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FORENSIC ACCOUNTING: An Emerging Trend with special reference to SFIO

PROFESSOR CA (Dr.) CHITTARANJAN SARKAR
Professor of Commerce, Netaji Subhas Open University, Salt Lake City, Kolkata-700064
Former Professor of Commerce, The University of Burdwan &
Professor and Director of MBA, Raiganj University, Raiganj, Uttardinajpur

The business houses in the present scenario of complex business atmosphere have become highly subservient to corruptions in areas like financial discrepancies, fraud, financial manipulations as well as corporate malpractices leading to corporate failures in many cases. There are galore of instances that owing to lack of appropriate preventive measures, many corporate houses have to face the destiny of corporate massacre and destitute. At this juncture, the need for fraud detection, controlling financial discrepancies etc. have got momentum in the form of forensic accounting and auditing where the Chartered Accountants with their vast and in-depth knowledge base and expertise can play crucial role under the canopy of SFIO to control and prevent corporate frauds.

Forensic Accounting- Concept and Meaning

Unlike a traditional financial audit where the function of audit work concentrates on checking and analysing the degree of true and fair view exhibited in financial statements prepared and supplied by the clients, a forensic audit is defined as a systematic in-depth investigation to unearth financial and procedural anomalies in financial statements like financial manipulations including embezzlement, money laundering, financial crimes, corporate fraud etc. Forensic accounting is a specialist area of accounting and auditing encompassed with the investigative aspects towards looking into financial records to bring to light the evidence of fraud, quantum of money embezzlement, other fraudulent activities causing corporate failures and disasters. Forensic accounting in its special approach applies blended activities in accounting, auditing, investigating, analytical skill as well as calibrating aptitude to reveal financial discrepancies, monetary disorders, financial irregularities undertaken by corporate houses for various reasons including showing of jaundiced picture of financial status to misled others and at the same time to collect and prepare evidence for taking legal proceedings and actions against the wrongdoers. In fact, the forensic accountants and auditors critically analyse the complex and convoluted financial data, identify financial irregularities, and are entrusted to present their findings in a manner that can be placed before the court as expert evidences/witnesses.

Significance of Forensic Accounting

Forensic accounting examines accounting information, books of accounts, other historical financial data for the cause of identifying fraud and suspected criminal conduct. Forensic Accounting is a specific field of accounting and investigation to identify and unearth fraud and fraudulent activities. It is a systematic approach to employ accounting, auditing techniques

and investigative skills to uncover fraudulent activities committed by an individual or entity to deceive another individual or entity. In the present economic scenario, forensic accounting has become an essential tool to cope with the growing incidence of accounting fraud, misapplication of money and other assets. The essence of forensic accounting lies on to discover and investigate financial crimes to assist the litigation proceeding covering diverse areas of improper accounting, mismanagement of fund, embezzlement of cash etc.

Role of Forensic Accounting

Forensic accounting is used in a variety of circumstances for court cases, criminal investigations, money laundering, embezzlement and insurance etc. to detect fraud. It analyses and interprets financial records and accounts to perform its classic role to provide legal evidence to testify in court cases as expert witnesses. Forensic accounting with the help of integrated accounting, auditing and investigative techniques significantly unveils financial crimes, traces funds, identifies misuse of assets, conducts asset recovery, and performs due diligence reviews on fraud. The crucial roles of Forensic Accounting may be highlighted to include:

- ❖ Identifying financial fraud and crime
- ❖ Providing evidence for legal proceedings
- ❖ Preventing fraud by suggesting internal control, anti-fraud policies etc.
- ❖ Mitigating financial loss caused by fraud
- ❖ Ensuring compliance with rules and regulations

Concept of Fraud

Fraud is universally recognised as the act of deceit that is subject to both civil and criminal action. Fraud is commonly observed in various transactions involving the buying/selling of property including real estate, personal belongings and intangible assets like stock, bonds and copyrights etc. with the intention to deceit others by wrongful or criminal manner to result in financial or personal gain. In India, not all frauds are considered criminal in nature. Prosecutors usually consider which cases to be pursued criminally. Victims have the option to seek redress in civil court when the impact of fraud is limited to a specific company/individual without affecting the broader economy.

In contrast, if the fraud committed with a company/entity has far reaching implications affecting the entire economy, the appropriate curse of action is the criminal prosecution under the different criminal law statutes, including the Indian Penal Code, 1860. Here, not only the accused is punished but also to take measures to recover the ill-gotten gains of the accused from the fraudulent activities.

The Companies Act, 2013 in section 447, Chapter XXIX, defines fraud in relation to the affairs of a company or a body corporate, as any act, omission, concealment of facts or abuse of position committed by any person or in connivance with other person with the intent to deceive or to take undue advantage or to injure the interests of the company, its shareholders, creditors, or any other person, whether or not there is any wrongful gain or loss.

