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RESEARCH ARTICLE

FORENSIC ACCOUNTING: A DYNAMIC APPROACH TO INVESTIGATE FRAUD

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ABSTRACT

Forensic accounting has come into limelight due to rapid increase in financial frauds and white-collar crimes. The integration of accounting, auditing and investigative skills creates the specialty, known as forensic accounting. In fact, forensic accounting is the 'specialty' practice area of accounting that describes engagements, which 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. It uses accounting, auditing, and investigative skills to conduct investigations, and thefts and frauds cases. No doubt, FA is listed among the top-20 careers of the future. Initially, forensic accountants were used by government agencies to uncover and investigate leading frauds. They became financial detectives; independent experts employed by management to uncover fraudulent financial reporting and misappropriated assets. In the current reporting environment, forensic accountants are in great demand for their accounting, auditing, legal, and investigative skills. They can play a vital role in coordinating company efforts to achieve a cohesive policy of ethical behavior within an organization. The article aims at finding the role and importance of forensic accounting and a forensic accountant in detecting frauds.

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INTRODUCTION

Forensic accounting is a specialized field of accounting which deals with legal claims and complaints. Forensic accountants usually called as forensic audits or detector accountants are bound to provide other specialists with required evidence in law courts. Forensic accountant is an agent who is familiar with financial, accounting, auditing and legal problems acting as a referee, expert, inspector or proxy especially in financial claims and cases of financial fraud. In other words, forensic accountants are considered as experienced auditors, accountants and inspectors of legal and financial documents who are employed to investigate fraudulent activity and prevent it. They also provide services in some fields such as accounting, damages, valuation and general consultation. Forensic accountants have critical role in divorce, insurance claims, personal damage claims, fraud claims, construction, auditing of publication right and detecting terrorism by using financial precedence's. Most of forensic accountants run parallel with proxies and rule executives in their investigation and play their role in law courts as expert witnesses. All big and small firms have special circles for forensic accounting. Forensic accounting itself has sub branches in which some are

expert in insurance claims and some are expert in personal damage, fraud, construction, affairs. A forensic accountant's primary duty is to analyze, interpret, summarize and present complex financial and business-related issues in a manner that is both readily understandable by the layman and properly supported by evidence. In addition, a forensic accountant must also be familiar with legal concepts and procedures, including the ability to differentiate between substance and form when grappling with any issue.

Services provided by a Forensic Accountant

A well-trained forensic accountant can provide the following services:

1. Review of financial books and records for suspicious or unusual transactions warranting further attention; Search for potential preferential payments and fraudulent transfers; Prepare analyses of pre-and post-petition financial statements;
2. Locate diverted funds or assets of the debtor; Identify misappropriated assets; identify reversible insider transactions; Analyze business operations and performance;
3. Evaluate the factors contributing to the debtor's current financial condition and future viability; Analyze business

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plans and financial projections to determine the feasibility of reorganization

4. Analyze monthly operating reports to ascertain business trends and issues warranting further investigation e.g. the services of Forensic Accountant is of great significance when there is Merger and Amalgamations of the Companies with reference to preparing of 'due diligence' report of the amalgamating and amalgamated companies.
5. Analyze, interpret, summarize and present complex financial and business-related issues in a manner that is both readily understandable and supported by pertinent data and analyses performed in accordance with procedures recognized in the profession
6. Prepare visual aids to support trial evidence; analyze questionable accounting practices; provide analyses to support motions; provide analyses of debtor's court motions
7. Validate the stated reasons for the bankruptcy filing and provide expert testimony.

Role of Forensic Accountant

A Forensic Accountant is often retained to analyze, interpret, summarize and present complex financial and business-related issues in a manner that is both understandable and properly supported. Forensic Accountants can be engaged in Public Practice or employed by insurance companies, banks, police forces, government agencies and other organizations.

Criminal Investigations

Practicing forensic accountants could be called upon by the police to assist them in criminal investigations which could either relate to individuals or corporate bodies. The forensic accountant would use his/her investigative accounting skills to examine the documentary and other available evidence to give his/her expert opinion on the matter. Their services could also be required by Government departments, the Revenue Commissioners, the Fire Brigade, etc for investigative purposes.

Personal Injury Claims

Where losses arise as a result of personal injury, insurance companies sometimes seek expert opinion from a forensic accountant before deciding whether the claim is valid and how much to pay.

