindrances which hinder the use of forensic accounting in the general course of accounting. This paper examines the techniques which have been used for the fraud detection and also looks at the perceived level of effectiveness of the various fraud prevention and detection methods used in India.

Keywords: Financial Fraud, Corporate scams, white collar crimes, financial irregularity.

INTRODUCTION

Accounting is more than just maintaining financial transactions and preparing reports on the transaction and books of accounts. It is also an accountant's responsibility to ensure that there is no malpractice in the accounting process. Whether internal or external, the auditing process is to verify if the company is abiding by the accounting standards and to identify any accounting malpractices. When fraud has been detected, the company usually takes the necessary legal action.

Forensic Accounting is an approach to accounting which utilizes accounting, auditing and investigative skills to conduct an examination into the finances of individual or business. George A. Manning in his book "Financial Investigation and Forensic Accounting" defines Forensic Accounting as the science of gathering and presenting financial information in a form that will be accepted by a court of jurisprudence against perpetrators of economic crimes. 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 identify, interpret and communicate findings.
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Forensic accountants analyze financial records and accounts that may be used as legal evidence and often testify in court cases as expert witnesses. They may work on cases such as fraud and embezzlement and explain the nature of a financial crime in court. The work done by a forensic accountant is far more detailed and in depth than that of an auditor. This paper attempts a look into the major financial frauds committed in India and how forensic accounting can help in identifying the financial frauds

Literature Review

Bhasin (2007) finds that the services of forensic accountants are in great demand in the areas which include criminal investigation, settlement of outgoing partner; settlement of insurance claims, detection of employee fraud and case relating to professional negligence.

Arokiasamy and Cristal-Lee, (2009) Dhar and Sarkar, (2010) studied that from an auditor's perspective, forensic accounting deals with the application of auditing methods, techniques or procedures to resolve legal issues that require the integration of investigative, accounting, and auditing skills

Mazumder (2011) remarked that law enforcement personnel in recent years have become more aware of white-collar crimes and have lacked the training and expertise in combating such crimes. They are better trained at combating violent or personal behavior crimes, but now it has the responsibility to expand its knowledge and expertise into the economic crimes area.

Objectives

1. To know the types of Financial and Corporate Frauds.
2. To understand the significance of forensic accounting by examining various scams in India.
3. To examine the services rendered by Forensic Accountants.
4. To examine the techniques used by forensic accountants in investigating corporate frauds and scams.

Methodology

This paper and study is based on secondary data and few prominent cases of financial fraud in the corporate sector have been discussed. The study is a theoretical analysis of the role of forensic accountant who keeps a watchful eye on the financial operation of the firms to minimize the occurrences of financial frauds. However, forensic accounting covers a wide range of operations of which fraud examination is a small part where it is most prevalent. For the purpose of the study, scams were selected which are political, financial, corporate etc. Entries are arranged in chronological order.

Types of Frauds

Frauds are usually not exhaustive as fraudsters use new methods each time. As technology is advancing, fraudsters are able to 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 is as 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.
- 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.
- Creating ghost employees and embezzling their wages/salaries.
- Accepting bribes from the customers and suppliers of the business with various reasons.
- 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. 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.

Scams in India

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.

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 this paper some scams from the year 2000 are provided as follows:

Scam/Fraud	Loss Suffered	Fraud details
UTI Scam of 2001	₹4800cr	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 few executive directors, duped lakhs of small investors through false propaganda, while allowing windfall profits to the handful of big corporate who had invested in UTI.
Ketan Parekh Security Market Scam of 2001	₹1250cr	Ketan Parekh created a trading ring of his own and identified a number of stocks (popularly called the K-10), and 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
UP Food Grains Scam of 2003	₹35,000cr	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.
IPO Scam of 2004	-	A number of 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 of SEBI guidelines were not followed by depository. This obviously has bought the role of Depository System in question.
Satyam Scam of 2008	₹140000cr	Inflated figures of cash & bank balance, operating profit artificially boosted from 61 crores to 649 crores, fictitious names of employees
2G Spectrum Scam of 2010	₹1,75,000cr	This scam shows the worst 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
Common Wealth Games Scam of 2010	₹35,000cr	Allegations of corruptions and mismanagement by the organizing committee chairman Suresh Kalmadi, delay in the construction of main venue leading to misuse of funds, infrastructural compromise, hefty payments made in the name of nonexisting parties
Coal Gate scam of 2012	1,86,800Cr	Govt of India alloted coal blocks in an inefficient manner without competitive bidding process leading to windfall gain to allottees who were the politicians and big corporate.
VVIP Chopper Deal Scam of 2013 (Augusta westland Chopper Scam)	₹3620 cr	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.
Vijay Mallya - Kingfisher Fraud of 2016	₹9,000cr	In 2016, Mallya absconded the country and sought refuge in the UK after he was accused of fraud and money laundering in the country. Vijay Mallya allegedly owes various banks over Rs 9000 crores, which he'd taken as a loan to keep his now defunct Kingfisher airlines from failing. He was recently declared a fugitive economic offender under the Fugitive Economic Offenders Act.
Nirav Modi PNB Bank Fraud of 2018	₹11,400cr	This fraud reportedly took place through Punjab National bank's Brady house brand. Not just Nirav Modi, his uncle Mehul Choksi and two senior PNB officials were also involved in this fraud. In 2018, PNB filed a case with CBI accusing Nirav Modi and the companies he was connected to of obtaining Letters of Undertaking (LoUs) from PNB without paying up the margin amount against loans. This meant that if those companies failed to pay the loan, PNB would have had to pay the amount.

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

Services Rendered by Forensic Accountant

1. **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.
2. **Detect fraud in criminal matters:** Forensic Accountant render their services as an investigator inthe 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.
3. **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.
4. **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.
5. **Dispute Settlement:** Multiple problems have been introduced in growing business trade. Sobusiness firms engage forensic accountants to handle and solve these types of matters like construction claims, contract disputes, trade mark cases etc.

Techniques Adopted by Forensic Accountants to Identify Frauds

- a) **Benford's Law:** It is a mathematical tool to determine whether variable under study is a case of errors or frauds. Use of parametric test called the Z test is carried to measure the significance of variance between two populations i.e. Benford's percentage numbers for first digit and observed percentage of first digit for a particular level of confidence. Benford's Law is not affected by scale invariance and is of help when there is no supporting document to prove the authenticity of transactions.
- b) **Theory of relative size factor:** It highlights all unusual fluctuations, which may be routed from fraud or genuine errors. RSF is measured as the ratio of the largest number to the second largest number of the given set. In practice there exists certain limit (e.g. financial) for each entity such as vendor, customer, employee, etc. These limits may be defined or analyzed from the available data- if not defined. If there is any stray instance of that is way beyond the normal range, then there is a need to investigate further into it.
- c) **Data Mining Techniques:** It is a set of 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.It explains association, trends and variations. 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. This method involves "pattern matching" algorithm to 'extract' any rare or suspicious cases.

- d) **Ratio Analysis:** Another useful fraud detection technique is the calculation of data analysis ratios for key numeric fields. Like financial ratios that give indications of the financial health of a company, data analysis ratios report on the fraud health by identifying possible symptoms of fraud. Using ratio analysis, a financial expert studies relationships between costs and some measures of production, such as units sold, dollar of sales or direct labor hours.

CONCLUSION

India has already faced substantial losses 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. Moreover, the Forensic Accounting is in an infancy state in India. But due to ever increasing cases of bank & cyber frauds its growing importance cannot be denied. In the emerging economic scenario, given the pervasiveness of fraud and the necessity of special skills in order to uncover 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 included forensic auditing into its curriculum 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.

KPNG has set up an investigation detection centre in India. Networks Limited, a Delhi based organization, working in the similar field, they are also trying to innovate ways and means to detect financial irregularities and crimes in India. Serious Investigation Fraud Offices(SIFO), has been established in India for the same reason, i.e. detection and prevention of economic irregularities and crimes. The need for such bodies and the importance of Forensic Accountants have been highlighted by L.N.Roy Committee, Lenin Parekh Committee has also expressed the view that one "fraud detection committee" need to be established. The main aim of such boards should be to prevent the interest of the stakeholders.

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