Types of Corporate Frauds and Flag Indications for Fraud Detection

Corporate fraud involves several deceptive and illegal acts committed by individuals or organizations for financial or strategic gain over and above the normally accepted benefits. Corporate fraud may take various forms including:

a) Personal purchases
b) Ghost employees
c) Skimming

d) Tax evasion
e) Asset theft
f) Unauthorised use
g) Financial statement falsification

Flag Indicators of Fraud

Flag indicators of fraud represent some warning signs, behavioural cues, or transaction patterns that suggest potential illegal activities, manipulation of accounts, unauthorised use or waste of money, embezzlement of fund etc. that may be considered as the proof of fraud or fraudulent activities. Depending on the nature and gravity in highlighting fraud and fraudulent activities, flag indicators of fraud may be termed as Red Flag, Yellow Flag and Green Flag.

1) **Red Flags**-This represents frequent discrepancies observed between reported profits and actual cash flows, or unexplained drops in revenue. This also includes unplanned or last-minute journal entries used to balance books or cover missing funds, repeated disbursements to the same vendor, wrong inventory calculations suppressing actual stock figures etc. Sudden spikes in transactions, dormant accounts activating with large orders, or unusual geographic leaps also reveal red flags indication of fraud.

2) **Yellow Flags**- Yellow flags in fraud detection represent looking over ambiguous behaviours or patterns that are commonly experienced among fraudsters and swindlers where secondary verifications may be attempted to ensure genuine fraud. Unlike red flags which strongly indicate misconduct or fraudulent activities, a yellow flag alone does not evidence fraud, but it serves as an early warning to prompt further review or monitoring. Examples may include activities like-keeping a video camera off during online meetings or unusually high-volume or off-hour card transactions or so.

3) Green Flags- Green flags in fraud detection process represent positive, normal, and verified indicators of legitimacy. Green flags in fraud detection and prevention measure represent positive, trustworthy indicators involving activity matching of consumers' historical buying patterns, symmetry in frequency of buying habits, no change in consumers' phone numbers, positive biometric verifications as well as regularity in user profile maintenance of consumers. However, forensic accountants and auditors should be aware of that "all-green" or "too-good-to-be-true" patterns may not always become trustworthy and can occasionally be turned into mask underlying fraud or bypass scrutiny.

Scope of Forensic Accounting and the Role of Chartered Accountants

Forensic Accounting or Forensic Science Accounting is a unique method of accounting that explores fraud in the light of historical data to actively help in legal proceedings for dispute resolution. It is a sensible blending of accounting, auditing as well as investigative skills to detect financial irregularities and fraud. Section 210 of the Companies Act, 2013 has paved the way of conducting forensic accounting by empowering the Central Government to investigate into the affairs of a company on the basis of the Registrar of Companies' inquiry report for which investigation may be initiated under section 212(1) of the Companies Act, 2013 to unveil potential corporate fraud. The Companies Act, 2013 has brought white-collar crimes into the ambit of Serious Fraud Investigation Office (SFIO) and this enactment has boosted up the pace of forensic accounting and investigation in India. SFIO is the Indian fraud investigating agency to investigate serious cases of fraud received from the Department of Company Affairs.

Because of their deep mastery in diverse areas of financial reporting, taxation, corporate laws, and auditing standards, the Chartered Accountants are uniquely positioned for conducting forensic accounting and auditing. They examine client's books of accounts and records, trace fund flows, reconstruct altered or missing records, and spot financial anomalies like embezzlement, vendor fraud, or money laundering in the course of forensic accounting and

auditing. With the help of their versatile knowledge, they track hidden, diverted, or siphoned assets across domestic and international accounts during corporate scams enquiry or insolvency proceedings. They also act as expert witnesses in civil and criminal proceedings, quantifying financial damages, shareholder disputes, or insurance claims to assist corporate investigation. In India, the Chartered Accountants work alongside or assist enforcement agencies such as the Serious Fraud Investigation Office (SFIO), Enforcement Directorate (ED), Reserve Bank of India (RBI), and the Securities and Exchange Board of India (SEBI) in various regulatory and litigation cases. While conducting forensic audits, the Chartered Accountants working under the aegis of the Institute of Chartered Accountants of India (ICAI) must adhere to the Forensic Accounting and Investigation Standards (FAIS), to ensure that the evidence gathered by them meets the required legal thresholds to commensurate with the forensic audit.

Serious Fraud Investigation Office (SFIO) and its Establishment

SFIO is the Indian Statutory Corporate Fraud Investigation Authority and it was established in 2nd July, 2003 to conduct investigation under section 235 to 245 of the Companies Act, 1956. However, section 211 of the Companies Act, 2013 has provided legislative status to SFIO. It is thus a regulatory agency entrusted with resolving and prosecuting white-collar crimes in India. Section 211 deals with the establishment of SFIO.

