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## FORENSIC ACCOUNTING AND FRAUD

**Dr. R MARI SAKTHI**

Assistant Professor,

Department with Commerce with CA,  
AVP College of Arts and Science, Tirupur

&

**B. KIRUTHIKA & S. RAKSHITHA**

II- B.Com PA, Department of Commerce with CA,  
AVP College of Arts and Science, Tirupur

### *Abstract*

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*Forensic accounting is one of such options that don't get much limelight and attention in the career field as well as accounting field. But forensic accounting gets its business on when fraudulent activities get to their peak. Forensic accountant is always ready to investigate the crimes that revolve around the accounting and banking crime environment. Forensic accounting is an area where a forensic accountant examines financial information to detect and investigate financial fraud. ICAI has incorporated a Certified Course on Forensic Accounting and Fraud Detection for practising CAs. Using scientific tests to investigate a crime." Forensic accounting examines financial data for signs of suspected criminal conduct. Accounting, auditing, and investigative procedures are used by forensic accountants to determine whether a person or corporation has committed financial crimes such as fraud or embezzlement. A forensic accountant is a financial professional who specialises in investigating and analysing financial information for legal purposes.*

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**Key words:** *Forensic accounting, fraud, crime, business, finance*

### **Introduction**

Financial deceit, misappropriation, and dishonesty within the business realm pose substantial threats to organizations and their stakeholders. In response to this

challenge, the field of forensic accounting emerges as a critical tool for unravelling the intricate web of fraudulent activities. Forensic accounting, a specialized branch of accounting, goes beyond traditional

financial analysis. It involves a meticulous examination of financial records, transactions, and statements with the aim of uncovering discrepancies, fraud, or other financial misdeeds. In essence, forensic accountants act as financial detectives, employing a combination of accounting knowledge, investigative skills, and technological tools to bring financial wrongdoing to light.

### **Implications and Consequences of Financial Fraud**

Financial fraud can have severe implications for individuals, businesses, and the overall economy. Immediate consequences may include financial losses, reputational damage, legal action, and criminal charges. Individuals convicted of fraud may face heavy penalties like fines, restitution payments, asset seizures, or even imprisonment, depending on the nature of the crime and the jurisdiction.

### **Forensic accounting a brief definition**

Forensic accounting deals with the matters of financial crimes across all financial statements. It can be any kind of crime that happens in the financial arena of the company.

### **Forensic accounting as a Tool**

Forensic accounting is considered as an important tool for investigating frauds in accounts and financial statements. Manipulation of accounts became common in this modern era which ensures that forensic accounting plays a major role in finding fraudulent activities. The detection techniques used in forensic accounting includes conducting interview, reviewing public document and doing the background check, analysing the financial statement, Benford's law, ratio analysis,

data mining, and computer assisted auditing works, critical point auditing, proprietary audit

### **Causes of Growth of Forensic Accounting in India**

- India not having enough forensic accountants and lack of awareness and understanding of the profession.
- Conventional accounting could not bring into light many financial irregularities, appropriation and expropriation detrimental to stakeholders due to failure of internal and external audits in the organisations.
- Culprits are using sophisticated technologies in committing frauds hence to replace old investigation methodology in the right way of new technology on the IT platform.
- To collusion and lobbying rotation and appointment of the statutory auditors by companies in India.
- Auditor's certificates are hardly scrutinised carefully especially when the reports are unclean, doubtful and qualified.

### **Types of forensic accounting:**

#### **1. Money laundering**

Money laundering is the process of making illegally obtained funds, often from criminal activities; appear to be legitimate by passing them through a complex sequence of banking transfers or commercial transactions. Essentially, it's the act of cleaning "dirty money" to make it seem like it comes from legal sources.

#### **2. Bankruptcy**

Bankruptcy is a legal status of an individual or entity that is unable to repay their outstanding debts. It is a formal

process initiated by the debtor or creditors through a court order.

### **3. Asset misappropriation**

Asset misappropriation refers to the intentional theft or misuse of an organisation's resources or assets by individuals within the organisation. This type of fraud involves employees or even management diverting funds or resources for their personal gain.

