

The Role of Forensic Accounting in Fraud Investigation

Kanchan

Assistant Professor

University of Rajasthan

Jaipur, Rajasthan, India.

Abstract

Maurice Peloubet who was a New York based CPA, first coined the term “Forensic Accounting” in 1946. Forensic Accounting is viewed as a blend of Accounting, Investigation and Auditing. It is a practice of employing Accounting, Auditing & Investigative skills to obtain particular results. The increase in the number of fraudulent activities in world has emphasized the importance of forensic accounting. Nowadays most of the companies irrespective of their size have started appointing forensic accountants so that their assets are safe. Forensic accountants utilize economic theories, business information, accounting standards, and audit standards and procedures, data management & data analysis techniques and financial reporting systems for fraud detection and gathering evidences. The fraud investigation approach used by forensic accounting is significantly different from the traditional auditor/accountant. Forensic accountants possess an intuitive ability to investigate fraud and a traditional accountant may not have an experience to carry out an investigation.

Keywords

Forensic accounting, Fraud, Investigative auditor, Fraud auditor, Traditional accountants.

1. Introduction

1.1 Evolution of Forensic Accounting

The Meyer vs Sefton case in 1817, Canada is the first known case of using an accountant as an expert witness. The credit of emergence of Forensic Accounting is given to Frank Wilson, who was appointed to a task force to investigate the dealings of Al Capone that is America’s most notorious Chicago gangster in 1930 while working for the Internal Revenue Service as a CPA. Maurice Peloubet who was a New York based CPA, first coined the term “Forensic Accounting” in 1946.

Many institutions have been established so far. Some of them are as follows:

1887: The American Institute of CPAs (AICPA)

1992: The American College of Forensic Examiners was established.

1997: The American Board of Forensic Accountants was established.

2014: International Institute of Certified Forensic Accountants (IICFA) was incorporated.

2016: the Forensic Auditors Certification Board (FACB) of England and Wales was established.

1.2 Concept of Forensic Accounting

Forensic Accounting is a blend of Accounting, Investigation, and Auditing. It is a practice of employing Accounting, Auditing & investigative skills to obtain particular results. It is also called Investigative Accounting or Fraud Audit. Combined meaning of the word “Forensic Accounting” in the accounting profession deals with the application of financial data to legal problems. Forensic accounting is defined by Horty, “The science that deals with the relation and application of finance, accounting, tax, and auditing knowledge to analyse, investigate, inquire, test and examine matters in Civil law, Criminal Law and Jurisprudence in an attempt to obtain the truth from which to render an expert opinion”. Forensic accounting is closely connected to the legal process and has the potential to be involved in proceedings in the civil and criminal courts. In criminal court’s cases, forensic accounting plays a vital role to fight against white-collar crimes.

It is believed that a forensic accountant is like a bloodhound of bookkeeping that sniffs fraudulent acts in financial records and looks beyond the numbers with evidence. Forensic accountants utilize economic theories, business information, accounting standards and audit standards and procedures, data management & data analysis techniques, financial reporting systems for fraud detection and gathering evidence. The Forensic Accountants provide fraud investigation services to various institutions such as Bank, Insurance Companies, Police Forces and Government agencies, etc. Forensic Accountants have been given the training to deal with business affairs. They gather a lot of information for producing evidences in the courts. Their duties are the same as audit

but different from the audit that is planned on a one-year or two-year basis. Because frauds can be committed anytime and anywhere, so their role is important to prevent fraud. Forensic Accountants have knowledge of Accounting as well as Law, so it is easy for them to assess frauds as well as prove the actual amount of fraud in court. They not only detect frauds but also prevent frauds. Their letter of engagement depends upon the nature of their cases. Every case is unique as the frauds are pre-planned and to exposing such planning becomes too difficult. Their analysis can be considered as genuine evidence in court so professionalism is required in conducting their duties. They are also referred to as fraud examiners or inspecting officers to lay down evidence during the trial of cases. The main steps in analysing the frauds are (a) Developing a plan (b) Collection of information (c) Analysis on this information and (d) Opinions regarding the fraud.



