International Journal of scientific research and management (IJSRM)
||Volume||3||Issue||1||Pages|| 1956-1966 ||2015||
Website: www.ijsrm.in ISSN (e): 2321-3418

Forensic Accounting And Fraud Examination

Dr. T.Naga Lakshmi

Faculty Member (PG), Department of Commerce,
Indian Institute of Management and Commerce (IIMC)
Adj: Telephone Bhavan, Saifabad,
Khairatabad, Hyderabad - -500 004.
Telangana, India.

Abstract

Everyday across the world, thousands of businesses are victimized by fraud. Who commits these bad acts? Why? In addition, How? Until they grab hold of the fatality, it is a million dollar question that where the thousands of public money is disappearing. Every time Auditors and Chartered Accountants are catching hold of the frauds and victims – yet again after few days, months and years quite a few new frauds is committed. The impact of fraud can be devastating and the results can have deep consequences for the marketplace, organization, employees, clients and suppliers. As recent corporate incidents have shown, financial losses arising from fraudulent activity may lead to redundancies, factory closures, the loss of business opportunities or even business failure. The misappropriated funds might otherwise have been used to re-invest in the business, to build new facilities, create employment or develop better products and services. There is a need for forensic accounting in examining the frauds. The present paper focuses on what is the concept of Forensic Accounting and Fraud. What are different types of frauds? What are different types of accounts useful for forensic accounting? etc, and the Whistle Blowing Act relating to Forensic Accounting and Fraud Examination.

Key Words: **Fraud, Examination, Forensic accounting, Auditing, Business**.

Definition of 'Forensic Accounting'

Forensic means relating to the use of science or technology in the investigation and establishment of facts or evidence in a court of law.

Forensic Accounting utilizes accounting, auditing, and investigative skills to conduct an examination into a company's financial statements. Thus, providing an accounting analysis that is suitable for court.

History of Forensic Accounting

The word forensic is a derivative of the Latin word forensis, meaning belonging to the forum, which was ancient Rome's site for public debate. Forensic testimony or forensic medicine was used to assist the court or the attorneys in resolution of legal issues, including assistance at trial. The integration of accounting, auditing, and investigative skills yields the specialty known as forensic accounting. Modern day forensic accounting can be defined as using financial knowledge and skill in conjunction with investigative techniques to resolve a matter in a legally defensible manner exacting to the specifications of the law. Archaeological findings reveal that, as far back as 3300-3500 BC, the scribes of ancient Egypt, who were the accountants of their day, were involved in the prevention and detection of fraud.

In more recent times, a close relationship developed between the accountancy and legal professions in the 1800 are, with accountants acting as expert financial witnesses in court cases. And in 1930's America, while Eliot Ness got all the publicity in the case against Al Capone, it was the work of Elmer Irey, an accountant with the Internal Revenue Service working behind the scenes, that ensured Capone's conviction for tax evasion. He was probably America's first high-profile forensic accountant. Therefore, far from being a new practice, forensic accounting has long been part of the accounting profession. While it took a back seat in the early 20th century with general accounting taking a greater role, it is now merely returning to its traditions. Today's forensic accountants are involved in a wide variety of cases, from the more mundane family law and commercial matters through to a range of criminal investigations, which include white-collar crimes, such as business and insurance fraud through to organized crime, murder and even terrorism, where forensic accountants are used to trace the money trail and uncover just who is financing the terrorist groups.

Introduction

Forensic Accounting has existed for many years. With the growing complexity of the business environment and the growing number of business related investigations, Forensic Accounting professionals are increasingly asked to assist in the investigation of financial and business related issues.

Objectives

1. To know about the significance of forensic accounting and fraud examination in the recent arena.
2. To know about the accounting scandals, whistle blowing act in relation to forensic accounting and fraud examination.

Methodology

The present study based on the secondary sources of data and discussions with eminent persons in the corporate field, also some inputs taken from the national seminar attended on Forensic accounting and fraud examination. However, forensic accounting covers a wide range of operations of which fraud examination is a small part where it is most prevalent.

