

## FORENSIC ACCOUNTING- A NEW OPPORTUNITY FOR CHARTERED ACCOUNTANTS

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### Pencil Parable

### The Pencil Parable

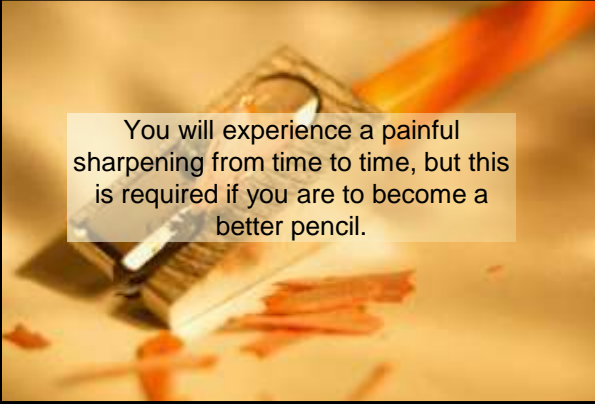
In the beginning, the Pencil Maker spoke to the pencil saying,

"There are five things you need to know before I send you out into the world. Always remember them and you will become the best pencil you can be."


#### **First:**

You will be able to do many great things, but only if you allow yourself to be held in someone's hand.




**Second:**

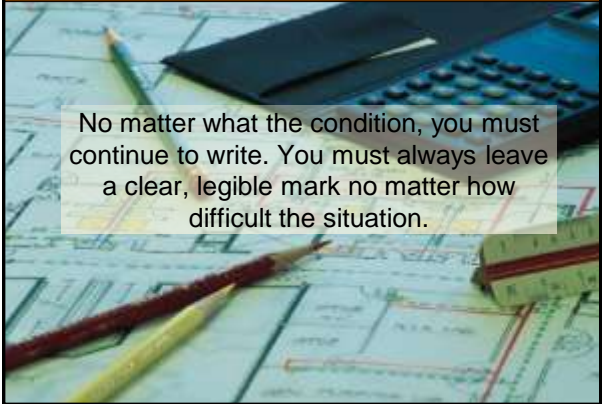
You will experience a painful sharpening from time to time, but this is required if you are to become a better pencil.

**Third:**

You have the ability to correct any mistakes you might make.

**Fourth:**

The most important part of you will always be what's inside.

**Fifth:**

No matter what the condition, you must continue to write. You must always leave a clear, legible mark no matter how difficult the situation.



The pencil understood, promising to remember, and went into the box fully understanding its Maker's purpose.

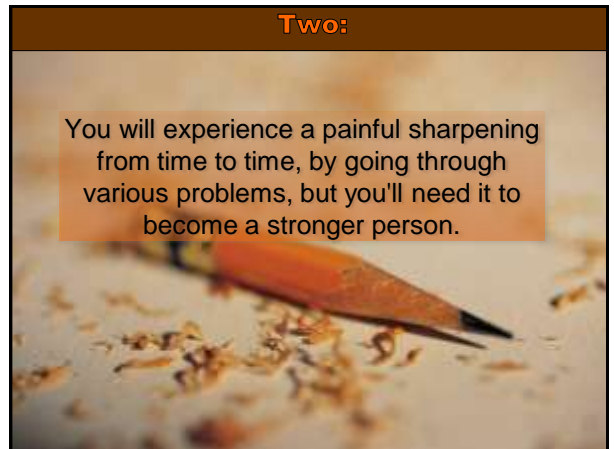


Now replacing the place of the pencil with you; always remember them and never forget, and you will become the best person you can be.



### One:

You will be able to do many great things, but only if you allow yourself to be held in someone's hand. And allow other human beings to access you for the many gifts you possess.

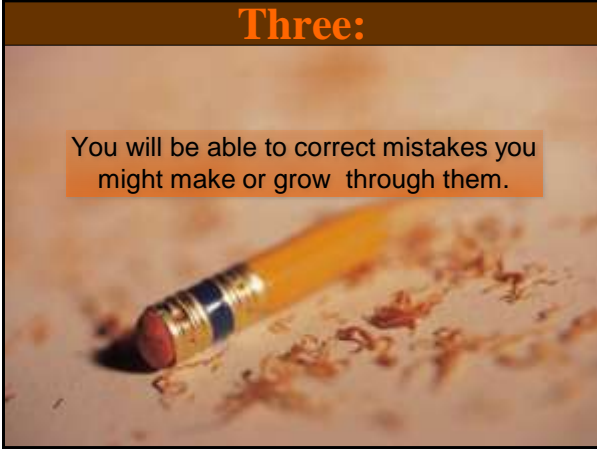


### Two:

You will experience a painful sharpening from time to time, by going through various problems, but you'll need it to become a stronger person.

