

FORENSIC ACCOUNTING

New Era of Accounting and its Opportunities



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TODAY WE WILL DISCUSS...

MEANING OF
AUDIT

DIFFERENCE
BETWEEN
FORENSIC
AND OTHER
AUDITS

MEANING OF
FORENSIC
AND
FORENSIC
ACCOUNTING

NEED OF
FORENSIC
ACCOUNTING

SCOPE OF
FORENSIC
ACCOUNTING

FRAUD
COMPONENT
IN FORENSIC
ACCOUNTING

THE FRAUD
TRIANGLE

WAYS OF
CONDUCTING
FRAUD

FRAUD
DETECTION
TECHNIQUES

METHODOLGY
OF FORENSIC
ACCOUNTING

FORENSIC
ACCOUNTING
BROAD
METHODS

FORENSIC
ACCOUNTING
TECHNIQUES

FORENSIC
ACCOUNTING
STANDARDS
(FAIS)

OPPORTUNITIES
FOR
PROFESSIONALS
IN FORENSIC
ACCOUNTING

CONCLUSION

WHAT IS AUDIT?

- An **Audit** is an unbiased examination and evaluation of the financial statements of an organization.

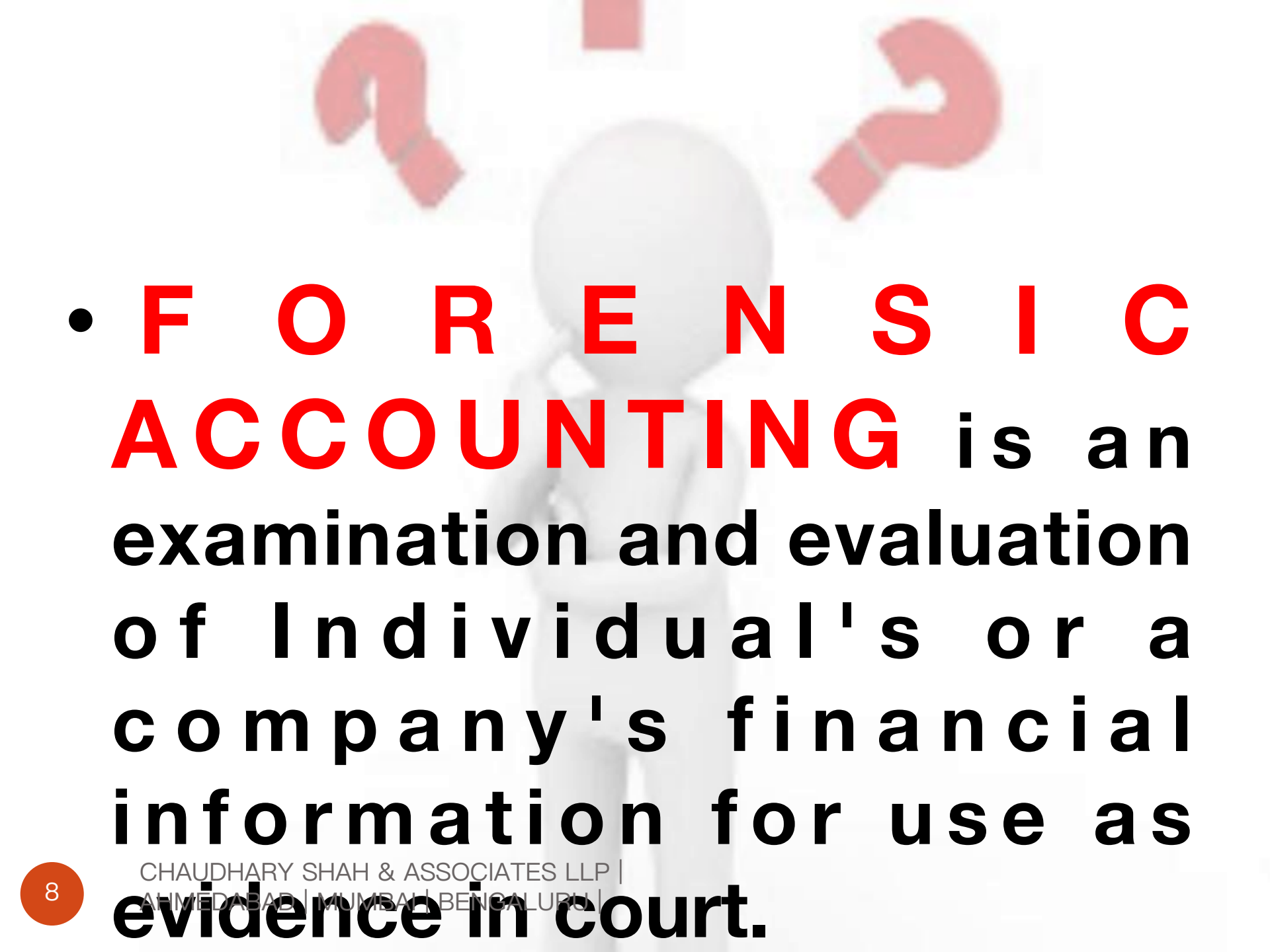


WHAT IS FORENSIC ?

- **F o r e n s i c** is an investigation used to gather facts or evidence to be disclosed in a court of



WHAT IS FORENSIC ACCOUNTING ?

- 
- **F O R E N S I C**
ACCOUNTING is an examination and evaluation of Individual's or a company's financial information for use as **evidence in court.**

WHAT IS DIFFERENCE IN FORENSIC ACCOUNTING THAN OTHER AUDITS ?

