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A Study on the Importance of Forensic Accounting and Forensic Accountants

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Abstract: ***Over the years, financial frauds have been reported in numerous sectors of the world. Especially in India, financial/corporate scandals like, Harshad Mehta (1992), Satyam computers (2009), Ketan Parekh(2008), 2G Scam (2009) and Punjab National Bank – Nirav Modi (2018) have severely impacted the progress of the corporate and non-corporate sectors. In scams that have surfaced in the past, Directors of respective companies have been charged with allegations of manipulative corporate reporting and false filing of financial statements to the government authorities. After surfacing of such scams,Forensic Accounting has gained momentum since it detects frauds and errors. Forensic Accounting is a blend of auditing, accounting and investigative skills to carry an examination of the financial statements of the company. Application of Forensic Accounting is expected to detect corporate governance fraud which is expected to improve efficiency of corporate and non-corporate sectors. As Forensic Accounting is still in its development stage in India, the main aim of this study is to derive insights into the fact if forensic accounting is expected to be helpful in protecting the interest of stakeholders, employees, customers and suppliers who are directly involved with the companies.***

I. INTRODUCTION

Forensic accounting, also known as investigative accounting is the application of specialized skills and knowledge to recognize transactions which are not lawful and have been entered into in order to derive illegal benefits. The job of forensic audit is to investigate such transactions where the responsibility of the fraud is established and the report is regarded as evidence of the investigation made in any proceeding or the court of law.

According to PwC's 2018 Global Economic Crime and Fraud Survey, 49% of global organizations faced situations of economic crime since two years. Financial frauds take place mainly due to lack of awareness within the organizations. Hence, all organizations should identify the true nature of threat as crime works under a shadow with tentacles developing almost in every sector and country.

Forensic accounting encompasses two major components: a) in case of lawsuit, skills of examination by a forensic accountant are used in two ways -courtroom testimony or expert opinion based on his investigation. b) Forensic accountant's skills for examination are required for analyzing, collecting and evaluating financial evidence. Forensic accounting is used for fraud investigation which covers allegations from initiation to disposition, interviewing, collecting evidence, writing reports, and testifying. The skills needed for practicing forensic accounting is high as this branch of accounting is concerned with using the skills and experiencesin matters related to law in criminal, civil and jurisprudence. Forensic accounting hinge on various pillars. These pillars comprise the character, the knowledge of law and experience of the accountant. Hopwood et al. (2008) mentioned that forensic accounting needed analytical and investigative skills.

Also, Rasmussen and Leauance (2004) deployed 'investigative accounting' as substitute idiom for forensic accounting. This name was suggested as a forensic accountant must read the financial reports and related documents with respect to accounting in order to check their validity and analyze the origin.

Fraud and Fraudulent cases in some countries have increased the demand for forensic accounting. Fraud includes wide varieties of unlawful practices possessed to change the existing financial conditions for the benefit of third party. Also, the fraudsters hide or forge original documents, figures and records so that they gain illegal profits. This highly requires the intervention of a forensic accountant to investigate issues that involve fraud and misrepresentation. Discovering fraud requires the skill of experienced and professional forensic accountants to find the evidences needed to prove that the cases involved fraudulent activities or not. High forensic accounting expertise makes it possible to discover frauds.

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The major concern of a country is to avoid white collar crimes which affect the country's economy. Forensic accounting is an effective tool for curb this menace but practice of forensic accounting in India is relatively very much lower than in other developed countries. As there is no effective tool to detect, measure and prevent fraud and corruption in India, forensic accounting appears as a one of the strategic tools for the prevention of frauds. It needs cooperation and reinforcement of technology perennially. To prevent scams in financial sector, RBI has urged banks to include forensic auditing practices so that frauds, if any are detected at an early stage. The Association of Chartered Certified Accountants (ACCA) has also provided guidelines to perform audit in general.

