



Forensic Accounting: A Strategy for Identifying and Terminating Financial Frauds in India

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Abstract

Forensic accounting is a specialized field of accounting that involves using financial and investigative techniques to uncover fraud, financial irregularities, and other criminal activities. In India, the use of forensic accounting as an approach to preventing and detecting fraud is gaining popularity due to the increasing instances of financial fraud in the country. The approach involves a combination of traditional accounting methods and forensic techniques to investigate, analyze, and interpret financial data. This includes identifying patterns of financial behavior, analyzing financial statements, interviewing suspects and witnesses, and collecting and analyzing electronic evidence. Forensic accounting is particularly useful in India, where the legal system can be slow and inefficient in dealing with financial crimes. By providing concrete evidence of financial fraud, forensic accounting can help speed up legal proceedings and ensure that justice is served. Furthermore, with the growing adoption of technology and digital payments in India, forensic accounting is becoming even more critical in detecting and preventing cyber fraud, which has become a significant challenge for businesses and financial institutions in the country. In conclusion, the use of forensic accounting in India is an effective approach to preventing and detecting financial fraud. By combining traditional accounting methods with forensic techniques, forensic accountants can identify financial irregularities and provide concrete evidence of fraudulent activities, making it easier for the legal system to hold perpetrators accountable.

Key Words: Financial Accounting, Forensic Accounting, Traditional Accounting Method.

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1. INTRODUCTION

A global wave of corporate and white-collar frauds began in the late 1990s, including the Waste Management Scandal (1998), Enron Scandal (2001), WorldCom (2002), Tyco Scandal (2009), Health South Scandal (2003), Freddie Mac (2005), American Insurance Group (2008), Lehman Brothers (2008), Bernie Madoff (2008), Satyam (2009), Olympus (2011), Toshiba (2014), and others have occurred. India has also been witnessing an increase in financial fraud over the past few years, and this has resulted in the need for more effective ways of preventing and detecting such fraudulent activities. Forensic accounting is a specialized field of accounting that has been gaining popularity in India as an approach to combat financial fraud. Forensic accounting involves the application of accounting, auditing, and investigative skills to identify, investigate, and analyze financial information for the purpose of uncovering fraudulent activities. This approach combines traditional accounting methods with forensic techniques to detect fraudulent activities and provide concrete evidence for legal proceedings. Forensic accounting is particularly relevant in India due to the country's complex legal system, which can make it challenging to bring financial criminals to justice. Additionally, with the increasing use of technology and digital payments, cyber fraud has become a significant challenge for businesses and financial institutions in India. Forensic accounting provides a valuable tool for detecting and preventing cyber fraud by using digital forensic techniques to analyze electronic evidence. The growth in financial scandals at the start of the twenty-first century cast doubt on the reliability of the organisational financial structures and the function of audit in preventing and detecting fraud. As a result, the adage "Auditor is a watchdog not a bloodhound" has altered. In addition to ensuring that the firm's books and accounts are in accordance with GAAPs, auditing standards, and corporate regulations, auditors should also, like a bloodhound, try to spot frauds and scams in the financial records of the organisation. Although forensic accountants examine behind the numbers, accountants focus on the numbers. "As opposed to the sample techniques employed by auditors, forensic accountants aim to study 100% of the data and go beyond the figures." According to AICPA, "Forensic Accounting is the application of accounting principles, theories and discipline to facts or hypothesis at issues in a legal dispute and encompasses every branch of accounting knowledge," Forensic Accounting borrows knowledge from accounting, finance, law, computerization, ethics, criminology etc. In this context, this paper aims to explore the role of forensic accounting in preventing and spotting fraud in India. The paper will discuss the various techniques used in forensic accounting, the challenges associated with detecting financial fraud in India, and the benefits of using forensic accounting in preventing and detecting financial fraud.

2. OBJECTIVES OF THE STUDY

The objective of the study is

- [i] To be aware of numerous kinds of financial scams in India.
- [ii] To comprehend the function of Forensic Accounting techniques in the investigation of fraud.
- [iii] To comprehend the various services provided by forensic accountants.
- [iv] To understand the future of forensic accounting in India given the rising number of frauds.

3. DATA COLLECTION

The data was gathered from numerous websites, publications, accounting journals, relevant books, reports released by the Government of India, the Reserve Bank of India, KPMG, and other connected organizations.

