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FINANCIAL FRAUDS AND FORENSIC ACCOUNTING IN INDIA

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ABSTRACT:

Financial Fraud can be broadly defined as intentional act of deception involving financial transactions for the purpose of personal gain. Many fraud cases involve complicated financial transactions conducted by business professionals with specialized knowledge and criminal intent.

Financial Frauds are ever increasing in India and all over the world. In India we can name few scams say Satyam scam (2009), KetanParekh securities scam (2001), Speak Asia scam (2011), Shradha Chit fund scam (2013).

Forensic Accounting is the combination of the Accounting, Auditing and Investigation skills. Forensic accounting is the specialty practice area of accounting that describes engagements, which result from real or anticipated litigation. It is theuse of professional accounting skills in matters involving potential or actual civil or criminallitigation, including, but not limited to, generally acceptable accounting and audit principles; thedetermination of lost profits, income, assets, or damages; evaluation of internal controls; fraud;and any other matter involving accounting expertise in the legal system. However forensic accounting is a gross area of operations of which fraud examination is a small part.The main objective of thisarticle is to discuss frauds as well as the role and importance of forensicaccounting and a forensic accountant in detecting frauds.

Keywords: Frauds, Forensic accounting, ForensicAccountant.

INTRODUCTION:

Frauds:

Fraud is a deception

Fraud Examination is divided into three basic aspects:

- Fraud Detection
- Fraud Investigation
- Fraud Prevention

There is a very thin line between the fraud detection and the fraud investigation in India.

To explain it in a simpler manner the detection process is carried out by the auditor (or the employees performing the similar supervision functions). Fraud Investigation is the work of the law enforcement officials like police department in India and the prevention is the work of the management.

Types of frauds:

Following are the types of frauds:

1) Bank frauds

2) Corporate frauds
3) Insurance frauds
4) Cyber frauds
5) Securities frauds

Financial frauds in India:

Satyam Scam in India:

In a country's biggest corporate fraud involving about Rs.8,000 crore, iconic IT major Satyam was another disasterfollowing the shocking disclosure of accounts fudging byits founder, who then quit as chairman—leaving anuncertain future for the company and its 53,000 employees.It was the failure of audit committee chairman to raise theissue of frauds to the tune of Rs.2,000 crore lying inSatyam's current account, otherwise the scam could havesurfaced much earlier, referring to striking points in theRs.8000 crore scam. Satyam fraud may be first of its kindin India, but not the first such fraud of the world, wherefraud was given effect by fudging the books of accounts.

Security Scam: Harshad Mehta

By year 1990, Mehta became a prominent name in theIndian stock market. He started buying shares heavily. Theshares of India's foremost cement manufacturerAssociated Cement Company attracted him the most andthe scamster is known to have taken the price of thecement company from 200 to 9000 approx., in the stockmarket – implying a 4400% rise in its price. It was later revealed that Mehta used the replacement cost theory to explain the reason for the high-level bidding. The replacement cost theory basically states that older companies should be valued on the basis of the amount of money that would be needed to create another similar company. Mehta, along with his associates, was accused of manipulating the rise in the Bombay Stock Exchange (BSE) in 1992. They took advantage of the many loopholes in the banking system and drained off funds from inter-bank transactions. Subsequently, they bought huge amounts of shares at a premium across many industry causing the Sensex to rise dramatically. However, upon the exposure of the scam, Mehta was imprisoned.

Ketan Parekh's Scam

Ketan Parekh is a former stockbroker based in Mumbai who was convicted in 2008 for being involved in engineering the technology stocks scam in India's stock market in 1999-2001. He is currently disqualified from trading in the Indian market till 2017. Parekh and his associates also secured Rs 1,000-crore as loan from the Madhavpura Mercantile Co-operative Bank despite RBI regulations that the maximum amount a broker could get as a loan was Rs15-crores.

TELGI Stamp Scam

TELGI stamp was one of the biggest scam in India. This type of scam which are caused every now and then.Telgi and his two associates to ten years'each for their role in selling counterfeit stamps of Rs 17lakh face value to a legal firm in 1995. Financial magnitude in the entire fake stamp paper case masterminded by Abdul KarimTelgi amounted to only Rs 172 crore. Telgi clearly had a lot of support from other departments and institutions of government that are responsible for the production and sale of high security stamps.

UTI Scam:

The UTI scam involved the flagship US-64 scheme of UTI, which was meant to channel the funds of small investors into instruments bearing high returns. Gradually, US-64 developed an investor base of around 2 crore investors. The economic liberalization in India, coupled with the absolute opacity in the operations of UTI, led to a situation wherein the Government was forced to announce a huge bailout of about Rs 3,500-4,000 crores in an order to prevent default in payments to the investors. The consequences of such a situation are unimaginable. But the story does not end here. Later, it turned out that the UTI Chairman appointed at this time, Mr P S Subramanyam, along with a couple of executive directors, acted wrongly to selectively benefit a powerful coterie of brokers and industrialists, while at the same time, jeopardizing the interest of lakhs of small investors.

Frauds in different countries:

Enron collapse:

The Enron collapse is the biggest scandal in the history of US capitalism. In just 15 years, Enron grew from to be America's seventh largest company, employing 21,000 staff in more than 40 countries. It started out as a pipeline company, and transformed into an energy trader, buying and selling power. Among other businesses, Enron was engaged in the purchase & sale of natural gas, construction & ownership of pipelines and power facilities, provision of telecommunications services, and trading in contracts to buy & sell various commodities. It expanded into many diverse industries. From at least 1998 through late 2001, Enron's executives and senior managers
engaged in wide-ranging schemes to deceive the investing public about the true nature and profitability of Enron's businesses by manipulating Enron's publicly reported financial results and making false and misleading public representations.