Basic Types of Financial Fraud in Businesses

Too often, a business owner finds out too late that even the most loyal employee may commit financial fraud and steal from the company if the opportunity arises and the temptation becomes too great — or if the employee finds himself caught up in a serious personal financial dilemma and needs fast cash.

The four basic types of financial fraud are:

- **Embezzlement**
- **Internal theft**
- **Payoffs and kickbacks**
- **Skimming**

Fraud prevention

Organizations need to accept that no organization is immune to fraud. Too often, complacency is the fraudster's best ally. It is estimated that most instances of reported fraud in organizations go undetected for between 12 and 25 months. Organizations have a duty to strengthen their fraud prevention and detection control systems and to intensify internal reviews to highlight areas of control weakness. For the same reason, auditors and other assurance providers should pay increased attention to the fraud-risk issue when conducting audits and assurance reviews.

In order to confront fraudulent behavior, an organization should:

- accept that fraud exists and could occur;
- acknowledge the importance of fraud awareness;
- implement adequate and enforced controls, policies and procedures;
- create and support a strong ethical environment;
- introduce and observe a clear and effective segregation of duties within the organization;
- define and limit conflicts of interest; and
- continually monitor and control activities.

Investigating fraud

Fraud investigations indicate that fraudulent behavior particularly occurs in organizations when:

- there are no controls in place or controls are weak and inadequate;
- employees are inadequately managed or are pressured to achieve set financial goals;
- employees who are trusted by management have unresolved personal issues, especially of a financial nature, or suffer from an addiction to alcohol, drugs or gambling;
- the industry in which the organization operates is naturally susceptible to corruption or corruption is common within it; and
- The organization is experiencing problems such as facing financial trouble, losing market share or its services or products are becoming unsellable.

The Top 10 Corporate Accounting Scandals

If there were one theme to rival terrorism for defining the last decade-and-a-half, it would have to be corporate greed and malfeasance. Many of the biggest corporate accounting scandals in history happened during that time. Here is a chronological look back at some of the worst examples.

Waste Management Scandal (1998)
Company: Houston-based publicly traded waste management company

- What happened: Reported $1.7 billion in fake earnings.
- Main players: Founder/CEO/Chairman Dean L. Buntrock and other top

executives; Arthur Andersen Company (auditors)

- How they did it: The company allegedly falsely increased the depreciation time length for their property, plant and equipment on the balance sheets.
- How they were caught: A new CEO and management team went through the books.
- Penalties: Settled a shareholder class-action suit for $457 million. SEC fined ArthurAndersen $7 million.
- Fun fact: After the scandal, new CEO A. Maurice Meyers set up an anonymous company hotline where employees could report dishonest or improper behavior.

Enron Scandal (2001)
Company: Houston-based commodities, energy and Service Corporation

- What happened: Shareholders lost $74 billion, thousands of employees and investors lost their retirement accounts, and many employees lost their jobs.
- Main players: CEO Jeff Skilling and former CEO Ken Lay.
- How they did it: Kept huge debts off balance sheets.
- How they got caught: Turned in by internal whistleblower Sherron Watkins; high stock prices fueled external suspicions.
- Penalties: Lay died before serving time; Skilling got 24 years in prison. The company filed for bankruptcy. Arthur Andersen was found guilty of fudging Enron's accounts.
- Fun fact: Fortune Magazine named Enron "America's Most Innovative Company" 6 years in a row prior to the scandal.

WorldCom Scandal (2002)
Company: Telecommunications company; now MCI, Inc.

- What happened: Inflated assets by as much as $11 billion, leading to 30,000 lost jobs and $180 billion in losses for investors.
- Main player: CEO Bernie Ebbers
- How he did it: Underreported line costs by capitalizing rather than expensing and inflated revenues with fake accounting entries.
- How he was caught: WorldCom's internal auditing department uncovered $3.8 billion of fraud.
- Penalties: CFO was fired, controller resigned, and the company filed for bankruptcy. Ebbers sentenced to 25 years for fraud, conspiracy and filing false documents with regulators.
- Fun fact: Within weeks of the scandal, Congress passed the Sarbanes-Oxley Act, introducing the most sweeping set of new business regulations since the 1930s.

Tyco Scandal (2002)
Company: New Jersey-based blue-chip Swiss security systems.