Figure 1: Concept of Forensic Accounting

1.3 Forensic Accountants – Skills and Qualities Required

The following are the competencies that a forensic accountant must possess.

- Communication skills
- Interviewing skills
- Sound judgement
- Relevant experience
- Commercial awareness
- Detail-Oriented approach
- An ability to analyse data thoroughly
- Organisation and time management skills
- The ability to produce quality written reports
- Ability to collect documentary evidences
- Work with law enforcement officers and agencies
- Creative thinking and Problem-solving skills

1.4 Professional Bodies for Certification in Forensic Accounting

The table gives a list of professional bodies through which one can become a qualified Forensic Accountant. Apart from the above mentioned courses, there are many Certification programmes conducted online, on-campus and hybrid globally.

Table 1: List of Professional Bodies for Certification in Forensic Accounting

S. No.	Qualification	Granted By	Country
1.	Certified Forensic Accounting Professional (CFAP)	India Forensic Center of Studies	India
2.	Certificate Courses on Forensic Accounting & Fraud Detection	ICAI	India
3.	Certified Global Forensic Accountant (CGFA)	International Institute of Certified Forensic Accountants (IICFA)	USA
4.	Chartered Certified Forensic Accountant (CCFA)	International Institute of Certified Forensic Accountants (IICFA)	USA

S. No.	Qualification	Granted By	Country
5.	Certified Professional Forensic Accountant (CPFA)	Institute Certified Forensic Accountants (ICFA)	USA
6.	Certified Forensic Accountant Analyst	Institute Certified Forensic Accountants (ICFA)	USA
7.	Certified Fraud Examiner (CFE)	Association of Certified Fraud Examiner (ACFE)	USA
8.	Master Analyst in Financial Forensic (MAFF)	National Association of Certified Valuators and Analysts (NACVA)	USA
9.	Certified Forensic Auditors (CFA)	Forensic Auditors Board of England and Wales (FACB)	England and Wales

1.5 Various Users of Forensic Accounting

Nowadays most companies irrespective of their size have started appointed forensic accountants so that their assets are safe. Larger accounting firms as well as many medium sized firms and police and government agencies have forensic accounting departments. They have several kinds of services to be rendered to their client these may include services in the nature of insurance claim, personal damages and intellectual property rights etc.

Banks: Banks and other Financial Institutions are at risk of various fraudulent practices, such as fraudulent borrowers, cybercrimes, and identity theft. So they require trained professionals to mitigate these kinds of threats through risk assessment.

Insurance companies: The main motive of forensic accounting in Insurance Companies is to assess the economic loss of each case. Forensic Accountants evaluate a claim amount and make a recommendation on payment to the insurance company.

Courts: There are some cases where the forensic accountant can provide great assistance include shareholder/partner disputes, breach of contract, white-collar criminal investigations, and bankruptcy arena.

Police force: Forensic accounting helps police to solve crimes forces by using various methods.

Government agencies: Forensic accountants conduct financial analysis and provide litigation support in both civil and criminal matters.

2. Objectives of the Study

1. To study the evolution and concept of forensic accounting.
2. To study the skills and qualities required by forensic accountants.
3. To study the professional bodies that certifies forensic accountants.
4. To study the various uses of forensic accounting.
5. To study the role of forensic accounting in fraud investigation.
6. To study the approaches to forensic accounting assignment.

3. Research Methodology

Nowadays frauds prevail in each kind of business. Any fraud in business should be prevented and detected since it affects the parties involved in the business. Forensic accounting is helpful in detecting fraud. Keeping this in mind, the present study was carried to outline the role of forensic accounting in fraud investigation. This study is based on the existing literature. We have studied books and research papers related to forensic accounting to figure out the role of forensic accounting in fraud investigation.