- **O**ther **A**udits are conducted in order to provide an opinion on the given financial data of the company. The report of such audits are generally not used as an evidence in court of law

- **FORENSIC ACCOUNTING** is an examination and evaluation of Individual's or a company's financial information for use as evidence in court.

FORENSIC ACCOUNTING INVESTIGATION

DISCOVER



ANALYZE



REPORT



**FINDING
EVIDENCE OF
FINANCIAL CRIME**

**DETERMINING
WHAT WAS
DONE AND HOW**

**LAYING OUT
THE CASE FOR
AUTHORITIES**

HISTORY OF FORENSIC ACCOUNTING

- Forensic accounting was not formally defined until the **1940s**.
- Originally ***Frank Wilson is credited with the birth of forensic accounting in the 1930s.***
- When Wilson was working as a CPA for the US Internal Revenue Service,
- he was assigned to investigate the transactions of the infamous gangster Al Capone.

NEED OF FORENSIC ACCOUNTING

- Modern businesses are bound to find cleverly masked fraudulent activity when they go through their books, but only when **FORENSIC ACCOUNTING**ors find such evidence.
- Growing cyber crimes, failure of regulators to track the security scams, series of co-operative banks bursting - all are pinpointing the need of **FORENSIC ACCOUNTING**

NEED OF FORENSIC ACCOUNTING

- A **FORENSIC ACCOUNTANT** can ensure the integrity and transparency of financial statements by actively investigating for fraud, and can help to create a positive working environment where employees do not indulge themselves to abuse their responsibilities.
- So, by helping companies to prevent and detect frauds the **FORENSIC ACCOUNTING**ors can help to establish a comprehensive Corporate Governance Policy.

SCOPE OF FORENSIC ACCOUNTING

- **Given the nature and types of fraud in India, the Reserve Bank of India (RBI) has compulsorily made forensic accounting audits mandatory for all banks.**



- **The establishment of the Serious Fraud Investigation Office (SFIO) in India has become the turning point for forensic accountants.**

SCOPE OF Forensic ACCOUNTING

Due
Diligence
and M & A

Anti-Bribery
Anti-
Corruption

Fraud Risk &
NPA
Assessment

Fraud
Investigation

Forensic
Technology

Whistle
Blowing

Litigation
support

Forensic Accounting helps in detecting



FRAUD COMPONENT IN FORENSIC ACCOUNTING

- A **FORENSIC ACCOUNTING** mainly focuses on Fraud detection.
- So It is very important to understand fraud before we understand **FORENSIC ACCOUNTING**



MEANING OF FRAUD

- **Fraud** refers to an intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage
- The notable points of above definition are :-
 - Intentional act
 - Those charged with governance
 - Third parties
 - Deception
 - Unjust advantage



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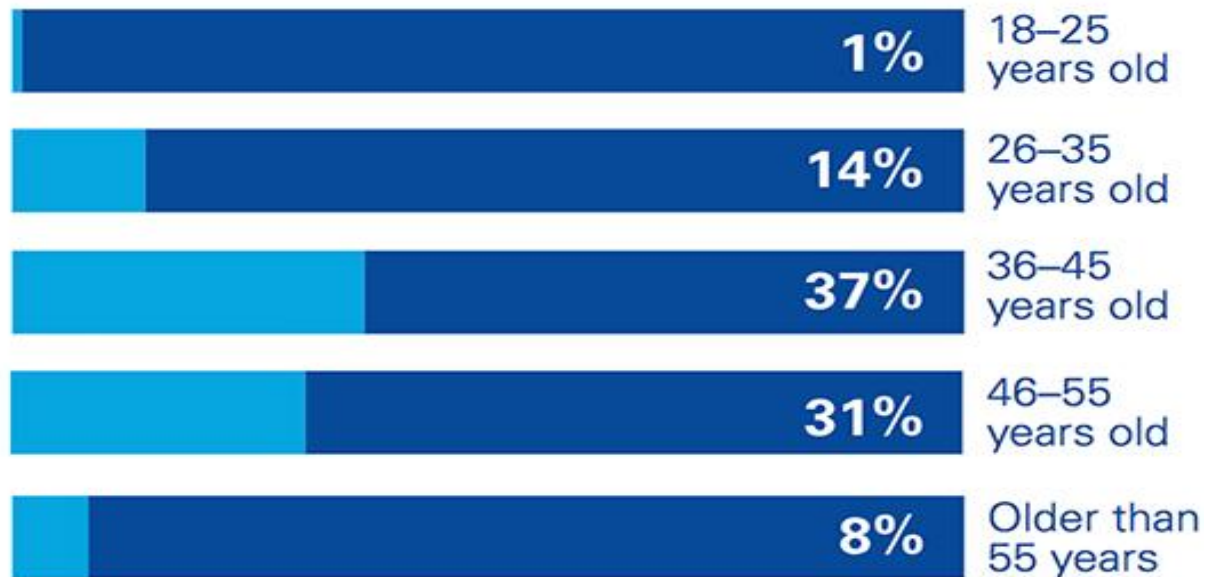
PROFILE OF FRAUDSTERS

A Fraud sick person generally shows the following symptoms:–

- **Experiencing financial difficulties.**
- **Unusually close association with vendors/customers.**
- **Excessive work pressure.**
- **Control issues; unwillingness to share duties.**
- **Complaints about pay.**

PROFILE OF FRAUDSTERS

Age of the fraudster



THE FRAUD TRIANGLE

- A Fraud Triangle is a tool used in **FORENSIC ACCOUNTING** that explains three interrelated elements that assist the commission of fraud

- **Pressure** (motive),

- **Opportunity** (ability to carry out the fraud)

- **Rationalization** (justification of dishonest intentions).



