



Forensic Accounting: A Theoretical Overview

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ABSTRACT

The field of forensic accounting falls under that of a relatively recent profession that makes use of a variety of methodologies and execution strategies. The global economy, society, and legal framework all have a role in how this branch of forensic science is organized and developed. Due to the rise in financial accounting frauds and deceptions in the worldwide economy, forensic accounting is now seen as the profession that will save the financial administration processes of academic, scientific, and commercial institutions. This particular field is defined by the whole of the talents in accounting, auditing, and investigation. Forensic accounting is quickly emerging in the field of corporate accounting frauds to play a comparable function, much like forensic science has long been used to apprehend criminals. By evaluating the earlier studies done in this area of forensic science, the goal of this study is to establish a novel method of tackling economic crime utilizing forensic accounting approaches.

Keywords: *Forensic Accounting, Economy, Frauds, Global economy, Investigative techniques, Financial crime, etc.*

I. Introduction

A combination of an auditing, accounting, and investigation procedures, forensic accounting can spot numerous types of white-collar crimes linked to financial scams. Investigation, a critical part of forensic accounting, is only applied when an event or transaction is ambiguous. The reason of the activity and, if any damage has been done, its extent are identified when laps have been established. It can be described as an exhaustive investigation and clarification of any ambiguity surrounding a transaction or event. Look up and consider the events to come to a decision. To find it, the cause of the record-keeping that led to a gap, and the responsible party, a deliberate search and examination of the record in accordance with the established and agreed-upon principles are necessary.

II. Literatures reviewed

The majority of medium-sized and bigger firms, in addition to all the larger accounting firms, believe the market is sizable enough to justify a separate section devoted solely to "forensic" accounting. **Bhasin**¹ came to the conclusion that the rapid rise in white-collar crimes and the perception that our law enforcement agencies lack the knowledge or the time necessary to unearth frauds are the main reasons why forensic accounting in India has just lately gained attention.

In order to determine whether there were any differences in perceptions of the requisite skills outlined in the practitioner literature, **Digabriele**² undertook a nationwide research of forensic accounting professionals, academics, and clients. The results show that forensic accountants need to have a solid understanding of the law as well as critical thinking, flexible investigative methods, and analytical expertise.

Mr. Frank John Wilson³, who played a crucial role in developing the techniques used in forensic accounting, was honored by Catania and given additional exposure.

According to **Akinbowale**⁴ et al. analysed the one of the problems that has persisted to restrict the use of forensic accounting as a weapon for battling fraud is the absence of a proper framework. The major goal of the project was to produce two conceptual models that could be utilised to effectively reduce fraud. These models were considerably simplified.

Popoola⁵ et al. have taken into account forensic accountant and auditor capability (i.e., attitude and skills) and forensic accountant and auditor competence (i.e., TPFRA) in order to decrease fraud in the Malaysian public sector.

III. Growth and Development of Forensic Accounting

Numerous important developments in forensic accounting have occurred recently. There is a growing need for forensic accountants in the accounting industry. The industry is expected to expand by 6.7% between 2013 and 2022 based on the number of employees. Every profession, including forensic accounting, has evolved throughout time. The industry is impacted by changes in society, the economy, and technology. The initial definition of forensic

accounting was provided by Frank Wilson in the 1930s after he worked on a financial case involving American gangster and businessman Al Capone. This extremely difficult accounting ability may have been around much longer than it has been formally recognized. In fact, it's thought that forensic accounting originated with the Egyptians. According to experts, forensic accounting today shares many similarities with accounting practices used in ancient Egypt. Accountants were used in ancient Egypt to keep track of the Pharaoh's assets. Forensic accounting has expanded during the past 70 years. Some assert that the introduction of fraud as a topic for scientific study began with the publication of Principles of Criminology, coauthored by Donald Cressey and Edwin Southland, in 1934. The aforementioned career path was not extremely common, as forensic accounting was not even given that term until 1946. Even the initial forensic accounting book wasn't released until 1982. Forensic accounting services have steadily and quickly increased in both popularity and demand over the past few decades. In the 1960s, there were about 700 Special Agent Accountants working for the FBI. In its Financial Crimes Section today, they still employ a similar number of employees. Investigations are conducted into instances of financial fraud, cybercrimes, money laundering, and several other economic crimes. A rigorous six-week training curriculum is required before someone may start working for the FBI Financial Crimes team. They regularly demonstrate to any conclusions in court as most forensic accountants are required to do, and they are frequently divided into investigation and litigation assistance. However, they work together. The father of forensic accounting is Mr. Frank John Wilson, who was fundamental in the creation of methods employed in the discipline today.