As per section 211 of the Companies Act, 2013, the Central Govt. shall establish an office to be called the SFIO to investigate frauds relating to a company. The SFIO shall be headed by a Director who shall be an officer not below the rank of a Joint Secretary to the Govt. of India having knowledge and experience in dealing with matters relating to the company affairs.

The SFIO shall also consist of such number of expert members to be appointed by the Central Govt. from the following fields: a) Banking, b) Company Affairs, c) Taxation, d) Forensic audit, e) Capital market, f) Information technology, g) Law and h) other fields.

Investigation Function of SFIO

Section 212 of the Companies Act, 2013 prescribes the functions for investigation into the affairs of companies by SFIO. The Central Govt. may by order assign an investigation into the affairs of a company in the following situations:

a) On receipt of a report of the Registrar or inspector under section 208;

b) On intimation of a special resolution passed by a company that its affairs are required to be investigated;

c) In the public interest;

d) On request from any department of Central /State Govt.

If an investigation case is assigned to the SFIO, the case shall not be investigated by the Central Govt./State Govt. and all existing investigations into the affairs of a company shall be transferred to the SFIO.

Under section 212(3), where the Central Govt has directed the SFIO to investigate into the affairs of a company, the SFIO must undertake the assignment and submit its report to the Central Govt. within the time frame as may be specified by the Central Govt. order.

However, the SFIO has no time constraint under the Companies Act, 2013 for completing the investigation and submitting the investigation report. The question arises whether the mandate of SFIO would be terminated if the investigation report is not submitted within the time frame set by the Central Govt. It is determined that the time limit mentioned in the Central Govt. order is merely advisory and not binding.

The authority to investigate shall not be terminated even if the time limit mentioned by Central Govt. is expired. According the Companies Act, 2013, the SFIO shall submit an interim report if necessary or a report after completion of the investigation to the Central Govt.

Section 212(4) of the Companies Act, 2103 provides that the Central Govt. may, after receipt of the report from the SFIO instruct the SFIO to start prosecution against the company, its executives and employees provided that there is sufficient reason to sustain a charge. The investigation report filed with the Special Court framing charges must be assumed to be a report filed by a Police Officer under section 173 of the Criminal Procedure Code (CPC) which is often referred to as a 'Charge Sheet'.

Forensic Accounting and Investigation Standards (FAIS)

The Institute of Chartered Accountants of India has well formulated standards to be followed by forensic accountants for preventing the rising scams and irregularities on accounting, financial and loan. The domains of Forensic Accounting and Investigations (FAIS) are highly specialized, and require particular emphasis to certain attributes and conduct of professionals practicing in these areas.

Under the aegis of the Digital Accounting and Assurance Board (DAAB), a non-standing Committee of the Institute of Chartered Accountants of India (ICAI), a set of Forensic Accounting and Investigation Standards (FAIS or "Standards") are issued to harmonise the work undertaken by its members.

These standards are specifically designed to cater to the needs of banks, regulators, corporate bodies as well as enforcement agencies like Enforcement Directorate, SFIO, CBI, RBI etc. to conduct forensic accounting and fraud detection in a beneficial manner.

The standards set by ICAI lays down primary qualitative measures for conducting investigations by different enforcement agencies and members of ICAI. Many Forensic Accounting and Investigation Standards have been issued by Digital Accounting and Assurance Board (DAAB) of ICAI for building digital competencies to ensure Chartered Accountants meet challenges and leverage opportunities of digital era.

The FAIS gives much focus on due diligence, integrity and confidentiality that must be secured by the forensic accountants. The professionals shall at all times, must work diligently with utmost care, skill and caution, exercise team integrity while performing the investigation work, maintain utmost confidentiality of all information acquired during the course of the engagement.

This includes the need to protect privacy rights of the suspect and to discover evidence in a manner which does not infringe upon the privacy rights of individuals. The professional shall not disclose any such information to a party outside the team formed to conduct the engagement and the engaging management.

Certificate Course on Forensic Accounting and Fraud Detection by ICAI

Considering the emerging economic scenario where growing number of incidents of committing frauds, cyber-crimes, money laundering etc. have been distressing the society to a large extent, the ICAI has launched a certificate course on 'Forensic Accounting and Fraud Detection'. The Certificate Course on Forensic Accounting and Fraud Detection of ICAI aims to develop and inculcate amongst its members such investigative skills that are required to uncover corporate/business frauds, measure resultant damage, provide litigation support/outside counsel by applying accounting, auditing principles for the detection of frauds.

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