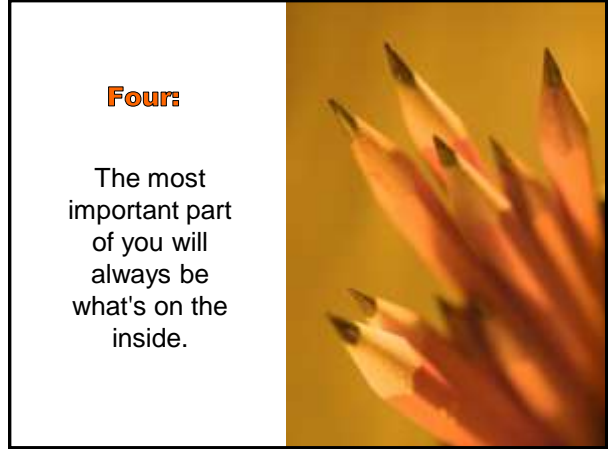
### Three:

You will be able to correct mistakes you might make or grow through them.



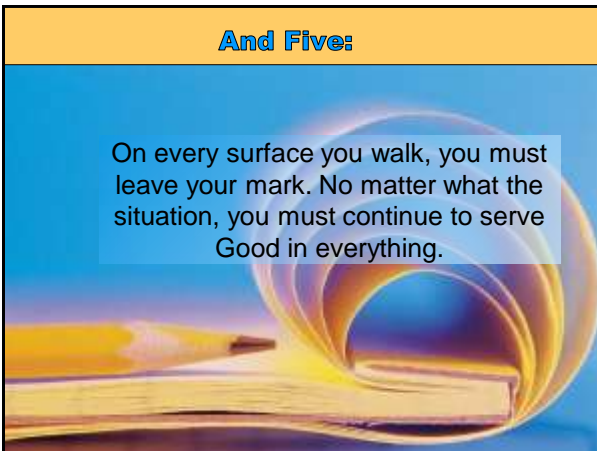
### Four:

The most important part of you will always be what's on the inside.



### And Five:

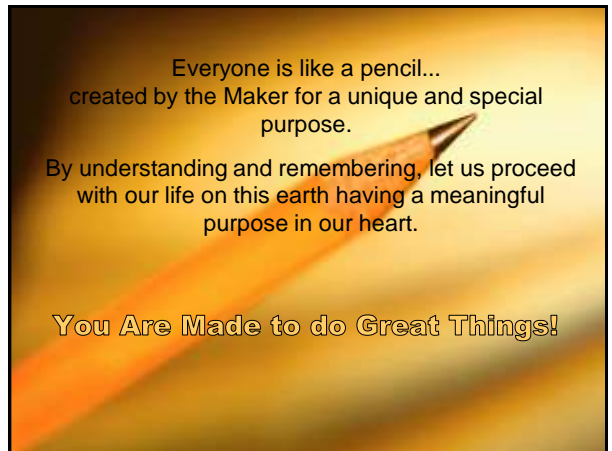
On every surface you walk, you must leave your mark. No matter what the situation, you must continue to serve Good in everything.



Everyone is like a pencil... created by the Maker for a unique and special purpose.

By understanding and remembering, let us proceed with our life on this earth having a meaningful purpose in our heart.

**You Are Made to do Great Things!**



## Types of Fraud

- Bank frauds
- Corporate frauds
- Insurance frauds
- Cyber frauds
- Securities frauds

## Who is a Forensic Accountant?

- Forensic accountants may be involved in recovering proceeds of crime and in relation to confiscation proceedings concerning actual or assumed proceeds of crime or money laundering. Some forensic accountants are also Certified Fraud Examiners, Certified Public Accountants, Certified Money Laundering Specialists, or **Chartered Accountants**.

## Who is a Forensic Accountant?

- Forensic accountants utilize an understanding of business information and financial reporting systems, accounting and auditing standards and procedures, evidence gathering and investigative techniques, and litigation processes and procedures to perform their work.

## Role of Forensic Accountant

- Forensic accountants are trained to look beyond the numbers and deal with the business realities of situations
- Analysis, interpretation, summarization and the presentation of complex financial and business related issues are prominent features of the profession
- A forensic accountant will also be familiar with legal concepts and procedures

### Role of Forensic Accountant

- Public practice or insurance companies, banks, police forces and government agencies are major employers of forensic accountants
- Forensic accountants are also increasingly playing more proactive risk reduction roles by designing and performing extended procedures as part of the statutory audit, acting as advisers to audit committees, fraud deterrence engagements, and assisting in investment analyst research.

### Forensic Audit

- Forensic Audit refers to the whole **process** of **investigating a financial matter**, including potentially acting as an expert witness if the fraud comes to trial.
- Work involves an investigation into financial affairs of the entity and is often associated with investigations into alleged fraudulent activity.
- Forensic Audit is the activity of forensic investigation, which refers to the practical steps that the forensic accountant takes in order to gather evidence relevant to the alleged fraudulent activity.

### Forensic Accounting & Auditing

- **Forensic Accounting** involves **examination** of Financial Statement & **providing analysis** using **accounting, auditing and investigative skills** for legal disputes, insurance claims etc.
- **Forensic Auditing** involves **application of audit skills** to situations **with legal consequences** – examining evidence and producing it to the court.