4. MEANING AND CONCEPT OF FRAUD AND ITS KIND

Fraud is a deceptive or intentional act committed by an individual or organization to gain a financial or personal advantage or to cause harm to another party. It involves the use of deceit, trickery, or dishonesty to achieve a goal or obtain something of value.

The objectives of frauds vary depending on the motives and circumstances of the perpetrator. Some common objectives of frauds include:

- [i] **Financial Gain:** The most common objective of fraud is to obtain financial benefits, such as money, assets, or property, through dishonest means. This can be achieved through various means such as embezzlement, theft, or false invoicing.
- [ii] **Concealing Financial Losses:** Sometimes, individuals or organizations commit fraud to conceal financial losses or mismanagement. They may manipulate financial records, overstate assets or revenue, or understate liabilities or expenses to hide financial problems.
- [iii] **Personal Gain:** Some individuals commit fraud to gain personal advantages, such as career advancement, promotions, or bonuses. They may falsify their qualifications, work experience, or performance records to deceive their employers.
- [iv] **Revenge or Retaliation:** In some cases, individuals commit fraud as an act of revenge or retaliation against someone they perceive as having wronged them. For example, an employee who has been passed over for a promotion may commit fraud to harm their employer or supervisor.
- [v] **Political or Ideological Motives:** Sometimes, fraud can be committed for political or ideological motives. This can include election fraud, propaganda, or other forms of political manipulation.

Overall, fraud is committed with the intent to deceive, mislead, or harm others for personal gain or other motives. It is important to prevent and detect fraud to protect individuals and organizations from its harmful effects.

5. FRAUDS CAN TAKE MANY FORMS INCLUDING BUT NOT LIMITED TO

- [i] False representation of information or facts
- [ii] Concealment of information or facts
- [iii] Misappropriation of assets or funds
- [iv] Falsification of financial statements or records
- [v] Forgery of signatures or documents
- [vi] Bribery or kickbacks



- [vii] Insider trading
- [viii] Ponzi schemes or pyramid schemes

Fraud can have serious consequences for both the perpetrator and the victim. It can lead to financial losses, damage to reputation, legal action, and even imprisonment. It is essential to identify and prevent fraud to protect individuals and organizations from its harmful effects.

6. THE FORENSIC ACCOUNTING TECHNIQUES

Forensic accounting is a specialized field that combines accounting, investigative, and legal skills to detect and prevent fraud, financial misconduct, and other financial irregularities. Some common techniques used in forensic accounting include:

- [i] **Data Analysis:** Forensic accountants use data analysis techniques to detect patterns, anomalies, or trends in financial records, transactions, or operations. They may use software tools to analyze large datasets and identify unusual or suspicious transactions.
- [ii] **Document Examination:** Forensic accountants use document examination techniques to identify and verify financial records, such as invoices, receipts, bank statements, and tax returns. They may also look for signs of forgery, alterations, or tampering in financial documents.
- [iii] **Interviews and Interrogations:** Forensic accountants may conduct interviews and interrogations with individuals involved in financial transactions or operations to obtain information and assess credibility. They may also use techniques such as statement analysis to detect deception or inconsistencies in statements.
- [iv] **Expert Witness Testimony:** Forensic accountants may provide expert witness testimony in legal proceedings to explain financial records, transactions, or operations to judges or juries. They may also prepare reports or other documents to support their findings.
- [v] **Financial Modeling:** Forensic accountants may use financial modeling techniques to simulate scenarios and assess the financial impact of potential fraud, financial misconduct, or other financial irregularities. They may also use financial models to identify opportunities for fraud or to test the effectiveness of fraud prevention measures.
- [vi] **Fraud Risk Assessment:** Forensic accountants may conduct fraud risk assessments to identify potential areas of vulnerability to fraud and recommend controls or procedures to prevent or detect fraud. They may also provide training or education to employees or management on fraud prevention and detection.

Overall, forensic accounting combines various techniques and skills to investigate, detect, and prevent financial irregularities and fraud. It plays a critical role in protecting individuals and organizations from financial harm and maintaining the integrity of financial reporting and operations.