THE FRAUD TRIANGLE

Perceived Opportunity

- Weak internal controls
- Ineffective monitoring of controls
- Assets susceptible to fraud

Financial pressure:

- Greed
- Addictions
- Poor credit rating or cash management

Work pressure:

- Dissatisfaction with pay
- Overlooked for promotion

Fraud Triangle

- "I'll pay it back."
- "I deserve a pay raise."
- "It's for a good purpose."

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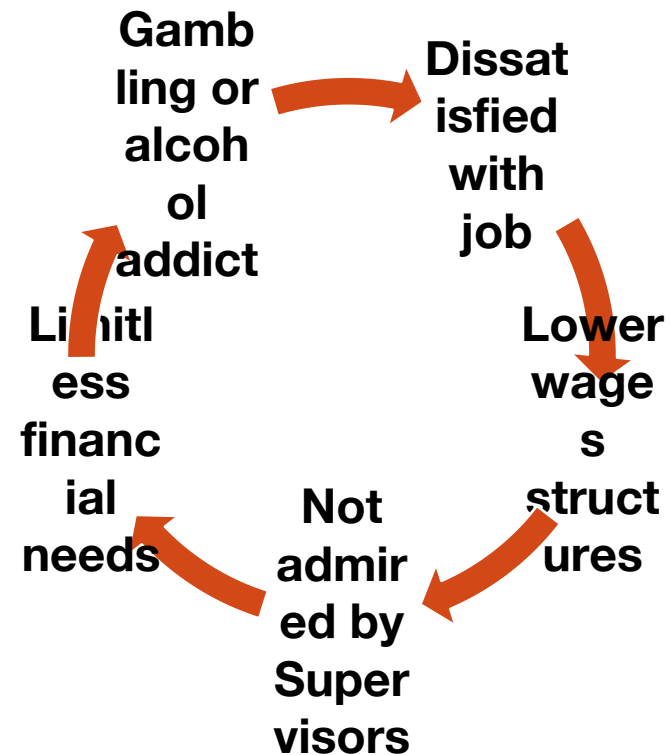
Perceived Pressure

Rationalization

THE PRESSURE FACTORS

- **Force which makes some one to do some act.**
Pressure is what causes a person to commit fraud.
- **Desperate people do Desperate things.**
Pressures comes from many forms such as :
 - ❑ **Pressure with Financial Contents**
 - ❑ **Pressure stemming from Bad Habits**
 - ❑ **Pressures Related With Jobs**

EXAMPLES OF THE PRESSURE FACTORS



THE OPPORTUNITY FACTORS

- **These factors directly involve top management and owners of the business in particular.**
- **The control structure of a business and fraud has inverse correlation i.e. Better the control structure; lower the scope of committing fraud and vice versa.**



EXAMPLES OF THE OPPORTUNITY FACTORS

- ❑ Weak moral policies**
- ❑ Undisclosed contracts made with third parties and partners**
- ❑ In capabilities to assess the quality of job performed by the employees**
- ❑ Absence of well disciplined environment in which fraudsters will be published**
- ❑ Ignorance, indifference and inabilities of top management**
- ❑ Lack of healthy audit work.**

THE RATIONALIZATION FACTORS

- **Rationalization** refers to an individual's justification for committing fraud.
- **Examples of common rationalizations that fraud committers use include:**
 - ❑ "They treated me wrong"
 - ❑ "Upper management is doing it as well"
 - ❑ "There is no other solution"



FRAUD STAKEHOLDERS

- Frauds are classified as per the **peoples that are affected by the fraud** and they are as follows:
 - 1. Creditors
 - 2. Institution/ Business
 - 3. Financial Institution's and Intermediary
 - 4. Federal or local government
 - 5. Financial Markets (Stock Market)
 - 6. Investors

WAYS OF COMMITTING FRAUD

1

- **Fictitious income**

2

- **Improper expenses recognition**

3

- **Incorrect asset/liabilities valuation**

4

- **Hidden liabilities and secret reserves**

5

- **Unsuitable disclosures.**

6

- **Deception such as manipulation, falsification or alteration of accounting records or supporting documents.**