4. Forensic Accountants, Investigative Auditors, and Fraud Auditors

The qualities of the forensic accounting might measure up to a well-prepared Pizza. Just like a pizza base there exists a base of forensic accounting too and that is the knowledge of accounting. A middle layer is the scattered information on auditing and internal control. It resembles the spread of the cheese in Pizza. The upper layer i.e. topping of pizza is just a beautification part a solid arrangement of relational abilities, both composed and oral. It is only the beautification part. The ideal blend of the Pizza base, Cheese spread, and topping make the pizza flavourful and forensic accountant perfect.

In the lexicon of accounting, terms such as fraud auditing, forensic accounting, and investigative auditor are not clearly defined. But there are some distinctions among the three.

Forensic accountants, fraud auditors, and investigative auditors measure financial transactions of various authorities. The accountant prepares the report and does not include an opinion on the findings. In an investigation, an evidence cannot be considered to be immaterial, even the smallest clue can be the largest evidence to the investigation process. Forensic accountants, Fraud auditors, and fraud investigators (i.e., all known as forensic accounting combinedly) set up things instead of taking them independently.

Forensic accounting goes beyond numbers while examining any kinds of financial data and Information Systems. Fraud audit involves assessment of risk, analytical procedures, and insuring compliance with standards of Auditing. Investigation audit deals with gathering evidences and clues through Scientific and Latest Investigation tools and techniques.

5. Role of Forensic Accounting in Fraud Investigation

Fraud is an intentional deception to gain illegally or not provide a person the right information. Frauds can contravene civil law or criminal law or sometimes it may not cause loss of money or rights but can still become a cause of civil or criminal crimes. The motive of committing fraud may be to obtain a gain of monetary or non-monetary nature. All the sectors of the economy are susceptible to frauds. The increasing incidence of financial frauds draws attention towards a very significant matter of concern as the Indian economy is continuously witnessing incidences of such frauds thus damaging the spinal cord of the Indian economy. Financial losses have been increasing day by day which shows that the financial sector is dealing with frauds, which needs thorough attention. There are various kinds of frauds such as securities fraud, insurance fraud, bankruptcy fraud, financial statement fraud, and tax fraud, etc.

Frauds can be classified on the following basis:

1. Beneficiary party:

- a. Frauds committed for only the benefit of the company.
- b. Frauds committed for the benefit of the individual.

2. Methods of committed frauds:

- a. Frauds done with the help of technology are covered under technological frauds. These kinds of frauds prevail in the bank sector.

- b. Frauds done by an employee of a company are covered under occupational frauds.

Forensic accounting provides analysis of financial information that provides evidences to the court that forms the basis for dispute resolution. In the context of fraud investigation, the knowledge and experience of a forensic accountant are useful as a consultant. Frauds generally involve complex accounting, tax and financial matters that require the specialized knowledge and expertise of highly trained accounting, finance and tax professionals. Forensic accountants play an important role in any investigation of fraud because they understand accounting systems and internal check and internal audit systems and fund flow into and out of the company. As an expert assists in case strategy, the accounting professionals know the rules of obtaining evidence, what documents to be required, whom they should interview, and, in civil cases, how to quantify the damages arising out of a particular situation. Good forensic accountants must know fraud practices both in the general industry and specific industry because some specific industries such as insurance and banking are prone to fraud. Forensic accountants are not legal practitioners rather they seek evidences in conducting their examination unbiasedly and objectively. The task of the forensic accountant is not only restricted to an investigation but also to an expert witness that assists in litigation. Forensic accounting provides help of an accounting nature in any kind of fraud. A typical fraud investigation assignment involves calculating the economic loss resulting from a breach of contract. In this capacity, the forensic accounting professional quantifies losses suffered by parties involved in legal cases and can assist in resolving disputes even before they reach the court. Every forensic accounting case does not necessarily end up in court. But if a matter reaches the court, the forensic accountant acts as an expert witness. The duty of an expert witness is to help the court to reach on a conclusion on matters. The contribution of a forensic accountants to fraud investigation will depend substantially on the nature of each case because fraud investigation involves a procedure to determine the fraud's nature and the extent and also determines the affected party. Forensic accountants are appointed to make an assessment of the financial losses involved. The appointment relating to civil disputes may be categorised into several categories- calculating and quantifying financial losses and economical damages, whether caused by a breach of contract, disagreement relating to company acquisitions,

breach of warranties, and business valuation. Forensic accountants assist in claims related to professional negligence too where they scrutinize the work of other professionals. It provides the help of an accounting profession in pending cases.