IV. Forensic accounting and the fraud triangle concept

The dictionary's definition of "FORENSIC" is "belonging to, having application with regard to a court of law and The practice of forensic accounting is frequently referred to as reporting involves gathering, recording, evaluating, comprehending, and communicating useful information regarding complex business concerns in order to be able to resolve legal disputes. The term "FRAUD" describes actions that include, among other things, theft, corruption, conspiracy, extortion, and bribery. Therefore, the word "fraud" has the most significance in the context of forensic accounting. Fraud is plausible given the three conditions of opportunity, attitude, and incentives or pressures. Incentives and pressures were ultimately motivate employees and management to commit fraud. Incentives include financial interests and bonuses that may be based on company performance.

V. Process of Forensic Accounting

The steps involved in forensic accounting and auditing are connected. The characteristics of the auditing procedure are included in forensic accounting. When auditors search for purposeful or unintentional misstatement, there is a difference. Every forensic accounting investigation begins with seeing the client and accepting the task. It is essential to have the skills required for the specific work, according to GAAS (Generally Accepted Auditing Standards). The initial plan for the investigation must be developed after accepting the role. With the aid of the investigation's overall plan, the investigator will be able to summarize the case. He will consider the client's surroundings, including any non-financial information, as well as the client itself. The use of the analytical method for making quick calculations with financial statement data will be advantageous to the investigator. This process takes into account ratios like return on sales and the debt-to-equity ratio. He will concentrate on weaknesses in internal controls and other areas that make fraud more likely. The detailed plan will subsequently be developed and implemented. After developing a thorough investigation plan, the forensic accountant must carry out the entire investigation. The gathering and analysis of the evidence is the next step in the investigation. The FA will focus particularly on regions with weak internal controls. The FA should take into account any red signals they observe. All investigation records must be kept for as long as possible to protect the chain of custody, allow witnesses to testify in court, and serve as evidence. After the data has been analyzed, a report with suggestions for corrective and preventative actions should be written.

VI. Methods of Analysis and Ratio Analysis

The forensic accountants assess the level of exploitation and discover frauds using analytical procedures. The most often used technique for detecting fraud is ratio analysis. Ratios are divided into six divisions in forensic accounting.

1. Direct/Transaction Method

The Direct Method in Forensic Accounting is also known as the Transaction Method. This method entails examining documents such as contracts, agreements, notices, cancelled checks, and invoices as well as public records. During these interviews, the accountant will probably also speak with management and staff. This will help them comprehend the accounting process and spot any potential fraud. Reviewing all relevant papers ensures a complete examination. The forensic accountant will also produce a working statement of cash flows in order to comprehend the cash inflows and outflows as well as any possible suspicious gaps or unidentified transactions.

2. Cash T Method

The Cash T Method is applied by comparing the amount of money received to the amount of money spent. This method is used to determine whether a company or individual overestimated their revenues. Make a list of every known source and use of money before implementing this technique. It's critical to remember that this strategy solely considers financial transactions. All monetary transactions are recorded as credits for cash payments and debits for cash receipts. This process is beneficial when the forensic accountant can calculate personal spending with accuracy. After totaling all cash receipts, the forensic accountant can establish unidentified revenue by deducting cash expenditures from cash receipts.

Cash Outlays - Cash Receipts = Undetermined Income

If the answer to this equation is 0, there is no unreported income, then fraud is not likely to have taken place.

3. Source and Application of Funds Method

Similar to the Source and Application of Funds Method is the Cash T Method. With this strategy, lifestyle costs are measured against earnings from investments and assets. This is yet another useful technique for determining a person's or a company's true net worth. This method considers "changes in assets and liabilities," in addition to cash transactions. Sources of cash, according to "Cash Intensive," can include "decreases in assets, increases in liabilities, or nontaxable receipts," while uses of cash can include "increases in assets, decreases in liabilities, and nondeductible expenses." This approach takes longer than the Cash T method to accomplish since it has to know the beginning and final account balances. If a balance sheet or statement of assets and liabilities is provided, using this method will be considerably simpler. To find any underestimate in adjusted gross income, total sources are subtracted from total applications after all sources and applications have been recognized.

Understatement of Adjusted Gross Income = Cash Applications - Cash Sources

4. Net Worth Method

The Net Worth Method is used to calculate net worth by deducting net liabilities from net assets.

Liabilities plus owner equity equal assets.

In the following step, net worth is "compared to reported income over several periods" (Kent). Forensic accountants are trained to spot anomalies and should look into them further. To find any inconsistencies, forensic accountants may also compute the change in net worth over a period of time ("Cash Intensive").

Net Worth Change is calculated as Ending Net Worth minus Starting Net Worth.