II. REVIEW OF LITERATURE

Godwin Oyedokunet. al. (2018) stated that financial statements were the face of financial impacts of business transactions, internal control system of the company.The study examined if forensic accounting techniques certified the veracity of the financial statements. Members of recognized professional accountancy bodies in Nigeria were a main part of the sample study and this study adopted survey research method with the use of primary data and purposive random sampling techniques. Hypotheses were formulated, tested, and analysed using multiple regression analysis. It was found that forensic accounting techniques "FAT" (FPDDS, FAIIS, LMAS, and CARDR) positivelyimpacted the integrity of financial statements (IFS). It was also found through the study that the implementation of forensic accounting techniques wouldreinforcethe internal control systems. This study in conclusion established that theforensic accounting techniques included fraud detection, prevention and deterrence skills, forensic investigation, forensic audit, and forensic interviewing skills, mediation and arbitration skills,litigation and, document reviews and computer-assisted reviews. The study recommended that business entities should consider installing forensic accounting units within the entity to ensure the integrity of financial statements and other financial information.

Hamdan M.W (2018) aimed to study the effect of forensic accounting on discovering and mitigate fraud. Questionnaire was used which composed of two parts. The first part was concerned with collecting information aboutrequirements of forensic accounting and the second part was concerned with studying the role of forensic accounting in surfacing fraud. Confirmatory factor analysis was used to test the forensic accounting variables and its contribution in surfacing fraud. The results showed that forensic accounting was an effective tool to find frauds. Poonam and NeetuDhayal (2017) opined that forensic accounting played a key role in finding white-collar crimes and financial frauds. Corporate governance mechanism did not aid the companies in reducing financial frauds which posed threats to government,investors and general public. Even the government's Serious Fraud Investigation Office (SFIO) in India has taken the help of forensic accountant to investigate the financial fraud. After the Satyam scam, companies want to identifythe early signals detecting afraud in Indian companies. The general objective of this study was to determine if fraud management and forensic accountingaided in the control and reduction of fraudulent practices in India.

Bhasin (2007) found that the services of forensic accountants had high demand which included settlement of outgoing partner,criminal investigation, detection of employee fraud,settlement of insurance claims and case relating to professional negligence.

A. Need of the Study

Forensic accounting is needed to reduce the financial frauds with an aim to improve the functioning of corporate sectors. Forensic accounting assures that accounting systems and policies are followed to the book and any unusual items introduced in such a system are detected. This study aims to assess how forensic accounting can reduce mismanagement and corporate fraud.

B. Statement of the Problem

In recent times, various frauds have been noticed in corporate sectors of the economy. This study aims to find out how forensic accounting can prevent corporate frauds, illegal profits and mismanagement.

C. Objectives of the study

The main purpose of this study is to analyze future prospects of Forensic Accounting in India.

1) To identify various uses of Forensic Accounting in India.
2) To analyze Forensic Accounting with reference to different scandals.
3) To ascertain the role of Forensic Accounting in solving financial problems like financial fraud and malpractices in corporate world.
4) To examine the possibility of reducing the occurrence of fraud cases using Forensic Accounting.
5) To determine the extent to which financial and economic crimes have impacted on the Indian economy and the effectiveness of forensic accounting functions.

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D. Statement of Hypotheses

1) H_1: Application of Forensic Accounting will improve the accounting practices.
2) H_0: Application of Forensic Accounting will not improve the accounting practices.
3) H_2: Forensic Accounting will be able to minimize financial frauds.
4) H_0: Forensic Accounting will not be able to minimize financial frauds.

Solved Cases with the help of Forensic Accounting

E. M/s. Kanishk Gold Pvt Ltd (KGPL) vs. SBI Consortium

M/s. Kanishk Gold Pvt Ltd (KGPL) is a company registered under the Companies Act 1956 in Chennai, Tamil Nadu. KGPL manufactured gold jewelry which was marketed under the brand name 'KRIZZ' at their manufacturing unit located in Kancheepuram district. Until FY 2014, the business model of KGPL was to sell through a distributor network across the country and abroad to the retailers in the industry. KGPL changed its business model from distributor network to Business to Business to Business (B2B) model in 2015 to avoid the third party intermediaries. Through B2B model, KGPL sold its products directly to retailers. KGPL also supplied directly to large retail jewelers like Joy Alukkas, GRT Jewelers, LalithaJewelery, Malabar, etc.