- What happened: CEO and CFO stole $150 million and inflated company income by $500 million.
- Main players: CEO Dennis Kozlowski and former CFO Mark Swartz.
- How they did it: Siphoned money through unapproved loans and fraudulent stock sales. Money was smuggled out of company disguised as executive bonuses or benefits.
- How they got caught: SEC and Manhattan D.A. investigations uncovered questionable accounting practices, including large loans made to Kozlowski that were then forgiven.
- Penalties: Kozlowski and Swartz were sentenced to 8-25 years in prison. A class-action lawsuit forced Tyco to pay $2.92 billion to investors.
- Fun fact: At the height of the scandal Kozlowski threw a $2 million birthday party for his wife on a Mediterranean island, complete with a Jimmy Buffet performance.

HealthSouth Scandal (2003)
Company: Largest publicly traded health care company in the U.S.

- What happened: Earnings numbers were allegedly inflated $1.4 billion to meet stockholder expectations.
- Main player: CEO Richard Scrushy.
- How he did it: Allegedly told underlings to make up numbers and transactions from 1996-2003.
- How he got caught: Sold $75 million in stock a day before the company posted a huge loss, triggering SEC suspicions.
- Penalties: Scrushy was acquitted of all 36 counts of accounting fraud, but convicted of bribing the governor of Alabama, leading to a 7-year prison sentence.
- Fun fact: Scrushy now works as a motivational speaker and maintains his innocence.

Freddie Mac (2003)
Company: Federally backed mortgage-financing giant.

- What happened: $5 billion in earnings were misstated.
- Main players: President/COO David Glenn, Chairman/CEO Leland Brendsel, ex-CFO Vaughn Clarke, former senior VPs Robert Dean and Nazir Dossani.
- How they did it: Intentionally misstated and understated earnings on the books.
- How they got caught: An SEC investigation.
- Penalties: $125 million in fines and the firing of Glenn, Clarke and Brendsel.
- Fun fact: 1 year later, the other federally backed mortgage financing company, Fannie Mae, was caught in

an equally stunning accounting scandal.

American International Group (AIG) Scandal (2005)
Company: Multinational Insurance Corporation.

- What happened: Massive accounting fraud to the tune of $3.9 billion was alleged, along with bid-rigging and stock price manipulation.
- Main player: CEO Hank Greenberg.
- How he did it: Allegedly booked loans as revenue, steered clients to insurers with whom AIG had payoff agreements, and told traders to inflate AIG stock price.
- How he got caught: SEC regulator investigations, possibly tipped off by a whistleblower.
- Penalties: Settled with the SEC for $10 million in 2003 and $1.64 billion in 2006, with a Louisiana pension fund for $115 million, and with 3 Ohio pension funds for $725 million. Greenberg was fired, but has faced no criminal charges.
- Fun fact: After posting the largest quarterly corporate loss in history in 2008 ($61.7 billion) and getting bailed out with taxpayer dollars, AIG execs rewarded themselves with over $165 million in bonuses.

Lehman Brothers Scandal (2008)
Company: Global financial services firm.

- What happened: Hid over $50 billion in loans disguised as sales.
- Main players: Lehman executives and the company's auditors, Ernst & Young.
- How they did it: Allegedly sold toxic assets to Cayman Island banks with the understanding that they would be bought back eventually. Created the impression Lehman had $50 billion more cash and $50 billion less in toxic assets than it really did.
- How they got caught: Went bankrupt.
- Penalties: Forced into the largest bankruptcy in U.S. history. SEC didn't prosecute due to lack of evidence.
- Fun fact: In 2007 Lehman Brothers was ranked the #1 "Most Admired Securities Firm" by Fortune Magazine.

Bernie Madoff Scandal (2008)
Company: Bernard L. Madoff Investment Securities LLC was a Wall Street investment firm founded by Madoff.

- What happened: Tricked investors out of $64.8 billion through the largest Ponzi scheme in history.
- Main players: Bernie Madoff, his accountant, David Friehling, and Frank DiPascalli.
- How they did it: Investors were paid returns out of their own money or that of other investors rather than from profits.
- How they got caught: Madoff told his sons about his scheme and they

reported him to the SEC. He was arrested the next day.