UNFORTUNATELY, FINANCIAL SCAMS ARE NOT UNCOMMON IN INDIA, AND SOME OF THE MOST NOTABLE ONES IN RECENT YEARS INCLUDE:

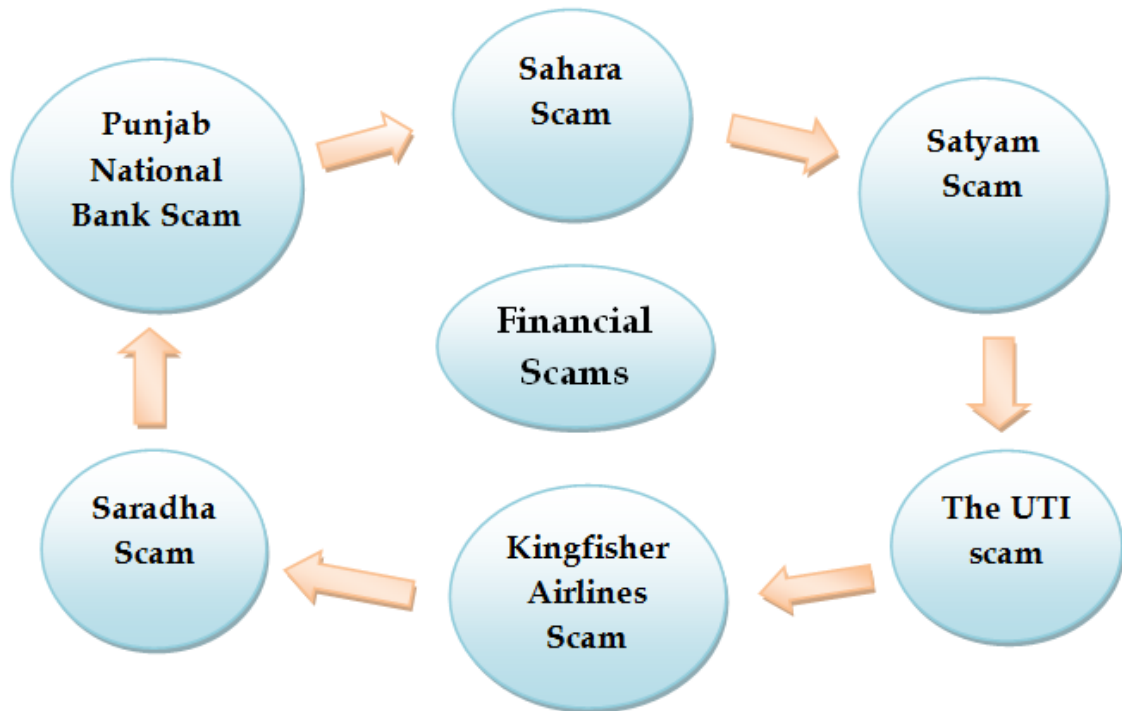


Figure:1 (Financial Scams)

Source: Self Prepared

- [i] **Punjab National Bank Scam:** In 2018, it was revealed that Nirav Modi, a diamond jeweler, and his associates had defrauded Punjab National Bank (PNB) of over Rs. 14,000 crore (approximately \$1.8 billion) through fraudulent letters of undertaking (LoUs) issued by PNB officials.
- [ii] **Sahara Scam:** Sahara India Pariwar was accused of raising funds from millions of small investors through illegal and unauthorized means, with the Securities and Exchange Board of India (SEBI) alleging that the company had collected over Rs. 24,000 crore (approximately \$3.3 billion) from investors.
- [iii] **Satyam Scam:** In 2009, Satyam Computer Services, one of India's largest IT companies, was found to have inflated its revenues, profits, and cash balances for years, with its founder and chairman, Ramalinga Raju, admitting to a fraud of over Rs. 7,000 crore (approximately \$1.5 billion).

- [iv] **Saradha Scam:** The Saradha Group, a consortium of companies, was accused of running a ponzi scheme in which thousands of small investors were lured with promises of high returns, resulting in a fraud of over Rs. 2,500 crore (approximately \$350 million).
- [v] **Kingfisher Airlines Scam:** Kingfisher Airlines, owned by Vijay Mallya, was found to have defaulted on loans worth over Rs. 9,000 crore (approximately \$1.2 billion) from various banks, including the State Bank of India.
- [vi] **The UTI scam** is one of the biggest financial scams in India's history, which took place in 2001. UTI (Unit Trust of India) was a mutual fund company owned by the government of India, with assets worth billions of rupees. The scam involved illegal investments made by UTI in risky companies, causing significant losses for investors. The scam was initiated in the late 1990s when UTI invested in companies such as Ketan Parekh's Magnum group, which was involved in stock market manipulation. The investments in risky companies resulted in massive losses for UTI and its investors, leading to a significant decline in the company's net asset value (NAV).