The loan accounts of KGPL were taken over by SBI from ICICI in the year 2008 with the sanction of Working Capital limits to the tune of Rs. 50 Crores and Term Loan limits to the tune of Rs. 10 crores. During March 2011, banking arrangement was converted into Multiple Banking Arrangement with Punjab National Bank and Bank of India. During 2012, the banking arrangement in respect of working capital credit facilities was converted into a consortium with SBI acting as the lead bank. Working Capital Credit Facilities were sanctioned with the option to avail as CC (Hyp)/Metal Gold Loan (MGL)/BG. KGPL used to purchase gold in the form of bullion either under MGL or under CC(Hyp) respectively. KGPL also purchased bullion from nominated banks in the consortium or from the open market utilizing the limits wither under MGL or under CC (Hyp) respectively. KGPL also purchased bullion from nominated banks other than the consortium members on the basis of the bank guarantee issued by the consortium member banks. For the purpose of availing credit facilities Credit Monitoring Arrangement (CMA) data based on the performance of the company was provided by the company. The company also provided projected level of income, expenses, profit, assets and liabilities for the subsequent years.

The company's banking exposure was periodically increased and the enhancement of working capital limits was periodically increased based on the reported growth of the currentassets and sales of the company. The company complied with all rating parameters and norms in respect of the business being carried out. The stocks of the company were insured with the bank's interest noted in the relevant policies and the same was submitted to the lenders. The end use of funds was reported to the bank and inspections were carried out by the consortium bankers at stipulated periodicity.

Apart from working capital credit facilities, KGPL had also availed Term Loan limit of Rs. 8.50 crores under solo banking arrangement from SBI for the purchase of machinery at the factory. Standalone documents were executed by the company and term loan was secured by the hypothecation on the plant and machinery installed at the factory situated in Kancheepuram district. The sign of sickness was noticed when the company delayed servicing interest in March 2017 in respect of 8 member banks. When the stock was initiated in April 2017, the company did not facilitate stock and receivables audit process. When the consortium members visited the corporate office, factory and showrooms, no activity was found. Joint inspection also showed no business activity in the KGPL premises. Hence, there were suspects that falsification of the records was being done since 2009. During the core committee meeting of the consortium, it was decided to conduct a forensic audit in the account. Accordingly, M/s Deloitte Touche Tohmatsu India LLP was appointed for conducting forensic audit – to identify fraudulent statements of financial statements, diversion of bank funds, siphoning of funds, asset stripping, etc during the period from 2009 to 2017. As per the forensic audit report, there were misrepresentation/falsification of records, diversion of funds and disposal of stocks by the company.

The value of closing stock of WIP of gold/gold jewelry and finished goods were higher than the average cost of the closing stock appearing in the stock valuation working record maintained by the borrower. Documentation pertaining to sample sale transactions were analyzed and it was observed that the rate for standard gold was unusually low since the unit of measurement for the quantity had been mentioned as kilograms insteadof grams in the accounting system and sales invoices. On analyzing the bank book, it was observed that an amount of Rs. 190.21 crores were transferred to the other banks outside the consortium. Also, unusual pattern of transactions with related parties in the accounting records of the borrower was found.

Forensic Audit revealed various discrepancies in the form of overvaluation of stock and incorrect quantity of stock in the stock valuation workings records maintained by the company. The company had not maintained proper records for the movement of goods. Incorrect unit of measurement of stock for sale and purchase transaction was utilized for the transaction in Tally. The

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certificates provided by the stock auditors appeared incorrect in the forensic audit which proved that the stock and statutory auditors had failed to record the deficiencies in the financial records and asset registers of the company which had adversely affected the bank's interest.

It was finally concluded that KGPL and its directors in collusion with the statutory auditors and others acted with a clear criminal/malafide intent to cheat and defraud the banks in order to gain illegal profit by falsifying the records and financial statements of the company. The purpose of availing credit facilities from the bank was to breach the trust and cheat the lenders which proved to be detrimental to the rights and interests of the banks. The account was classified as NPA as per the guidelines of RBI and recovery action was initiated by issuing notice under SARFAESI Act, 2002. A criminal case under appropriate sections of the Indian Penal Code, 1860 was registered.