WorldCom Scam:

WorldCom was one of the big success stories of the 1990s.It was a symbol of aggressive capitalism. Companyfounder Bernard Ebbers received $400 million in off-thebooksloans. The company found another $3.3 billion inimproperly booked funds, taking the total misstatement to $7.2 billion, and it may have to take a goodwill charge of$50 billion.An internal audit showed that transfers of about $3.06billion for 2001 and $797 million for the first quarter of 2002were not made in accordance with generally acceptedaccounting principles. In August 2002, an internal auditrevealed an additional $3.3bn (£2.2bn) of improperreported earnings—taking the total to more than $7bn,double the level previously reported. Over $3.3bn moneywas from the company's reserves, which wasmisrepresented as operating income.

Forensic Accounting:

"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. "Forensic accounting" is the practice of utilizing accounting, auditing, and investigative skills to assist in legal matters. Forensic accounting is the specialty practice area of accountancy that describes engagements that result from actual or anticipated disputes or litigation. According to AICPA (American Institute of Certified Public Accountants): "Forensic accounting is the application of accounting principles, theories, and discipline to facts or hypotheses at issues in a legal dispute and encompasses every branch of accounting knowledge." Forensic accounting is a combination of two key words forensic and accounting. While the term forensic means belonging to, used in, or suitable to court of law. Accounting is the system of recording, summarizing, analyzing, verifying business and financial transactions and reporting the results thereof. Forensic accounting as a specialized branch in the accountancy profession.

Therefore, forensic accounting is an aspect of accounting that deals with the relation and application of the system used to record and summarize business and financial transactions to a legal problem. Forensic accounting is not limited to the correctness of accounts; it encompasses accounting, investigative accounting, investigative audit, and litigation support. Forensic accounting is the new branch in accounting which has the sole aim of unearthing fraudulent activities within and outside an organization so far as the third party's action is in any way reflective on the activities of that organization. Forensic accounting is the science that deals with the relation and application of financial accounting, tax and auditing knowledge to analyze, investigate, inquire, test and examine matters in civic law and criminal law.

Techniques of Forensic Accounting:

- **Benford's Law:**It is a mathematical tool, and is one of the various ways todetermine whether error occurred is a case of unintentional errors (mistakes) orfraud. On detecting any such phenomenon, the error is subjected to adetailed scrutiny. The law states that fabricated figures (as indicator of fraud) possess adifferent pattern from random figures. The steps of Benford□s law are very simple. Oncethe error is decided, the left most digit of variableunder study extracted and summarized for entire population.
- **Theory of relative size factor (RSF):** It highlights all unusualfluctuations, which may be routed from fraud or genuine errors. RSF is measured as theratio of the largest number to the second largest number of the given set. In practice thereexist 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. Ifthere is any stray instance of that is way beyond the normal range, then there is a need toinvestigate further into it.
- **Computer Assisted Auditing Tools (CAATs):**CAATs are computerprograms that the auditor use as part of the audit procedures to process data of auditsignificance contained in a client's information systems, without depending on him.CAAT helps auditors to perform various auditing procedures such as: (a) Testing detailsof 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.
- **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.
- **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.

Forensic Accounting in India:

Forensic accounting is unique in that it combines accounting with investigation.These bloodhounds— as opposed to the watchdogs that are auditors attemptto sniff out fraudulent transactions from the financial records of banks andcompanies. Sherlock Holmes was probably the most famous practitioner But Kautilya wasthe first economist who openly recognized the need of the forensic accountants.He mentioned forty ways of embezzlement centuries ago.

Forensic accounting is still nascent in India. However, the nature of fraud inIndia has undergone a change. Reserve Bank of India has made forensicaccounting audit compulsory for banks in India. However banks are hesitant inapproaching certified fraud examiners, and are mostly dependent on theirinternal auditors.

A large global accounting firmbelieves the market is sufficiently large to support anindependent unit devoted strictly to 'forensic' accounting.All of the larger accounting firms, as well as, many medium-sized and boutique firms have recently createdforensic accounting departments. Forensic accounting, infact, integrates accounting, auditing, and investigativeskills to conduct an examination into a company's financialstatements. Broad-based knowledge (within the themeslisted above) is crucial to the success of entry-levelforensic accountants. Because forensic accounting isrelatively a new area of study, a series of workingdefinitions and sharing of corporate experiences should beundertaken and encouraged to ensure a commonunderstanding.

CONCLUSION:

Forensic accounting has been growing rapidly as a profession in the world and is accepted as a profession in countries such as Canada, Australia, the USA, and the UK is beginning to gain the importance that it deserves.

Forensic accounting in India has come to attention only recently due to rapid increase in Frauds and the white collar crimes and the belief that our law enforcement agencies do not have sufficient expertise or the time needed to uncover frauds.Applying the integrated financial fraud forensic analysis process model, obviously has some advantages in practice, providing forensic accountants and fraud auditors know the financial fraud process very well.

However, Forensic Accounting has tremendous potential as new area of practice for Indian Chartered Accountants. They should know how perpetrators commit fraud and the main characteristics of the various fraud schemes. This information can enable them to perform financial fraud investigation effectively or fraud prevention programs.

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