These financial scams have had a significant impact on the Indian economy, investors, and the financial sector as a whole. It underscores the importance of regulatory oversight, transparency, and accountability to prevent and detect financial frauds and scams in the future.

7. COMPTROLLER AND AUDITOR GENERAL OF INDIA'S REPORT ON FINANCIAL SCAM

The Comptroller and Auditor General (CAG) of India is an independent constitutional authority responsible for auditing the accounts of the central and state governments in India. They are mandated to scrutinize the finances of the government, public sector undertakings, and other organizations that receive public funds.

The CAG regularly publishes reports on their audit findings, including cases of financial scams and irregularities. Some of the recent reports published by the CAG on financial scams in India include:

Report No. 3 of 2020 - Performance Audit on Implementation of Crop Insurance Schemes: This report highlights irregularities in the implementation of crop insurance schemes, leading to financial losses for farmers and the government. The report reveals instances of over-estimation of crop losses, under-payment of compensation, and delays in claim settlement, among other issues.

Report No. 2 of 2019 - Compliance Audit Observations on Direct Taxes: This report highlights the non-compliance of taxpayers with tax laws, leading to a loss of revenue for the government. The report reveals instances of non-filing of tax returns, under-reporting of income, and non-payment of taxes, among other issues.

Report No. 3 of 2018 - Compliance Audit on Goods and Services Tax: This report highlights the implementation challenges and non-compliance issues in the implementation of the Goods and Services Tax (GST) in India. The report reveals instances of incorrect claim of input tax credit, non-matching of invoices, and discrepancies in tax payment, among other issues.

Overall, the CAG's reports on financial scams provide a comprehensive analysis of the financial irregularities in different sectors and organizations in India. These reports play a crucial role in holding the government and public sector organizations accountable and promoting transparency and accountability in financial management.

8. A FORENSIC ACCOUNTANT PROVIDES THE FOLLOWING SERVICES

Forensic accounting is a specialized field of accounting that combines accounting, auditing, and investigative skills to investigate financial crimes, fraud, and other financial irregularities. A forensic accountant provides the following services:

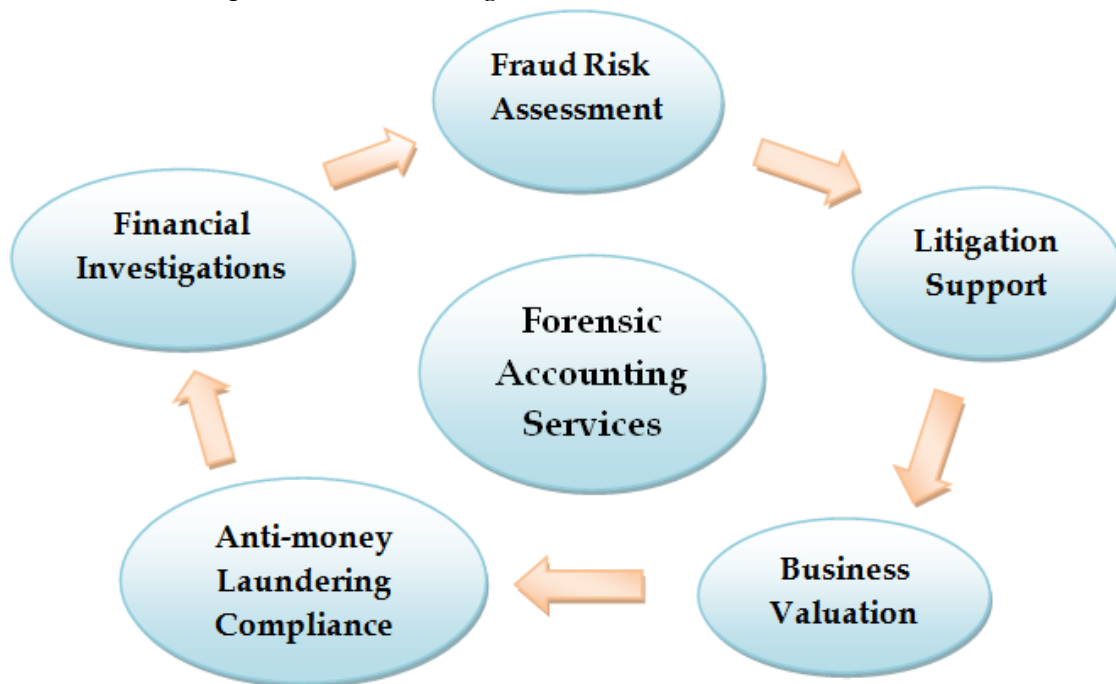


Figure: 2 (Financial Scams)
Source: Self Prepared

Financial Investigations: Forensic accountants conduct financial investigations to detect and investigate financial fraud, embezzlement, and other financial crimes. They use accounting and auditing techniques to uncover financial irregularities and collect evidence to support legal proceedings.

