

FORENSIC ACCOUNTING

Forensic Professional Accountant

(a) Forensic Accountant engaged by

Forensic Accountant can be engaged in public practice or employed by

- Banks,
- Police forces,
- Lawyers
- Insurance companies,
- Government agencies
- Other organizations.

(b) Importance of Forensic Accountants

Forensic Accountants can resolve the matters by combining accounting knowledge & experience with respect to:

- Fraud Prevention
- Fraud Detection
- Risk Management

(c) Services rendered by Forensic Accountants

- Fund diversions/Asset tracing
- Valuations/Estimations of loss/damage
- Anti-Money laundering
- Tax Evasion/Dues/License Fees
- Related party transactions
- Financial Statement manipulations
- Suspicious transactions under IBC

(d) Skills to be possessed by Forensic Accountant

In order to properly perform the services a Forensic Accountant Professional must be

- familiar with legal concepts and procedures;
- have expertise in use of IT tools and techniques that facilitate data recovery and analysis;
- able to identify substance over form when dealing with an issue.

Process of Forensic Accounting

(a) Step 1 – Initialisation (time pass)

- **Meeting with the client and accepting the engagement:** In order to understand important facts, players and issues etc., the investigator must meet the client.
- **Performing conflict check:** In order to achieve objectivity, a conflict of interest check should be carried out as soon as the relevant parties are established.

- **Performing initial investigation:** It is often useful to carry out a preliminary investigation (site visit, inquiry) prior to the development of a detailed plan of action. This will allow subsequent planning to be based upon a more complete understanding of the issues.

(b) Step 2 – Planning (time pass)

- This is to be developed based on the meeting with the client and carrying out the initial investigation.
- Plan will set out the objectives to be achieved and the methodologies to be adopted.

(c) Step 3 – Collection of Evidences (time pass)

- It involves obtaining relevant documents, economic information, tracing different assets/persons/unaccounted records, meeting with other experts, statutory and internal auditors of the client.
- The evidences gathered should be sufficient to ultimately identify and prove the fraudster and the mechanism adopted for such frauds.

(d) Step 4 – Performing Analysis (IMP)

The actual analysis to be performed will solely depend upon the nature of the assignment and may include:

- Calculating economic damages;
- Summarizing a large number of transactions;
- Performing present value calculations utilizing appropriate discount rates;
- Performing a regression or sensitivity analysis;
- Performing a tracing of assets;
- Utilizing a computerized application such as a spread sheet, data base or computer model;
- Utilizing charts and graphics to explain the analysis.

(e) Step 5 – Reporting

- Issuing a report is the final step. Information detailing the fraudulent activity, if any has been found need to be reported in the report. The client will expect a report containing the findings of the investigation, including a summary of evidence, a conclusion as to the amount of loss suffered as a result of the fraud and to identify those involved in fraud.
- The report may include sections on the nature of the assignment, scope of the investigation, approach utilized, limitations of scope and findings and/or opinions. The report will include schedules and graphics necessary to properly support and explain the findings.
- The report will also discuss how the fraudster set up the fraud scheme, and which controls, if any, were circumvented. It is also likely that the investigative team will recommend improvements to controls within the organization to prevent any similar frauds occurring in the future.

(f) Step 6 – Court Proceedings

- Investigation is likely to lead to legal proceedings against the suspect.
- Evidence gathered will need to be presented at court, and team members may be called to court to describe the evidence they have gathered and to explain how the suspect was identified.

Concept Of Forensic Accounting

- ‘Forensic’ means suitable for use in a court of law.
- Definition of Forensic Accounting keeps on changing in response to the growing needs of corporations. Forensic Accounting may be defined as follows:
 - ✓ Integration of accounting, auditing and investigative skills yields the specialty known as Forensic Accounting. It is the study and interpretation of accounting evidence. It is application of accounting methods to tracking and collection of forensic evidence, usually for investigation and prosecution of criminal acts such as embezzlement or fraud.
- **Red Flag:** Indicators of any impending (futuristic/potential) danger or inappropriate behavior. Red flag does not necessarily indicate existence of fraud however are indicators that caution needs to be exercised while investigating the situations. Red flags are classified in categories such as financial performance red flag, accounting system red flags, operational red flags and behavioral red flags. (Like - Fraud Risk Factors of audit SA-240)

Forensic Accounting vs. Financial Audits

BASIS	FORENSIC ACCOUNTING	FINANCIAL AUDIT
Meaning	<u>Examination of evidence regarding an assertion to determine its correspondence with established criteria</u> carried out in a manner <u>suitable to the court</u> .	Examination of Financial Information so as to express an opinion on true and fair view of state of affairs and financial results.
Objective	To determine <u>whether fraud</u> has taken place.	To express an opinion on true and fair view.
Frequency	<u>No specific period</u> .	Generally carried out for a financial year.
Techniques	Investigative and substantive.	Risk based with help of compliance & substantive procedures. (toc & tod)
Extent	<u>In-depth checking</u> .	<u>Test checking based</u> .
Verification of Asset and Liabilities	Verification of <u>suspected/selected</u> items is done where misappropriation is suspected.	<u>All</u> assets and liabilities are verified with the help of audit procedures or management certificate/representation.
Off balance sheet items (like contracts, etc.)	<u>Regulatory and propriety</u> of these transactions/contracts are examined.	Used to vouch the <u>arithmetic accuracy</u> and compliance with procedures.
Adverse findings if any	<u>Legal determination</u> of fraud impact and <u>identification of perpetrators</u> depending on scope.	<u>Modified opinion</u> (Qualified or Adverse) expressed with/without quantification.