F. Forensic Audit of Arvind Remedies Limited

Arvind Remedies Limited ("ARL") is a company incorporated under the Companies Act, 1956, on June 17, 1998. ARL was engaged in the business of manufacturing of allopathic and ayurvedic pharmaceutical formulations. ARL operated primarily in the hospital marketing segment comprising Central/State Government institutions, etc.

SEBI received a reference dated September 18, 2015, from Punjab National Bank ("PNB") informing that a consortium of banks led by PNB had a Forensic Audit of ARL conducted by M/s. Maharaj N. R. Suresh and Co. A copy of the Forensic Audit Report dated May 23, 2015, was also forwarded to SEBI, which revealed large scale irregularities including falsification of books of accounts and statements; maintenance of multiple databases, etc.

It was found that ARL's accounts were maintained in software called Focus 6.2, which lacked security control, access control and data base control. ARL maintained different sets of database – one for books of accounts and the other for the purpose of excise, sales tax and internal control purpose. Checks/controls in data entry and processing were absent as a result of which, wrong/erroneous data were also keyed in and processed.

The financial database modules were frequently changed but the overall financial figures were balanced with published accounts. The internal deletions/additions were made to satisfy various inspection agencies like Stock Auditors, Internal Auditors, Cost Auditors, etc. ARL prepared different Profit And Loss Account and Balance Sheet for the purpose of Excise Department where actual turnover was reported. In case of returns filed with the Tamil Nadu Sales Tax authorities, ARL updated the returns. ARL purchased majority of stocks from certain "Controlled Parties/Entities" and sold the same to them. This was to avoid/minimize extra outflow of VAT and to maintain revenue neutrality.

Major differences were observed in Inter–State purchases and Inter–State sales and exports. ARL was regularly inflating sales and purchases, which indicates that it had not manufactured goods shown as manufactured in the Annual Accounts, relied upon by bankers. ARL adopted certain practices to show these transactions, which were primarily records of non–existent movement of goods such as fake bills generated on customers who did not requisition such purchases. In many cases, ARL only passed book entries under Parties' Control Account or Journal Control Account (Collections from debtors were shown as debited to this account and payments to the customer's account were made by crediting the said account). The purchase account was debited for an amount and the supplier account was credited simultaneously. Later, the goods were shown to have been sold and the customer's account was accordingly debited. While the original Stores Ledger (which matched with Financial Books) was produced to the Forensic Auditors on March 5, 2015, another Stock Ledger was produced on March 7, 2015 (which was reconciled with the original Excise Return). Two sets of sales register were produced, one on February 17, 2015, that matched with books of accounts and another on March 14, 2015, which was reconciled with the Excise Return. In March 2014, the Deputy Commissioner of Income Tax confirmed that multiple accounts were maintained by ARL. Further, Central Sales Tax for the Financial Years 2011–12 and 2012–13 were paid through the abovementioned Control Accounts. No Central Sales Tax as exhibited in books was paid nor were original challans produced. Transactions were only book entries where tax paid amount were adjusted through the Control Accounts.

Pursuant to details provided by the Forensic Audit Report, SEBI conducted an investigation of ARL to ascertain whether its books of accounts were manipulated during the Financial Years 2011–12, 2012–13, 2013–14 and 2014–15 ("Investigation Period") and whether there were any other related violations.

The Company had filed all details regarding companies, sales, purchases, etc., respectively. ARL showed steady growth in Revenue and Profits till the quarter ended September 2014, where after, ARL started disclosing significant losses. The price of the scrip of ARL increased from the opening price of ₹43.95 on April 1, 2014, to reach a high of ₹66.05 as on September 8, 2014. Thereafter, the scrip witnessed significant fall and closed at ₹14.7 on March 31, 2015. Accumulated losses at the end of the 15 months period ended on June 30, 2015 completely eroded ARL's net–worth.

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ARL was found to have used many companies to show fictitious purchase and sale transactions which were referred to as Controlled Parties/Entitiesin the Forensic Audit of ARL conducted by M/s. Maharaj N. R. Suresh and Co. Circular Transactionswere observed i.e. funds received from ARL by a Controlled Entity (A) was transferred to another Controlled Entity (B) on the same day; thereafter, Controlled Entity (B) transferred the funds back to ARL on that same day. Although both purchase and sale transactions were shown in the books of accounts of ARL through such circular transactions, no real sale or purchase transactions were made. Also, in case of several Controlled Entities, Reversal Transactionswere observed i.e. Entity received a credit from ARL and on that same day, such entity transferred back almost the same amount to ARL. For all these Controlled Entities, it was found that the bank accounts were opened only for the purpose of showing fictitious transactions with ARL and not for any actual business purpose. Further, significant cash withdrawals were observed in the said bank accounts.