Fraud Risk Assessment: Forensic accountants can help organizations to assess their fraud risk and implement measures to prevent fraud. They evaluate the organization's internal controls, policies, and procedures to identify vulnerabilities and recommend solutions to reduce the risk of fraud.

Litigation Support: Forensic accountants provide support in legal disputes, such as litigation, arbitration, and mediation. They help in preparing financial evidence, calculating damages, and providing expert testimony in court.

Business Valuation: Forensic accountants can determine the value of a business or asset in the event of a dispute or litigation. They use various methods such as income approach, market approach, and asset-based approach to determine the fair market value of a business or asset.

Anti-Money Laundering Compliance: Forensic accountants help organizations to comply with anti-money laundering laws and regulations. They provide training and advice on anti-money laundering policies and procedures, and help in conducting due diligence on clients and third parties.

Overall, a forensic accountant plays a crucial role in investigating financial crimes, detecting fraud, assessing fraud risk, and providing litigation support. They help organizations to implement measures to prevent fraud, comply with laws and regulations, and protect their assets.

9. GROWING FRAUDS AND THE POTENTIAL OF FORENSIC ACCOUNTING

The growing prevalence of fraud in today's society is a major concern for businesses and individuals alike. Fraud can take many forms, such as embezzlement, financial statement fraud, and bribery, and can result in significant financial losses and damage to reputations. Forensic accounting is a specialized field that can help to detect, investigate, and prevent fraud.

Forensic accounting involves the use of accounting, auditing, and investigative skills to examine financial statements, transactions, and other financial data in order to identify potential fraud. Forensic accountants are trained to analyze financial information and identify irregularities or inconsistencies that may indicate fraudulent activity. They also work to uncover the root causes of fraud and develop strategies to prevent it from happening in the future.

One of the key benefits of forensic accounting is its ability to detect fraud early on, before it becomes a major problem. By analyzing financial data and identifying potential warning signs, forensic accountants can help businesses take proactive measures to prevent fraud from occurring. This can include implementing stronger internal controls, improving financial reporting processes, and increasing staff training on fraud prevention.

Another benefit of forensic accounting is its ability to help businesses and individuals recover losses from fraudulent activity. By conducting a thorough investigation and gathering evidence, forensic accountants can help to build a case against the perpetrators of fraud and assist in recovering lost assets. This can be particularly useful in cases where the fraud is complex and difficult to detect or where the perpetrator is a trusted employee or advisor.

In summary, the growing prevalence of fraud highlights the importance of forensic accounting as a tool for detecting, investigating, and preventing fraudulent activity. By leveraging their specialized skills and expertise, forensic accountants can help businesses and individuals protect themselves from financial losses and reputational damage caused by fraud.

10. CONCLUSION

Forensic accountants in India are trained to use specialized techniques to detect and analyze financial data and identify potential red flags that may indicate fraudulent activity. They also work to uncover the root causes of fraud and develop strategies to prevent it from happening in the future.

In recent years, the Indian government has taken steps to promote the use of forensic accounting in the country. The Institute of Chartered Accountants of India (ICAI) has established a Forensic Accounting and Investigation Board to promote the development of the forensic accounting profession in India.

Despite these efforts, there is still a need for greater awareness and education about the importance of forensic accounting in India. Many businesses and individuals are not aware of the benefits of forensic accounting and may not have the necessary resources to implement effective fraud prevention and detection measures.

In conclusion, forensic accounting is a valuable technique for fraud prevention and detection in India. With the increasing prevalence of fraud in the country, it is essential that businesses and individuals take steps to protect themselves from financial losses and reputational damage caused by fraudulent activities. Forensic accounting can help to achieve this goal by identifying potential red flags, investigating suspicious activities, and implementing effective fraud prevention measures.

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