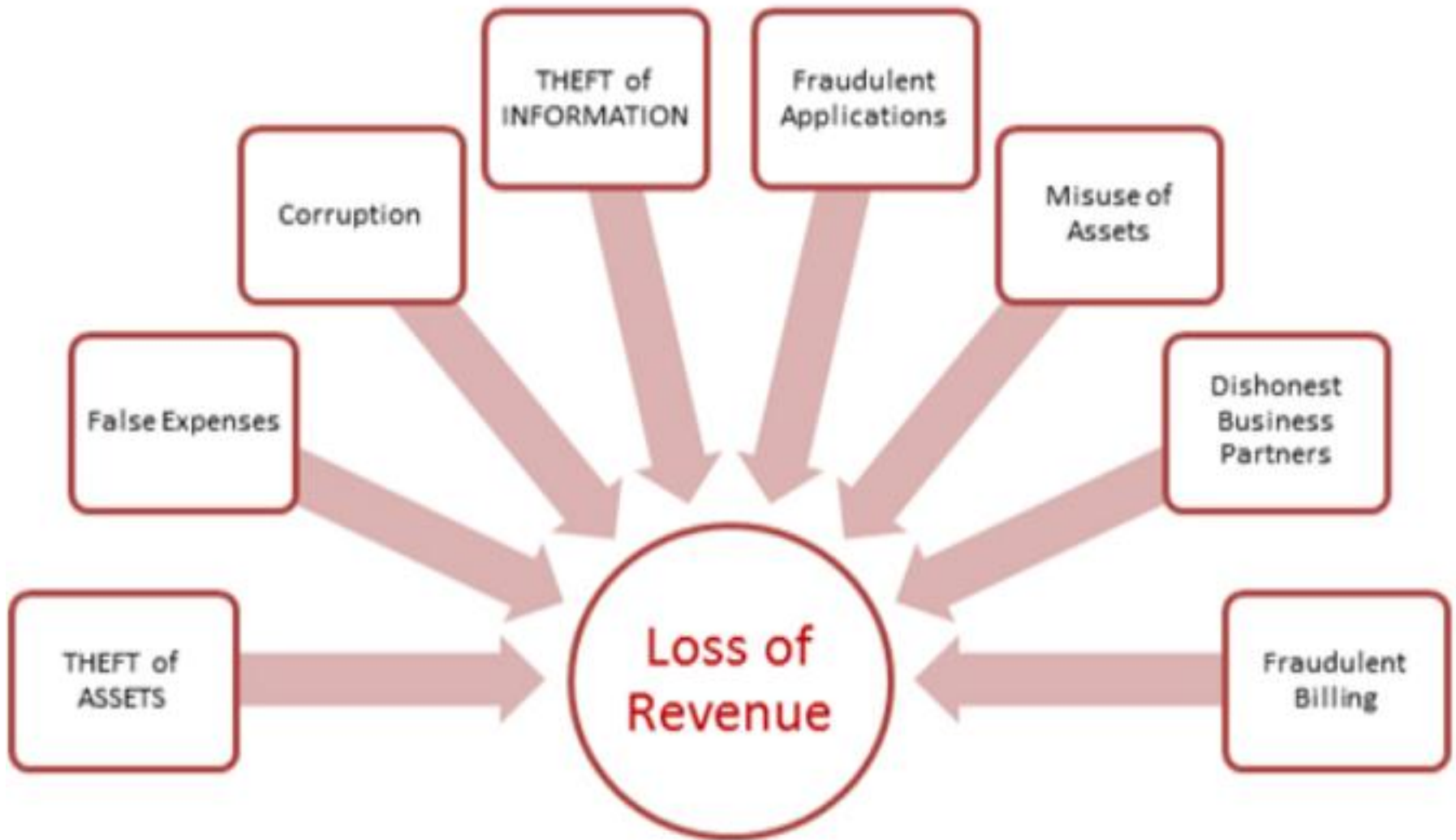
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- **Misrepresentation in or intentional omission from the financial statements, significant events, transactions or other information.**

8

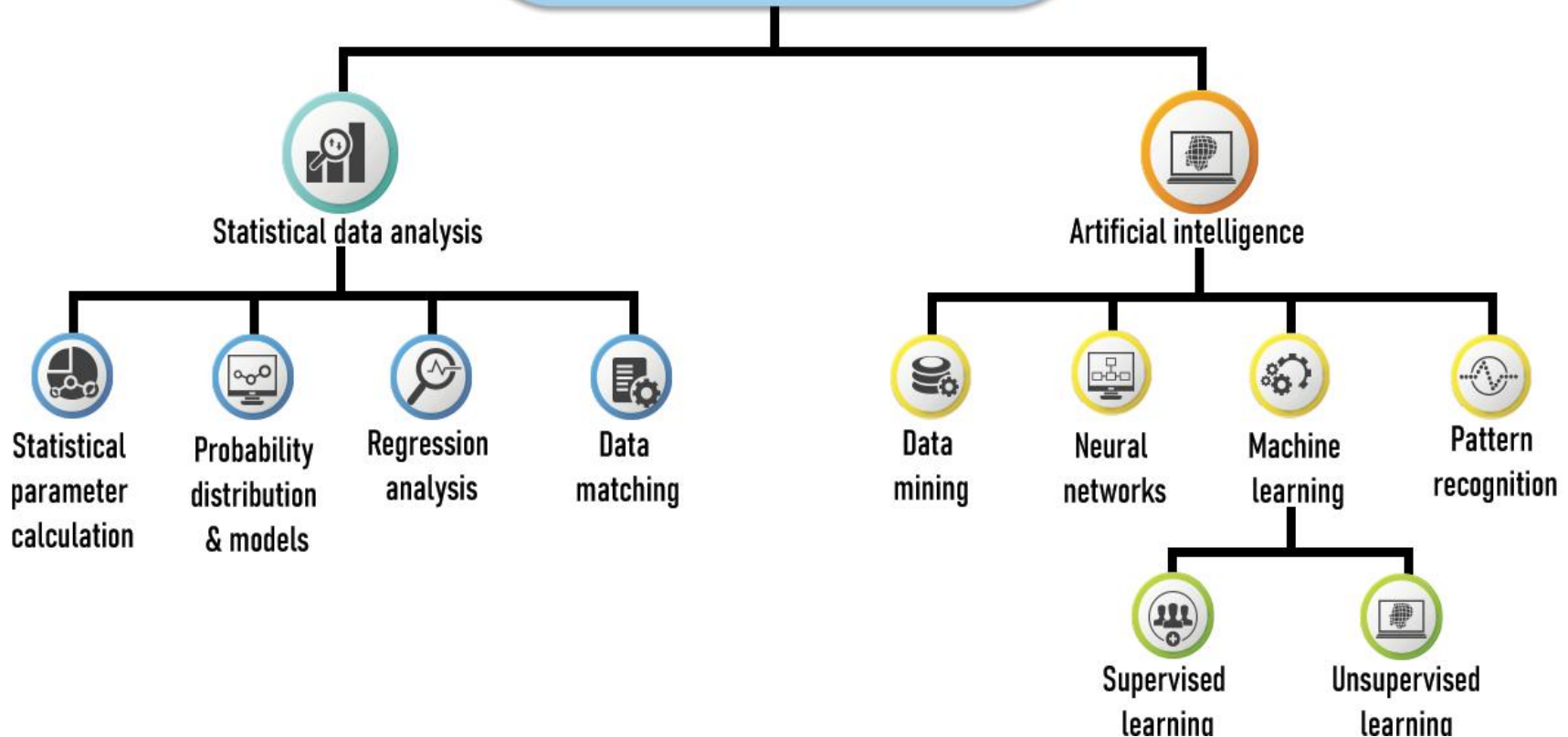
- **Intentional, mis-application of accounting principles**