Fraud Investigations

Forensic accountants might be called upon to assist in business investigations which could involve funds tracing, asset identification and recovery, forensic intelligence gathering and due diligence review. In cases involving fraud perpetrated by an employee, the forensic accountant will be required to give his/her expert opinion about the nature and extent of fraud and the likely individual or group of individuals who have committed the crime. The forensic expert undertakes a detailed review of the available documentary evidence and forms his/her opinion based on the information gleaned during the course of that review.

Matrimonial Disputes

Solicitors often need the services of forensic accountants in divorce cases involving disputes about matrimonial assets. Assignments of this sort might require the forensic accountants to trace, locate and evaluate assets. Such assets, for instance, might technically be owned by a business in which one of the parties to the divorce case has a share. The assets would need to be accurately valued to ensure equity when splitting the divorcing couples' assets and liabilities.

Professional Negligence

The forensic accountant might be approached in a professional negligence matter to investigate whether professional negligence has taken place and to quantify the loss which has resulted from the negligence. A matter such as this could arise between any professional and their client. The professional might be an accountant, a lawyer, an engineer etc. The forensic expert uses his/her investigative skills to provide the services required for this assignment.

Expert Witness Cases

Forensic accountants often attend court to testify in civil and criminal court hearings, as expert witnesses. In such cases, they attend to present investigative evidence to the court so as to assist the presiding judge in deciding the outcome of the case.

Mediation and Arbitration

Some forensic accountants because of their specialist training they would have received in legal mediation and arbitration, have extended their forensic accounting practices to include providing Alternative Dispute Resolution (ADR) services to clients. This service involves the forensic accountant resolving both mediation and arbitration disputes which otherwise would have been expensive and time consuming for individuals or businesses involved in commercial disputes with a third party.

Litigation Consultancy

The forensic accountant provides working with lawyers and their clients engaged in litigation and assisting with evidence, strategy and case preparation.

Computer Forensics

Some forensic accountants also assist in electronic data recovery and enforcement of IP rights etc.

Techniques of Forensic Accounting

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. Some of the techniques involved in Forensic Accounting are:

Benford's Law

It is a mathematical tool, and is one of the various ways to determine whether variable under study is a case of unintentional errors (mistakes) or fraud. On detecting any such phenomenon, the variable under study is subjected to a detailed scrutiny. The law states that fabricated figures possess a different pattern from random figures. The steps of Benford's law are very simple. Once the variable or field of financial importance is decided, the left most digit of variable under study extracted and summarized for entire population. The summarization is done by classifying the first digit field and calculating its observed count percentage. Then Benford's set is applied. A parametric test called the Z-test is carried out to measure the significance of variance between the two populations, i.e. Benford's percentage numbers for first digit and observed percentage of first digit for a particular level of confidence. If the data confirms to the percentage of Benford's law, it means that the data is Benford's set, i.e. there is 68% (almost 2/3rd) chance of no error or fraud. The first digit may not always be the only relevant field. Benford has given separate sets for 2nd, 3rd,... and for last digit as well. It also works for combination numbers, decimal numbers and rounded numbers. There are many advantages of Benford's Law like it is not affected by scale invariance, and is of help when there is no supporting document to prove the authenticity of the transactions.

Theory of Relative Size Factor (RSF)

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 exist certain limits (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. It helps in better detection of anomalies or outliers. In records that fall outside the prescribed range are suspected of errors or fraud. These records or fields need to relate to other variables or factors in order to find the relationship, thus establishing the truth.

Computer Assisted Auditing Tools (CAATS)

CAATs are computer programs that the auditor use as part of the audit procedures to process data of audit significance contained in client's information systems, without depending on him. CAAT helps auditors to perform various auditing procedures such as: (a) Testing details of transactions and balances, (b) Identifying inconsistencies or significant fluctuations, (c) Testing general as well as application control of computer systems. (d) Sampling programs to extract data for audit testing, and (e) Redoing calculations performed by accounting systems.

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.

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 various affinities, association, trends and variations in the form of conditional logic. 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.

Conclusion

The importance of the forensic accountant's role in the detection of fraud is continuously growing. Armed with combination of skills, these financial detectives are today important assets to modern legal teams. Forensic accounting is simply a specialty field within the broader arena of accounting. It is the use of professional accounting skills in matters involving potential or actual civil or criminal litigation, including, but not limited to, generally acceptable accounting and audit principles; the determination of lost profits, income, assets, or damages; evaluation of internal controls; fraud; and any other matter involving accounting expertise in the legal system. The article aims at finding the role and importance of forensic accounting and a forensic accountant in detecting frauds. In the backdrop of increasing levels of frauds, the demand for forensic accountants is bound to substantially increase in the future.

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