Evidences can be obtained from two primary sources by forensic accountants. The first source of evidence is the accounting document and vouchers. The forensic accountant's experience will decide what issues are clearly supported by accounting records only and which ones need some additional evidence. The second source of evidence is an interview. Interviews are conducted with key personnel, outsiders, and ultimately the suspected ones. The attributes of the interviews will depend on the nature of the fraud. The forensic accountants must also be a psychologist that can be able to determine the possibility that any given suspected one is a fraudster.

Forensic accounting and traditional audit are similar in nature, but the analysis done by the forensic accountant is considered to be superior. Fraud investigation approach adopted by forensic accounting is significantly different from the traditional auditor/accountant. Forensic accountants possess an intuitive ability to investigate fraud but a traditional accountant does not have the experience to perform an investigation. The methodology applied by forensic accountants is broader hence detection of fraud becomes easy. Forensic accounting controls all possible frauds what a traditional audit fails to do. Forensic accounting is stronger than traditional audit to control fraud.

In summary, a forensic accountant can assist in fraud investigation in the following ways:

- Providing the key document that should be made available as evidence. This is very necessary to support a claim.
- Review of the necessary documents at the initial stage of the case in order to identify possible areas of committing fraud.
- Advising lawyers on the matters.
- Review of the opponent expert's report.
- Assistance in dispute settlement.
- Prepare a detailed report on evidences in a language that can be readily understood by a person of non-accounting background.

6. Approach to the Work

Each assignment of a forensic accountant is unique in its own way. A forensic accountant will adopt different procedures to complete an assignment according to the nature of the assignment. The basic approach that the forensic accountants follow is given below:

- **Meeting with the client:** First of all, a forensic accountant will meet the client so that he can have a better understanding of the assignment. So that he can take the necessary steps to resolve that matter.
- **Preliminary investigation:** A preliminary investigation should be done before determining the actual procedure. It will to develop a detailed plan.
- **Develop a detailed plan:** This plan will be prepared based on preliminary investigation and the conclusion of meeting with a client. It will determine the objectives to be achieved and the methodology.
- **Gather necessary evidences:** The forensic accountant will gather necessary evidences as per the requirement of the case. For this purpose, he will conduct an inquiry and it will help the auditor to gather evidences about the employees involved in the particular transactions and enable him to obtain more detailed information about the case. This procedure also has its own purpose. It also assists the auditor to obtain information from other related parties and assists the auditor to observe what wrong might have occurred. In this stage, the forensic auditor can know if the fraud or any inappropriate activities have happened. This procedure seeks help from the management and employees of the company. However, the inquiry provides the knowledge for the forensic auditor to have an understanding of the facts.
- **Analytical procedure:** Before the analytical procedure a forensic auditor should always pay attention to the evidences to ensure that the data they use for analysis is accurate. Otherwise, the result of the analytical procedure cannot be used as evidence and it can lead to make a wrong conclusion.
 - Quantify the loss
 - Tracing of assets
 - Utilizing the computer application of data analysis
 - Utilizing various tools to explain the analysis

- **Report:** At the end, he will prepare a report. A report consists of a lot of information about the assignment, that are given below:
 - The nature of assignment
 - Scope of fraud investigation
 - Methodology adopted
 - Conclusion
 - Limitation of the analysis

6. Conclusion

Nowadays frauds are increasing in business at an alarming rate. That's why it has become essential to prevent and detect such frauds. The traditional auditors are not experienced enough to identify and report such frauds. Increasing frauds have created career opportunities to this profession. Forensic accounting is the rapidly growing area of accounting that enables a business to enhance the chance of success and reduces frauds. Thus several businesses need to employ forensic accountants to install fraud proof internal control systems in their organizations. This study has given an outline the role of forensic accounting in fraud investigation. The role of forensic accounting is extraordinary in fraud detection and fraud prevention.

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