MAJOR TYPES OF FINANCIAL FRAUDS



SOME FRAUDS DETECTION TECHNIQUES

TYPES OF FRAUD DETECTION TECHNIQUES



PNB CASE STUDY



The graphic features the Punjab National Bank logo at the top, which includes a yellow stylized 'P' icon and the text 'punjab national bank ...the name you can BANK upon!'. Below the logo, the text 'RS 11,400 CRORE' is displayed in large, bold, black letters. Underneath this, the word 'FRAUD' is written in even larger, bold, black letters, enclosed within a white rectangular box with a black border. To the left of the 'FRAUD' box is an illustration of a modern bank building with 'BANK' written on its facade. To the right is an illustration of a hand holding a magnifying glass over a document, symbolizing investigation or fraud detection.

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PNB CASE STUDY

- Jeweller Nirav Modi wants to import diamonds to design high-end collection. He approaches PNB and asks for a Letter of Undertaking (LOU)
- In PNB's case, LoUs had been issued by the branch officials through SWIFT without the approval of the competent authorities and the necessary documents of import
- Not knowing Nirav Modi or his credit history, the overseas bank extends credit based entirely on PNB's LOU.
- The money was not paid back by Nirav Modi, By rolling over the credit, he had ensured that subsequent LoUs repaid the dues on the earlier LoUs.
- This scam worth **Rs. 14,000 crores** became public on **Jan 29, 2018** after whistle blowing by a PNB official.
- Later BDO India was hired to carry out the forensic audit and uncover the truth of money rolling

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SATYAM CASE STUDY



ANATOMY OF A FRAUD

The genesis of the fraudulent financial engineering at Satyam Computer Services Ltd. but the facts started tumbling out after the company's aborted bid to buy the US-based company and Maytas Properties, which in turn was a part of sorts in India's corporate world.

CRACKING THE SATYAM SCAM 2009

It all began in 2008. Satyam Computer Services began to show a sharp decline in profits and revenues to show better financial performance. Analysts prop up a boost in the company's share prices. The promoters' quietly began to dilute shares at prices that reflected inflated profits.

It now appears this was part of a comprehensive plan. The price was gradually reduced from 25.6 per cent in March 2008 to 8.74 per cent in March 2009 (see attached table).

Meanwhile, Satyam's scale of operations began to grow manifold. For the company, it presented a complex problem as it had to misrepresent facts to keep on showing healthy profits. The gap between actual operations and reported figures reflected in the books of accounts continued to grow.

As the company put it, "The company's attempt to restructure its assets and cash out from estate ventures selling Maytas Infrastructure Properties to Satyam for an estimated \$1.6 billion. Did Satyam



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SATYAM CASE STUDY

- The founder and chairman of Satyam Computers, **B. Ramalinga Raju** created **false invoices** to show **inflated sales** which artificially inflated the accounts receivable account thereby **inflating the company's revenues**
- Mr. Raju **forged** board of director resolutions. Mr. Raju shipped money to offshore accounts and tax havens and re-routed it back to india for his own use...**money laundering**
- Mr. Raju and others on the inside offloaded worthless stock and participated in **insider trading**
- Even the Statutory Auditors of Satyam – PWC India was found **guilty**
- Disclosed on **Jan 7, 2009**, It was biggest accounting fraud **amounting over Rs. 7,000 crores** in the country which ran almost **14 years** and gained recognition to the forensic accounting as the profession.
- Satyam Share price fall to Rs. 11.5 after that day compared to the previous height of Rs. 544

ABG SHIPYARD CASE STUDY

₹22,842 crore

Amount CBI says 28 banks lost in the ABG Shipyard fraud

₹7,089 crore

ABG Shipyard's dues to ICICI Bank

₹2,925 crore

Size of SBI's exposure to ABG Shipyard

₹8.35 lakh crore

Indian banks' NPAs as of March 2021

THE 'FRAUD'

The four instances of alleged misappropriation of funds by Rishi Agarwal and ABG Shipyard officials



Rs 1,415 crore was allegedly transferred through vendors and group firms and round-tripped back to the company. 'Round-tripping' is circulation of money across jurisdictions, culminating in its return to the jurisdiction of origin, usually as foreign investment.