Areas of Forensic Accounting

Forensic accounting is generally involved in the below mentioned area of work:

(a) Expert Testimony

Area of Expert testimony comprises of Assisting in legal proceedings, Testifying in court as a expert witness, Preparing visual aids to support trial evidence.

(b) Fraud Detection

Area of fraud detection comprises of Investigating and analyzing financial evidence, detecting financial fraud, tracing misappropriated funds.

(c) Fraud Prevention

Area of fraud prevention comprises of reviewing internal controls to verify their adequacy, providing consultation in the development and implementation of an internal control framework aligned to an organisation's risk profile.

(d) Computer Forensics

Area of computer forensics comprises of developing computerized applications to assist in the recovery, analysis and presentation of financial evidence.

Forensic Accounting and Investigation Report

- Forensic Accounting & Investigation Standard 510 deals with responsibility of Professional to issue a written report to the stakeholders at the conclusion of the assignment.
- Reporting results and findings, is concluding part of the assignment. Since one engagement may include multiple assignments, multiple reports may have to be issued.

(a) Written Report

- Written report should convey the results, clearly and accurately.
- Findings reported shall be based on reliable and relevant evidences.
- Report should be precise and unambiguous.

(b) Report Addressee and Distribution

Report shall be addressed to Primary Stakeholders and shared with other stakeholder(s) if required or otherwise permissible.

(c) Format or Content of Report

- No fixed form or content of the report is mandated.
- Report shall include certain key elements to enable the recipient to
 - (1) Understand the purpose of the assignment,
 - (2) The extent and scope of work performed by the Professional,
 - (3) Any limitations, assumptions or disclaimers,
 - (4) The facts and evidence gathered and
 - (5) The conclusions drawn.

- Where form and content of report is mandated by the stakeholders, or specified by statutory or regulatory requirements, Professional shall report in line with those requirements.

Key Elements of the Report

- Title, addressee and distribution list (if any).
- Scope and objectives of the assignment.
- Approach and broad work procedures undertaken.
- An Executive Summary of the results, covering all important aspects and the essence of the findings.
- Reference to use of an expert, where applicable.
- The fact that the assignment has been conducted in accordance with FAIS, or any material departures therefrom List of findings supported by key evidences, sources of evidences, and other relevant matter; Assumptions, limitations and disclaimers of the assignment
- Conclusions (if any) drawn from the assessment undertaken.

(d) Discussion of Draft report

Where mandate of engagement requires a discussion of the findings with the subject party prior to finalisation, a summary of responses received from them shall be included in the report.

(e) Assumptions And Limitations

- Professional shall list any relevant assumptions made during the assignment having a significant bearing on the subject matter.
- Limitations, if any, imposed by management, should be covered in the report as a key element of the report.
- The report can, at best, highlight the circumstances and facts that may aid a stakeholder decision or further a civil or criminal investigation.

(f) Reporting Timelines

- Report shall be issued within reasonable time frame as per the engagement terms.
- Professional may be required to provide interim reports as per the engagement terms which can be given to the extent practicable without compromising the progress of the investigation.

Forensic Accounting and Investigation Standards (FAIS)

- FAIS are issued to ensure that members of ICAI deliver high quality output in the area of Forensic Accounting and Investigations.
- FAIS at a broad level seek to provide:
 - (1) Professionals with the minimum standards for undertaking FAI assignments;
 - (2) Users of FAI services with an indication of the quality of service that can be expected from such engagements;

- (3) Regulators and Governmental agencies with an appreciation of what can be expected from FAI services; and
- (4) Everyone, guidance on matters of implementation and related practical issues.
- Standards are intended to be principle-based, rather than rule based, thereby providing ample room for professional judgment when applying such principles to unique situations and under specific circumstances.
- If, for any reason, a member is unable to comply with any of requirements of FAIS, or if there is a conflict between Standards and other mandates, such as a statutory or regulatory requirement, the FAI report (or such similar communication) should draw attention to the material departures therefrom along with appropriate explanation.

Framework Governing Forensic Accounting and Investigations

- It aims to preserve and enhance the quality of practice of a member of ICAI performing forensic accounting & investigation services.
- This Framework needs to be read in conjunction with the Preface to the Forensic Accounting and Investigation Standards (FAIS).
- The main objectives of the Framework are to:
 - (1) Provide an overall understanding of Forensic Accounting and Investigations and its key components;
 - (2) Outline the manner in which these components come together in an inter-related cohesive manner when providing such services;
 - (3) Maintain and improve the quality of forensic accounting and investigation services.
- It comprises of four components inherent to the process of forensic accounting and investigations. These components implicitly form part of the FAIS, even though they may not be mentioned explicitly in the particular Standards. The four key components (forming the pillars) of the Framework are:
 - (i) Basic Principles of Forensic Accounting and Investigations.
 - (ii) Key Concepts.
 - (iii) Standards on Forensic Accounting and Investigations.
 - (iv) Guidance.