### **4. Criminal investigation**

Criminal investigation is the process of gathering, analysing, and evaluating evidence to solve a crime and build a case against a suspected perpetrator.

### **5. Defaulting on debt**

Defaulting on debt occurs when a borrower fails to fulfil their obligation to repay a loan or meet the terms of a debt agreement. This can happen for various reasons, such as financial difficulties, unforeseen circumstances, or a lack of resources to make scheduled payments.

### **6. Financial identity theft**

Financial identity theft occurs when someone wrongfully acquires and uses another person's financial information for fraudulent purposes.

## **Step by step process for investigating fraud in finance**

### **1. Identify Red Flags**

Recognize potential signs of fraud, such as unexpected financial discrepancies, unusual transactions, or patterns that deviate from the norm.

### **2. Secure the Scene**

If applicable, secure physical and digital evidence to prevent tampering. Ensure the preservation of documents,

electronic records, and any relevant physical assets.

### **3. Assemble a Team**

Form a multidisciplinary team including forensic accountants, investigators, legal experts, and IT specialists to cover various aspects of the investigation.

### **4. Preserve Evidence**

Document and preserve all relevant evidence, including financial records, emails, documents, and any electronic data. Maintain a chain of custody for physical evidence.

### **5. Notify Law Enforcement (if necessary)**

If the fraud involves criminal activity, report the incident to law enforcement authorities and collaborate with them throughout the investigation.

### **6. Conduct Initial Interviews**

Interview relevant personnel to gather information about the suspected fraud. Pay attention to details, timelines, and any information that might help uncover the fraud.

### **7. Analyze Financial Documents**

Review financial statements, bank records, invoices, and other relevant documents to identify inconsistencies, discrepancies, or suspicious transactions.

### **8. Utilize Forensic Accounting Techniques**

Apply forensic accounting methods, such as data analytics and tracing, to follow the money trail and identify patterns indicative of fraud.

### **9. Perform Digital Forensics**

If the fraud involves electronic transactions, conduct digital forensics to

analyze computer systems, emails, and other digital records for evidence

### **10. Review Internal Controls:**

Assess the organization's internal controls to identify weaknesses or vulnerabilities that may have contributed to the occurrence of fraud.

### **Forensic Accountant**

A forensic accountant is a financial professional who specializes in investigating and analyzing financial information for legal purposes. These professionals combine accounting, auditing, and investigative skills to uncover financial irregularities, fraud, and other discrepancies. Forensic accountants play a critical role in safeguarding the financial integrity of organizations and assisting legal entities in understanding complex financial matters. Their work contributes to the detection, prevention, and resolution of financial fraud and disputes.

Here are key aspects of a forensic accountant's role

- Investigative Skills
- Financial Analysis
- Fraud Detection:
- Litigation Support
- Expert Reporting:
- Ethical Considerations
- Asset Tracing

### **What do forensic accountants do?**

Forensic accounting is often divided into two main categories:

- (1) Investigative services
- (2) litigation/dispute services.

#### **1. Investigation service:**

Forensic investigations are a combination of accounting and investigative techniques used to discover,

prove or even rule out potential financial crimes. They can be performed in anticipation of criminal or civil litigation, or in some cases are performed in anticipation of filing an insurance claim to recover fraud-related losses. Investigative techniques can also be employed on a preventative basis to form systems to detect fraud or prevent fraud from occurring in the first place. The types of investigative projects are as numerous as the schemes that they are designed to investigate. Examples include, but are certainly not limited to, investigations of:

- Embezzlement
- Asset misappropriation
- Financial statement fraud, also known as “cooking the books”
- Corruption schemes
- Securities fraud
- Tax evasion
- Money laundering
- Ponzi schemes

#### **2. Litigation/dispute service**

Forensic accountants are often engaged to assist in disputes, either in a consulting or testifying capacity. As a consultant, a forensic accountant may be hired by an attorney to assist in collecting, analyzing, and interpreting financial information that is pertinent to a given case. Nearly every lawsuit has at least some financial aspect. Forensic accountants may also be engaged to serve as an expert witness. As an expert witness, the forensic accountant is uniquely positioned to testify at trial on financial matters due to their specialized knowledge or proficiency in the field of accounting. Some examples of litigation and dispute related projects include:

- Measurement of economic damages and/or lost profits
- Asset tracing in family law or divorce proceedings
- Measurement of losses due to business interruption
- Accounting assistance in business disputes
- Quantifying effects of intellectual property infringement
- Assisting the court in bankruptcy proceedings
- Assistance in professional malpractice lawsuits
- Valuation of business interests and other assets

#### **Awareness of Forensic Accounting in India**

Forensic accounting in India has gained recognition and importance in recent years due to the growing complexity of financial transactions and an increased emphasis on corporate governance. Organisations are becoming more aware of the need to investigate financial irregularities, fraud, and misconduct. Several professional bodies, such as the Institute of Chartered Accountants of India (ICAI), offer specialised courses and certifications in forensic accounting. The legal and regulatory framework in India has also evolved to address financial crimes, further highlighting the significance of forensic accounting. As businesses strive for transparency and accountability, the demand for forensic accountants is likely to continue rising in India, contributing to the overall awareness and adoption of forensic accounting practices. In the wake of increasing levels of frauds and economic

irregularities and considering to need to prevent it as the necessity of the day, it is expected that the prospects of forensic accountants are bound to increase considerably in the near future, their roles being:

- To aid in a settlement, claim, or jury award by reducing the financial component as an area of continuing debate.
- Avoiding fraud and theft.
- Restore and rejuvenate the public's confidence with the financial environment of the nation.
- To introduce a corporate governance policy giving due importance to forensic accounting and auditing.
- Helping in legal proceedings, giving one's expert opinion and facts in court as an expert witness and preparing visual aids to reinforce the trial evidence.

The main steps in forensic analytics are

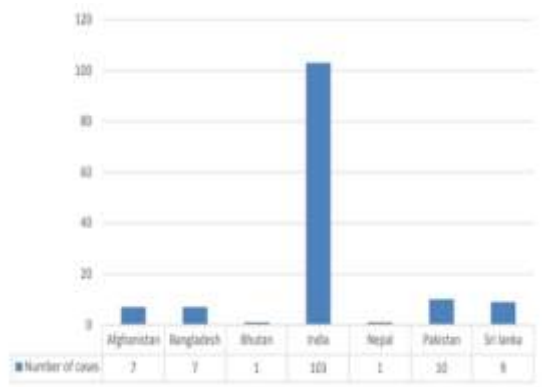
- Data collection
- Data preparation
- Data analysis
- Reporting.

There is a growing potential and future in forensic accounting as a 'specialised area' in accounting and finance. Given the abnormal levels of financial irregularities and frauds, the requirement for forensic accountants is more and is an in demand career in this decade.

#### **Report**

Globally, financial irregularities are a major concern around the world. It is also a key issue for emerging countries like India, which is now the fifth largest economy according to the International

Monetary Fund (IMF) as of June 2023. India is ranked 85th out of 180 countries in Transparency International's Corruption Perception Index (CPI) for the year 2022. Its reputation for combating corruption is not encouraging. Fraud and corruption are so ubiquitous that they are continuously becoming accepted as a normal way of life.



Source: Report to the Nation's 2022 by ACFE

India Ranks No. 1 in terms of the number of fraud cases in South Asian Nations, as per the Report to the Nation's 2022 by ACFE (Association of Certified Fraud Examiners).

There have been numerous instances of financial statement misrepresentation, which have negatively impacted both the auditors and companies like Enron, WorldCom, Adelphia, Global Crossing, Xerox, and many others like Cendant, Lincoln Savings, Sunbeam (Albrecht, 2005). For a nation in dire need of investment, eliminating fraud is important.

In the financial year 2023, the Reserve Bank of India (RBI) reported a total of more than 13 thousand bank fraud cases across India. This was an increase compared to the previous year and turned around the trend of the last decade.

**Case study on Satyam scam:**

**Satyam computers:**

Satyam Computer Services Limited, a worldwide IT firm based in India, is now part of a notorious roster of companies implicated in financial fraud. Its CEO, Mr. Ramalingam Raju, has acknowledged responsibility for manipulating accounting records, inflating revenues and profits, and falsely reporting a non-existent cash reserve of approximately \$1.04 billion.