ABG Shipyard invested in **\$43.5 million (Rs 326 crore)** worth of securities of ABG Singapore. According to EY's forensic audit, the money may have been siphoned out of the system.



ABG Shipyard transferred **Rs 83 crore** to related firms, but the assets were allegedly not shown as part of the company's asset pool.



Under restructuring, lenders set up a trust and retention account (TRA). The money coming into the company during the period is held in the TRA so that lenders can monitor its use. The SBI says over 50 per cent of ABG Shipyard's receipts had been outside this arrangement—a breach of the restructuring agreement.

FORENSIC ACCOUNTING Methodology

- **FORENSIC ACCOUNTING** involves efforts to resolve allegations or signs of fraud when the full facts are unknown or unclear.
- Therefore, it seek to obtain facts and evidence to help establish what happened, identify the responsible party, and provide recommendations where applicable.
- We should adopt such methods which enable us to find supportive evidences for our audit findings.

FORENSIC ACCOUNTING Methodology

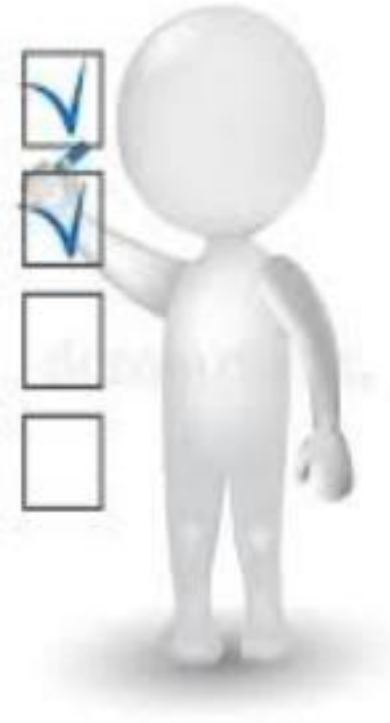
- **When conducting the FORENSIC ACCOUNTING to resolve signs or allegations of fraud, the FORENSIC ACCOUNTINGor should:**



- **Assume litigation will follow.**
- **Act on prediction.**
- **Approach cases from two perspectives.**
- **Move from the general to the specific.**
- **Use the fraud theory approach.**
- **Analyzing and testing of data**
- **Communicating Results**

FORENSIC ACCOUNTING Broad Methods and Procedures

- **Data Analysis**
- **Analytical Procedures**
- **Risk Assessment**
- **Inspection**
- **Observation**
- **External Confirmation**
- **Re-calculation**
- **Re-Performance**
- **Inquiry**
- **Interviews**
- **Interrogation**



Important FORENSIC ACCOUNTING Techniques

✓ Statistical and Mathematical Techniques

- Trend Analysis :-

- Careful review of the historical norms and investigating the trend deviations.
- Typical trend lines for analysis of financial statements are for :- revenues, gross margin, net profit margin, account receivable and debt.

Important FORENSIC ACCOUNTING Techniques

✓ Statistical and Mathematical Techniques

- Ratio Analysis :-

➤ A Ratio is a relative magnitude of two selected numerical values taken from an enterprise's financial statements. Most relevant ratio analysis is:

1. Gross margin and sales growth
2. Price to book and price earning
3. Return on assets and return on equity
4. Current ratio
5. Quality of earning and effective cash tax rate

Important FORENSIC ACCOUNTING Techniques

- ✓ Technology based/ digital forensic techniques
- Computer Aided Audit Tools (CAATS) :-
 - It is the practice of using computers to automate the IT audit processes.
 - The CAAT tool supports the forensic accounting in which larger amount can be diverted to the analytical form and it also prompts where the tool detects the fraud.

Important FORENSIC ACCOUNTING Techniques

- ✓ Technology based/ digital forensic techniques
- Data Mining :-
 - Data mining is an analysis process used to examine data sets or metadata to identify patterns, anomalies, and trends to answer business queries and provide predictive value for future events.
 - It incorporates algorithms to explore, analyze, classify, relate, and partition data sets

Important FORENSIC ACCOUNTING Techniques

✓ Analytical Procedures

- Tests of reasonableness:-

- Identify questionable transactions indicating wide fluctuations from the normal ones in general or related to main objectives.
- Review questionable transaction documents for peculiarities, like improper account, classifications, pricing, invoicing, or claims, etc.

Important FORENSIC ACCOUNTING Techniques

✓ Analytical Procedures

- Off-Balance Sheet Transactions:-

- There are certain transactions not prima facie discussed in the financial statements and nor suitable disclosures made. Since these are intangible in financial statement.
- These may encompass, significant purchases/sales of raw materials and/or finished goods with only a particular dealer or group companies

Important FORENSIC ACCOUNTING Techniques

✓ Key Examples of Analytical Procedures

- Falling of Stock prices on market and increase on short selling activities of the company
- Resignation of the senior personnel of the company for personal reasons or other diplomatic reasons
- Selling of large number of shares by promoters, company officers and major trading house to the effect of insider's information and trading.
- Using complicated disclosure and accounting practices to make naive and novice investors fooled into believing the statements.
- Audit fees are far less in comparison to the other management, legal fees paid to auditors.
- Heavy Raw material transported in lorries or small vehicles