As per the preliminary findings of the forensic Report, the directors was *prima facie* alleged to have violated the SEBI Act and Listing Regulations - Misstatement of accounts, Adoption of dubious and inconsistent practices in drawing up accounts and employing devices to defraud the investors.

G. Forensic Accounting Cases under Investigation

1) The finance ministry ordered a Forensic Audit Of Dena Bank and Oriental Bank of Commerce in 2017 after some of their Mumbai-based branches allegedly misappropriated funds worth Rs. 437 crore, mobilized through fixed deposits. Professional services firm KPMG in India was given the mandate to undertake forensic investigations. In the case of Dena Bank, the misappropriation was to the tune of Rs. 257 crore and related to funds mobilized from seven corporates. Oriental Bank was alleged to be involved in misappropriation of funds amounting to Rs. 180 crore, reportedly belonging to the Jawaharlal Nehru Port Trust. The Central Bureau of Investigation (CBI) has been already looking into the alleged fraud. The incident in Oriental Bank of Commerce dates to February 2014 and the bank had swung into action early recovering Rs. 110 crore,of the initial amount of Rs. 180 crore and handed over to the original remitter.

2) Pune Cosmos Bank - The hackers involved in the ₹94.42 crore Cosmos Bank heist had used 171 ATM cards from Pune and 428 ATM cards from other places during the crime, according to officials. The money siphoned off from the bank was found to be wired to 29 countries from where it was withdrawn. The Pune cyber cell obtained CCTV footage where the ATM transactions of Cosmos Bank took place and carried out a forensic examination where the Special Investigation Team (SIT) will probe the ₹94.42 crore cyber theft at Cosmos Bank. The cybercrime sleuths sought logs of all the foreign transactions from Visa payment gateway to conduct the massive online fraud. Cosmos Bank appointed PricewaterhouseCoopers, a multinational professional services network agency, to conduct a forensic audit of the fraud.

3) Punjab National Bank – A written complaint on 4th March 2018 alleged prima facie that NiravModi, Director of Firestar International Ltd and Firestar Diamonds International Pvt. Ltd., other directors/promoters, unknown public servants of Punjab National Bank entered into a criminal conspiracy pursuant to which, the Punjab National Bank had been cheated to the tune of Rs. 321.88 crore. The facts disclose commission of cognizable offences of criminal conspiracy, cheating and abuse of official position by public servants. The internal investigation by the authorities found that there were circular transactions between NiravModi promoted partnership firms namely Solar Exports, Stellar diamonds and Diamond R US and Firestar International Ltd and Firestar Diamonds International Pvt. Ltd.Firestar Group companies had been sanctioned credit limits by PNB under consortium and it was found that the transactions made by the companies were fraudulent as the limits sanctioned were not used for the purposes for which they were sanctioned. Hence, a criminal conspiracy was hatched and PNB had been cheated for which a criminal investigation was initiated. The NPA account had been declared as fraud and a forensic audit was suggested to be conducted so that the loss is recovered.

III. CONCLUSION

The main objective of this study was to analyze if the application of Forensic Accounting has improved the accounting practices and if the financial frauds have been minimized. The study used secondary data to compile the information and cases related to forensic accounting in India. It was found that many cases involving fraud and misrepresentation have been reported in India and appropriate steps were taken in order to assess, determine and recover the amount involved in the said frauds. Frauds committed were subject to forensic accounting and undisclosed and activities involving dubious transactions were found. However, the forensic accounting experts were able to recover the respective amounts involved in fraud and appropriate action was taken against the companies and individuals involved by SEBI, CBI, etc. This proved that the forensic audit conducted in companies was successful in detecting frauds and errors setting an example for the country not to indulge in financial frauds. This has definitely instilled a thought in the companies to improve their accounting practices by filing true and correct financial statements with the Government authorities and