- Penalties: 150 years in prison for Madoff + $170 billion restitution. Prison time for Friehling and DiPascalli.
- Fun fact: Madoff's fraud was revealed just months after the 2008 U.S. financial collapse.

Satyam Scandal (2009)

Company: Indian IT services and back-office accounting firm.

- What happened: Falsely boosted revenue by $1.5 billion.
- Main player: Founder/Chairman Ramalinga Raju.
- How he did it: Falsified revenues, margins and cash balances to the tune of 50 billion rupees.
- How he got caught: Admitted the fraud in a letter to the company's board of directors.
- Penalties: Raju and his brother charged with breach of trust, conspiracy, cheating and falsification of records. Released after the Central Bureau of Investigation failed to file charges on time.
- Fun fact: In 2011 Ramalinga Raju's wife published a book of his existentialist, free-verse poetry.

INTERNAL THREATS

Types of Fraud	Indian Co's %	Global Avg.%
Theft of Assets	33	28
Corruption	24	14
Financial Fraud	22	16
Information Theft	24	22

Soruce: Krall (BRIC)

From the above table it is observed that, 33% of Indian Companies face internal threat of theft of assets, 24% face the problem of Corruption, 22% visage the problem of Financial Fraud and 24% of Information Theft which is more than Global Average percentage, almost all the threats are more in Indian Companies when compared with Global companies.

FRAUD COMMITTED BY INTERNAL/EXTERNAL EMPLOYEES

Cou ntry	% of Co's Indicating Fraud Perpetrated by a Junior Employee	% of Cos Indicating Fraud Perpetrated by a Vendor or Supplier
BRA ZIL	25	31
RUS SIA	42	23
INDI A	9	40
CHI NA	28	38
GLO BAL AVE	42	32

RAG E		

Soruce: Krall (BRIC)

From the above table it is observed that as far as the fraud committed by external workforce is more in India when compared with other countries i.e.,40, external workforce such as vendor /supplier playing a vital role in committing fraud and in cheating the management, in eating away the funds of the organization, which otherwise would have been utilized for a better and feasible project.

LEGISLATION

Whistle blower act

The following is the State of Kansas Whistleblower Act which is listed in K.S.A. 75-2973 (1995 Supplement).

75-2973. Communications by state employees with legislators, legislative committees and others; prohibiting certain acts by supervisors and appointing authorities; appeal to state civil service board; posting copy of act; disciplinary action defined; officers and employees in unclassified service may bring civil action for relief.

(a) No supervisor or appointing authority of any state agency shall prohibit any employee of the agency from discussing the operation of the agency, either specifically or generally, with any member of the legislature.

(b) No supervisor or appointing authority of any state agency shall:

1. Prohibit any employee of the agency from reporting any violation of state or federal law or rules and regulations to any person, agency or organization; or
2. require any such employee to give notice to the supervisor or appointing authority prior to making any such report.

(c) This section shall not be construed as:

1. Prohibiting a supervisor or appointing authority from requiring that an employee inform the supervisor or appointing authority as to legislative requests for information to the agency or the substance of testimony made, or to be made, by the employee to legislators on behalf of the agency;
2. permitting an employee to leave the employee's assigned work area during normal work hours without following applicable rules and regulations and policies pertaining to leaves, unless the employee is requested by a legislator or legislative committee to appear before a legislative committee;
3. authorizing an employee to represent the employee's personal opinions as the opinions of a state agency; or
4. prohibiting disciplinary action of an employee who discloses information which:

(A) The employee knows to be false or which the employee discloses with reckless disregard for its truth or falsity,

(B) the employee knows to be exempt from required disclosure under the Open Records Act or

(C) is confidential under any other provision of law.