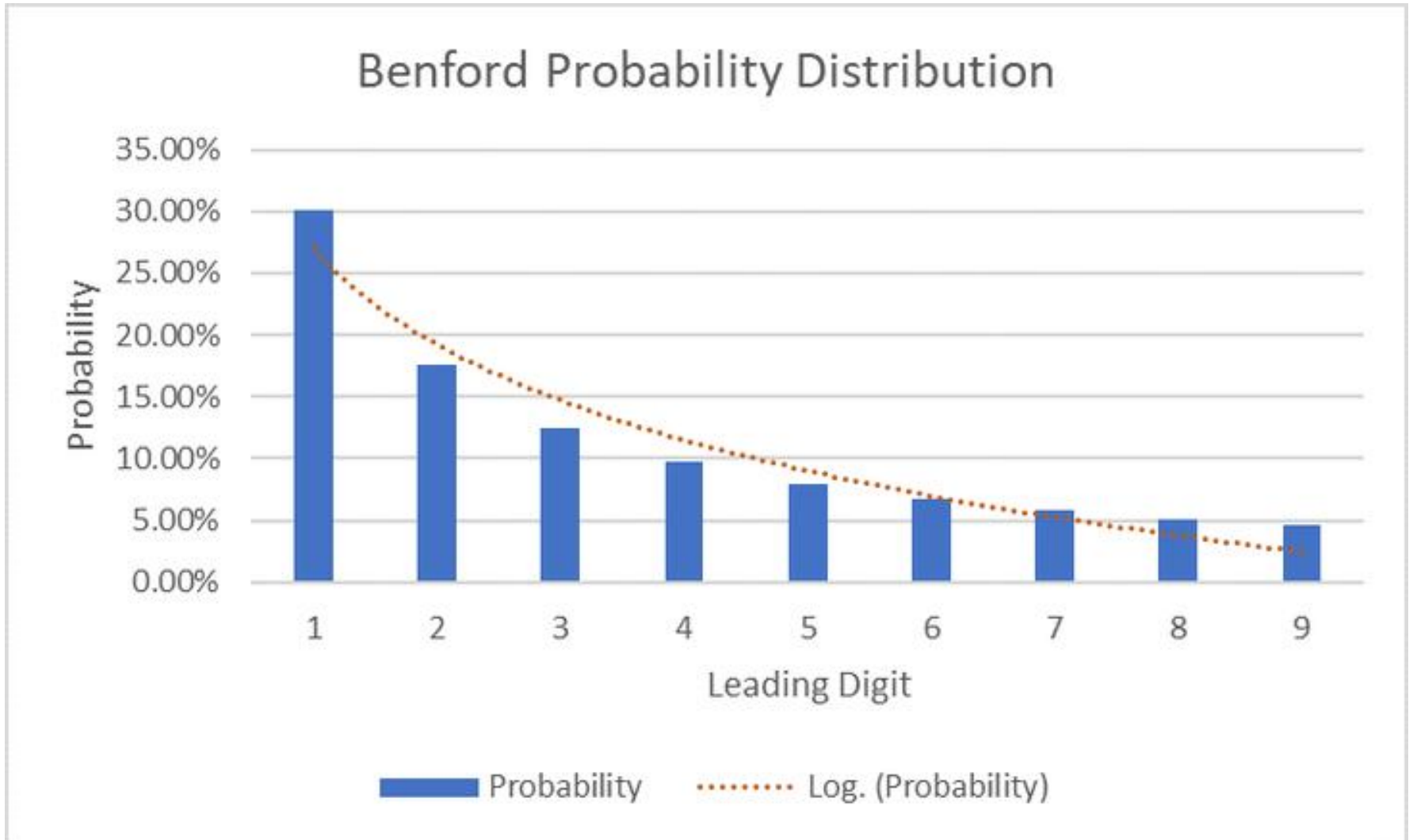


Important FORENSIC ACCOUNTING Techniques

✓ The Benford Law

- **Benford's law of anomalous numbers** states that generally, in naturally occurring collections of numbers, the leading digit is likely to be small. This means that the numeral 1 will be the leading digit in a genuine dataset 30.1 percent of the time; the numeral 2 will be the leading digit 17.6 percent of the time; and each subsequent numeral, 3 through 9, will be the leading digit with decreasing frequency.
- When we put the above data into a graph we get the Benford Probability curve. Auditors often compare the leading digits of financial transaction data, such as ledger entries, to a Benford curve to spot anomalies that may indicate fraud.

The Benford Law



Example of The Benford Law

- **An organization has alert thresholds set at \$500 and \$1,000. One of the bookkeepers has been writing bad checks for \$499 and \$999, just under the alert thresholds. After the organization performs an audit and compares the data from the books to the Benford curve, the bookkeeper is caught.**
- **In this situation, the digits 4 and 9 occur as the leading digits more frequently than they should in a natural dataset. This data does not conform to Benford's law and is cause for concern.**

Important FORENSIC ACCOUNTING Techniques

✓ INVESTIGATIONS OF IMPROPER RELATED-PARTY ACTIVITY

- **Related party transaction** occurs in the scope of corruption and commission where one party obtains unjust benefit from performing the transactions.
- This type of work is done when transaction are not performed owing to the fact that that ought to be done to be best interest of the shareholders, and are performed to the **benefit of the management.**