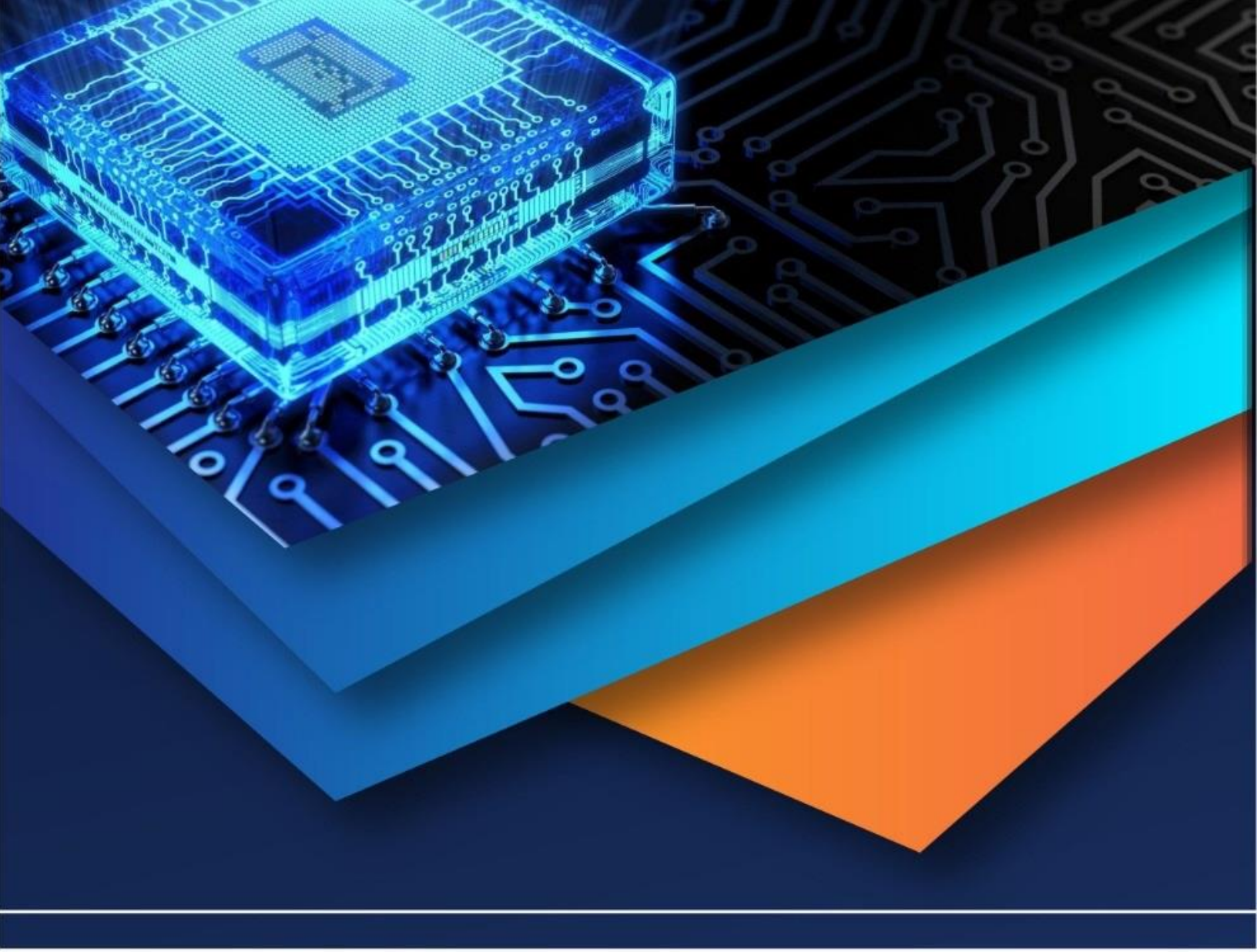
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implementing optimal internal control systems. Hence, the alternate hypotheses were accepted as forensic accounting has been successful in improving the accounting practices and minimizing financial frauds. Though forensic accounting is in its nascent stage in India, the number of fraud cases are expected to reduce with increased vigilance and stringent measures introduced by the Government.

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