(d) Any officer or employee who is in the classified service and has permanent status under the Kansas Civil service Act may appeal to the State Civil Service Board whenever the officer or employee alleges that disciplinary action was taken against the officer or employee in violation of this act in any court of law or administrative hearing. The appeal shall be filed within 30 days of the alleged disciplinary action. Procedures governing the appeal shall be in accordance with subsections (f) and (g) of K.S.A. 75-2949 and amendments thereto and K.S.A. 75-2929d through 75-2929g and amendments thereto. If the board finds that disciplinary action taken was unreasonable, the board shall modify or reverse the agency's action and order such relief for the employee as the board considers appropriate. If the board finds a violation of this act, it may require as a penalty that the violator be suspended on leave without pay for not more than 30 days or, in cases of willful or repeated violations, may require that the violator forfeit the violator's position as a state officer or employee and disqualify the violator for appointment to or employment as a state officer or employee for a period of not more than two years. The decision of the board in such cases may be appealed by any party pursuant to law.

(e) Each state agency shall prominently post a copy of this act in locations where it can reasonably be expected to come to the attention of all employees of the agency.

(f) As used in this section "disciplinary action" means any dismissal, demotion, transfer, reassignment, suspension, reprimand, warning of possible dismissal or withholding of work.

(g) Any officer or employee who is in the unclassified service who alleges that disciplinary action has been taken against such officer or employee in violation of this section may bring a civil action for appropriate injunctive relief, or actual damages, or both within 90 days after the occurrence of the alleged violation. A court, in rendering a judgment in an action brought pursuant to this act, shall order, as the court considered appropriate, reinstatement of the officer or employee, the payment of back wages, full reinstatement of fringe benefits and seniority rights, actual damages, or any combination of these remedies. A court may also award such officer or employee all or a portion of the cost of litigation, including reasonable attorney fees and witness fees.

Conclusion:

Over time, the definition of forensic accounting has gradually changed from merely preventing theft, to testifying in court, to the creation of the modern day investigative accountant. History tends to repeat itself and the need to effectively and efficiently respond to scandals and disputes will continue to surely grow in the 21st century. Forensic accountants may help with risk management and risk reduction through customized design of accounting and auditing systems and procedures. As a function of due diligence and investment analysis, they will advise on a wide variety of financial transactions:

- Contemplated mergers and acquisitions
- Venture capital investments
- The purchase of corporate bonds, commercial paper and stocks
- Bankruptcy proceedings

The criminal activity uncovered may include fraud, embezzlement, money laundering, the concealment of debt, the concealment of assets or other fraudulent activities, or even financial crimes.

References:

1. Information obtained from ‘A Guide to Forensic Accounting” by Jill A. Blumenfeld, Reprinted with permission, Faulkner & Gray 1992.
2. http://www.nafanet.com/index_files/forensicaccounting.htm
3. http://www.nafanet.com/index_files/fahistory.htm
4. http://www.investopedia.com/terms/f/forensicaccounting.asp
5. http://www.forensicaccounting.com/index.htm
6. http://www.k-state.edu/internalaudit/reporting-fraud/frauddefinition.html
7. http://www.dummies.com/how-to/content/basic-types-of-financial-fraud-in-businesses.html
8. http://www.gaaaccounting.com/fraud-at-work/#sthash.BXuLKD0z.dpuf
9. http://www.gaaaccounting.com/fraud-at-work/
10. http://trak.in/banking/2013-bank-cyber-fraud-india-statistics/
11. http://timesofindia.indiatimes.com/business/india-business/Fear-of-fraud-rises-in-India-Inc-Survey/articleshow/24618540.cms
12. http://www.ijifr.com/pdfsave/22-09-201476V2-E1-006.pdf
13. http://rbi.org.in/scripts/BS_SpeechesView.aspx?Id=826
14. http://www.complianceweek.com/blogs/enforcement-action/2013-
15. http://www.accounting-degree.org/scandals/
16. http://www.investopedia.com/articles/financial-careers/08/forensic-accounting-career.asp
17. http://www.envoynews.com/rwcpas/e_article001108198.cfm
18. http://www.dolmanbateman.com.au/125/history-of-forensic-accounting/

Author Name:
Dr.T. Nagalakshmi [M.com, M.A.(Eco), MBA (HR), Ph.D]

Faculty Member (PG), Department of Commerce,
Indian Institute of Management and Commerce (IIMC)
Adj: Telephone Bhavan, Saifabad,
Khairatabad, Hyderabad - -500 004.
Telangana, India.