Important FORENSIC ACCOUNTING Techniques

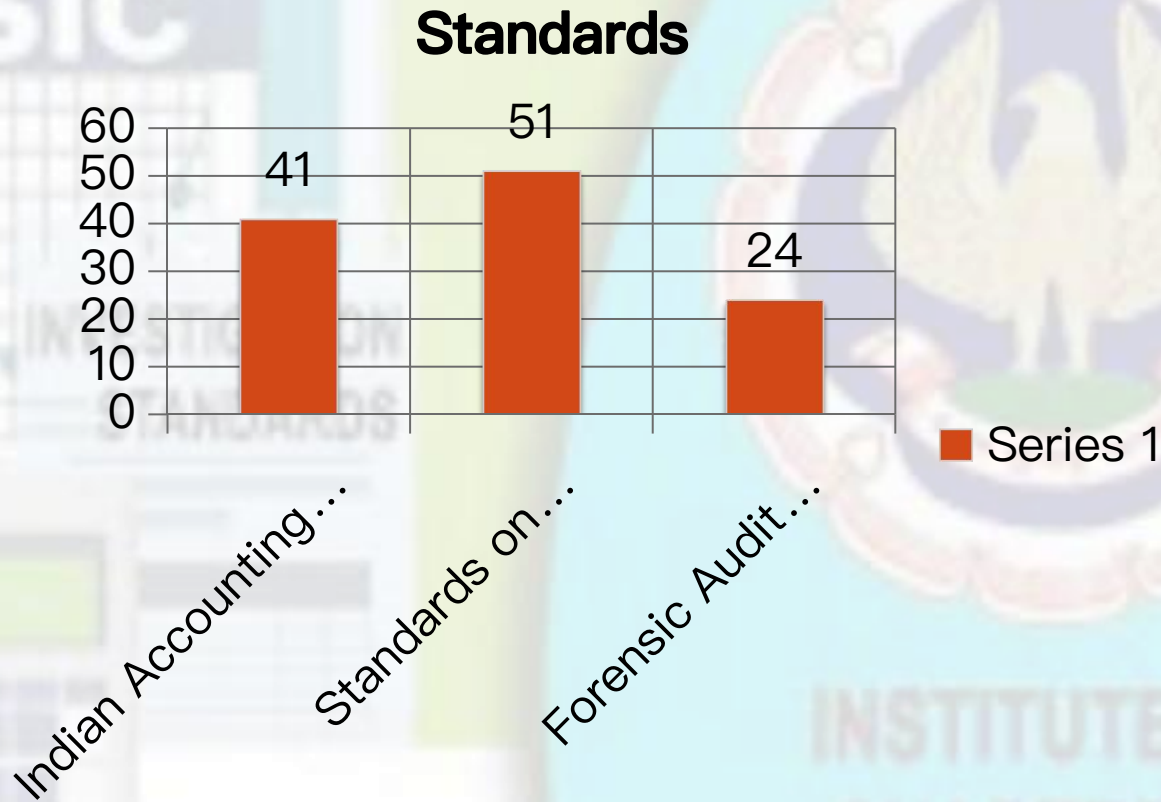
✓ EXAMPLES OF IMPROPER RELATED-PARTY ACTIVITY

- Purchase of major raw materials from one party or a single group of companies.
- Sale/Purchase to a party are higher than the arm's length price
- Accounts receivable is pending from a long time and no strict measures taken by the management for its recovery.
- Repetitive purchase of one companies stock even if prices are declining

STANDARDS ON FORENSIC ACCOUNTING

- The Institute of Chartered Accountants of India (ICAI) has released Forensic Accounting and Investigation Standards (FAIS) amidst rising cases of accounting, financial and loan irregularities.
- It is to be noted that currently, there are no standards or guidelines prescribed by any regulator or authority to monitor or regulate the functions of FORENSIC ACCOUNTING.

STANDARDS ON FORENSIC ACCOUNTING



FAIS Overview : STANDARDS ON FORENSIC ACCOUNTING

OVER-ARCHING DOCUMENTS

Preface

Frame-work

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440 Related and Connected Parties

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500 REPORTING

510 Reporting Results

(1)

600 QUALITY

610 Quality Control

(1)

OPPORTUNITY FOR PROFESSIONALS IN FORENSIC ACCOUNTINGS

- **FORENSIC ACCOUNTING IS AN EMERGING FIELD FOR PROFESSIONALS.**
- **THE NUMBER OF FRAUDS ARE INCREASING AND SO THE
NEED OF FORENSIC ACCOUNTINGORS**
- **BANKS AND OTHER REGULATORY BODIES ARE EMPANELING CAs AND OTHER PROFESSIONALS AND MAKING THEIR OWN PANEL OF FORENSIC ACCOUNTINGORS**

OPPORTUNITY FOR PROFESSIONALS IN FORENSIC ACCOUNTINGS

- **TO BE A CERTIFIED FORENSIC ACCOUNTINGOR, IT IS NECESSARY TO POSSESS A PROFESSIONAL CERTIFICATE FROM A RECOGNISED INSTITUTE AND SHOULD HAVE RELEVANT EXPERIENCE IN THIS FIELD.**
- **SOME RECOGNISED FORENSIC COURSES ARE FAFD, CFAP, CERTIFIED COURSE ON BANK FORENSIC ACCOUNTING, CERTIFIED VIGILANCE AND INVESTIGATION EXPERT, ECT...**

CONCLUSION

- **In summary, a forensic investigation is a very specialized and detailed type of engagement, which requires highly skilled team members who have experience not only of accounting and auditing techniques, but also of the relevant legal framework.**
- **There are numerous different types of fraud that a forensic accountant could be asked to investigate, which is likely to ultimately lead to legal proceedings.**
- **Forensic accountants must therefore receive specialist training in such matters to ensure that their credibility and professionalism cannot be undermined during the legal process.**

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