This calculation is difficult because fair market value is not always equal to GAAP (generally accepted accounting standards) value. Since asset valuations can be arbitrary, there might be differences between book value and true net worth. Conservatism is advantageous while using this tactic. This method is very beneficial in divorce proceedings. A forensic accountant who compares computed and reported net worth believes that significant differences could be a sign of fraud.

5. Bank Deposit Method

Another method for comparing cash in and cash out is the bank deposit method. This approach "compares the total deposits plus cash expenses minus nontaxable sources of income to the total receipts shown on the return" ("Cash Intensive"). When the taxpayer deposits all receipts in the bank and the forensic accountant can precisely calculate expenses, this procedure is most helpful.

Total Receipts ("Cash Intensive") = Net Deposits plus Undeposited Cash Expenditures.

All bank deposits minus nontaxable income are considered net deposits. Pensions, gifts, loans, and any other nontaxable sources of income (regardless of whether they are deposited) are all considered nontaxable income. Checks written are subtracted from total expenses to determine cash expenditures. The number of checks written can be calculated by deducting initial bank balances + deposits from ending bank balances.

Checks Written = Beginning Bank Balances - Ending Bank Balances - Deposits

6. Benford's Law

Benford's Law is a statistical technique for determining whether the data under study shows any trends that might point to dubious behaviour. Benford's Law can be used to determine the possibility of fraud but not to actually detect it.

VII. Relative Size Factor Theory

It finds data that is odd, which could be the result of fraud or trivial mistakes. It is predicated on the fundamental tenet that every field in a transaction has a normal range, and that any data outside of that range should be considered strange or an outlier and should be further studied. It is calculated as the difference between the greatest and second-largest numbers in a particular set. Recently, auditors have been employing computer assisted auditing tools (CAATS) to process complex transactions and deal with large amounts of data, which has improved efficiency and saved time.

VIII. Applications of Forensic Accounting

Forensic accounting is used to both investigate and prevent business fraud. Its deployment aims to uncover tax fraud. Fraudulent representation of investments, commodities, and stocks is the most common white-collar crime. The use of forensic accounting helps to prevent these frauds, Identification of hidden assets or asset abuse, settings of partnership and ownership, dispute identification and avoidance. Forensic accounting is used to determine the economic damages in negligence and auto accidents. Forensic accounting looks at insurance contracts, coverage issues, claim outcomes, and probable loss estimations. It examines for money laundering. It handles monetary problems in divorce and family conflicts.

IX. India's Forensic Accounting future

Forensic accountants should take note of the establishment of the Serious Fraud Investigation Office (SIFO) in India. Whether we see the need for forensic accounting or not, the surge in cybercrime, the incapacity of regulators to spot security scams, and a spate of failing cooperative banks all attest to its necessity. Forensic accountants are highly in demand in India due to the increase in frauds. Law enforcement employees are experts in fingerprint and narcotics analysis, but what about digital evidence analysis? There isn't much knowledge of it. It is a hunter's paradise. According to Maurice E. Peloubet, who coined the term in 1946, the preparation of financial statements has some, but not all, of the traits of forensic accounting.

This is a requirement for entry into the field for chartered accountants in India. It is the newest child in the area. Officers of CBI and CID undertake forensic accounting work. There had never been a distinct community in India. However, the movement is rapidly gaining traction within the Indian forensic community. The number of regulatory and administrative agencies will grow, as will the demand for services linked to forensic practice. Chartered accountants will increasingly practice what is essentially forensic accounting. The fact that accounting and assurance standards are always changing serves as more evidence for this. The top 100 American accounting firms are expanding their forensics and fraud services by almost 40%, according to Accounting Today. The day when forensic practice will account for the majority of the total revenue of an Indian CA organization is not far off, if this data is relevant to the Indian context. A forensic accountant is far different from the stereotypical image of an accountant that you may have had in the past; they are more like a private investigator with a good financial sense than a bookkeeper wearing green glasses.

X. Conclusion

Accounting programmes should emphasize and embrace forensic accounting as a result of the rising demand in the contemporary regulatory, legal, and business environments. Financial fraud is a significant problem that has spread throughout the modern economic world. Before it's too late, this trend needs to be stopped. Insofar as the actions of the third party are in any way indicative of the operations of the organization, forensic accounting is a new area of accounting whose main purpose is to uncover fraudulent activity both inside and outside the organization. The success of the profession in the future will be influenced by how the public perceives CPAs' abilities. Making fresh efforts in consultation, specialization, and awareness of international business practices and strategies is thought necessary. Before entering the niche market, we assess our strengths first. We can give our customers a high-caliber service while still making money if we are where the action is.

XI. References

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