The media has coined the Satyam accounting fraud case as "India's Enron." Ironically, "Satyam" translates to "truth" in the ancient Indian language of Sanskrit (Basilico et al., 2012). Despite receiving the "Golden Peacock Award" for the best-governed company in both 2007 and 2009, Satyam now faces a tarnished reputation due to the revelations of financial misconduct.

**The rise of Satyam computers:**

Founded in 1987 by Mr. Ramalinga Raju in Hyderabad, India, Satyam Computer Services Limited rapidly ascended as a prominent player in the outsourced IT-services industry, starting with a modest 20 employees and eventually expanding its global footprint to operate in 65 countries. The company achieved the distinction of being the first Indian firm registered with three International Exchanges—NYSE, DOW Jones, and EURONEXT.

Satyam stood as a testament to India's success, garnering awards for innovation, governance, and corporate accountability. In 2007, Mr. Raju was honoured with the 'Entrepreneur of the Year' award by Ernst & Young, and on April 14, 2008, Satyam



was recognized by MZ Consult for being a 'leader in India in CG and accountability' (Agrawal and Sharma, 2009).

### **Anatomy of Satyam fraud:**

#### **Maintaining records and reports:**

Mr. Ramaraju kept all his records of meetings and as well as the minutes since 2002. He still maintains records of the 2008-09 financial year

- **Fake invoices and bills :**

The Satyam company provided fake bills and invoices availing the financial fraud that occurred in the company. The research delves into the method employed for generating counterfeit invoices within the IMS system, posing the question: "How was the integrity of the IMS subverted in this process?" Notably, the IMS system mandates completion of the 'Invoice Field Status' for order processing.

#### **Spider web of companies:**

Accordingly a lot of investment companies were involved in the Satyam scam but a lot of companies denied that as a fact. All these companies have several transactions with them

#### **Fake and underutilised employees in the company:**

There are so many underutilised employees in the company but it didn't show up well as how the scam shows up in the court.

#### **Verdict of Supreme Court**

All the accused implicated in the Satyam fraud case, including Raju, faced charges ranging from cheating, criminal conspiracy, forgery, breach of trust, inflating invoices and profits, to fabricating accounts and violating numerous income tax laws. The Central Bureau of Investigation (CBI) filed three

charge-sheets initially, which were later consolidated into one extensive document spanning over 55,000 pages. Over the past six years, the examination involved scrutinising more than 3,000 documents and hearing testimony from 250 witnesses. On April 9, 2015, a special CBI court handed down a verdict, sentencing Mr. B. Ramalinga Raju, his two brothers, and seven others to seven years in prison in connection with the Satyam fraud case. Additionally, the court imposed a fine of Rs. 5 crore on Ramalinga Raju, the founder and former chairman of Satyam Computer Services Ltd, and his brother B Rama Raju. The remaining accused was fined in the range of Rs. 20-25 lakh each. Among the individuals found guilty were B. Ramalinga Raju, his brother and Satyam's former managing director B. Rama Raju, and former chief financial officer Vadlamani Srinivas.

#### **Conclusion**

In conclusion, forensic accounting plays a pivotal role in addressing and preventing fraud within financial systems. As businesses navigate complex financial landscapes, the need for specialised professionals adept at uncovering financial irregularities becomes increasingly crucial. Forensic accountants employ a range of skills, including financial analysis, investigative techniques, and knowledge of legal frameworks, to identify, document, and mitigate instances of fraud. Fraud, whether in the form of asset misappropriation, financial statement manipulation, or more sophisticated schemes, poses significant threats to organisational integrity and financial stability. Today is the right time to adopt

and adhere strictly the forensic accounting at all the levels of government, public and corporation accounting as an accounting tool to cure and prevent the entities from the financial and other ills. Forensic accounting serves as a robust line of defence against fraud, offering a multidisciplinary approach that combines financial expertise, investigative skills, and legal knowledge. The ongoing evolution of forensic accounting practices is essential in adapting to emerging challenges and safeguarding the financial health of organisations and economies.

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