### Forensic Audit

- The entire process would include the following steps:
  - First Stage - Planning Stage
  - Second Stage – Gathering of Evidence
  - Third Stage – Review Process
  - Fourth Stage – Report to the Client
- The purpose of the forensic audit would be to:
  - Discover if a fraud has actually taken place
  - Identify those involved
  - To quantify the monetary amount of the fraud
  - Present the findings to the Client/ Court



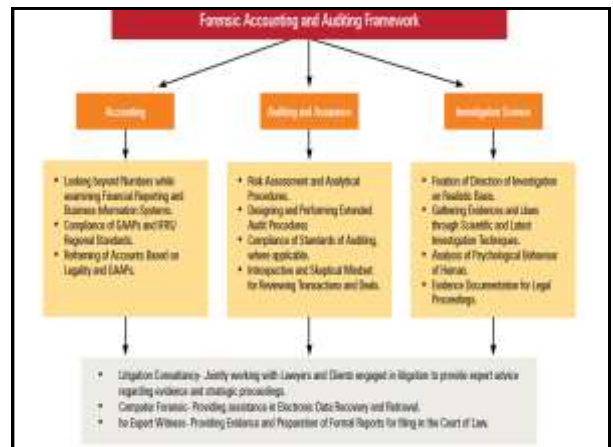
## Uses of Forensic Auditing/ Accounting

- **Fraud detection where employees commit Fraud:**
  - Locating any assets created by them out of the funds defalcated;
  - Interrogating suspected employees;
  - Conclusion of investigation.
- **Criminal Investigation:**
  - Preparation of formal report;
  - Presentation of proper evidence.

## Uses of Forensic Auditing/ Accounting

- **Cases relating to professional negligence:**
  - Non-conformation to Generally Accepted Accounting Standards (GAAS);
  - or non compliance to auditing practices or ethical codes of any profession.
- **Arbitration service:** Forensic accountants may render arbitration and mediation services for the business community, if they undergo special training in the area of alternative dispute resolution.
- **Settlement of insurance claims:** Insurance companies engage forensic accountants to have an accurate assessment of claims to be settled.

## Required Skills of a Forensic Accountant/Auditor



### Forensic Audit Documentation – Case Study

*XYZ Ltd. has approached you to conduct Forensic Audit as it has come to their notice that one of the employees Mr. ABC has misappropriated an estimated amount of Rs. 15 lacs as apparent from prima facie review of records*

### Forensic Audit Documentation – Case Study

The other facts of the case as known are as under:

- Mr. ABC was working in the capacity of sales manager dealing with clients pan-India and used to travel to their offices.
- He used to carry products of company for delivery as company was dealing with optical/camera products used in hospitals, clinics, laboratories.
- He also used to collect payments from these parties in cash/cheque.

### Forensic Audit Documentation – Case Study

The other facts of the case as known are as under:

- It is noticed that he has submitted train tickets and hotel bills for travel undertaken by him. There is a suspicion that these travel bills are not genuine.
- The Company used to give credit to its customers for 60 days & it is now found that cheque has been credited in the name of party in Hyderabad as informed by another employee to accounts department.

Decide what documents you would gather for the purposes of forensic audit to clearly unearth the quantum of fraud /misappropriation

### Forensic Audit Documentation – Case Study

*Decide what documents you would gather for the purposes of forensic audit to clearly unearth the quantum of fraud and misappropriation.*



## Forensic Audit Documentation – Case Study

Documents required are:

- Nature of duties of Mr. ABC
- Sales/Credit policies of Company
- Travel re-imbursement policy of XYZ Ltd.
- List of other sales managers
- List of customers dealt by Mr. ABC, along with their address and contact details
- Ledger account of all parties

## Forensic Audit Documentation – Case Study

- Sales Invoices
- Confirmations from parties
- Sales Tax/Vat Returns
- Copies of cash book and bank book
- Bank statements
- Travel Bills submitted by Mr. ABC

## Minimum Documents Required

- Details of suspicion on particular transaction
- Findings of the department concerned on present issue
- List and details of person concerned with the issue
- List and details of laws applicable on the present issue and their non compliance
- All concerned ledgers, vouchers and books of account
- Related regulatory filings
- Related persons
- Quantify the monetary benefit accrued
- Supporting documents for the monetary benefit accrued

## Engagement Letters

## How to Draft an Engagement Letter

- Introductory Information: Date, Address and Case Name
- Scope of Work involved and agreed by the management
- Independence and Conflicts of Interest
- Description of Practitioner Services
- Acknowledgment and terms of Payment for Services
- Performance by the Client
- Representations by the Client towards the documents/ information to be provided

## How to Draft an Engagement Letter

- Termination of the Engagement
- Privacy, Ownership, and Use of Materials
- Dispute Resolution Provisions
- Limitations on Liability and Damages
- Expiration of the Engagement Letter

## Forensic Audit Report

### Scope of Forensic Audit Report

- To conduct investigation and research to ensure compliances with accounting principles;
- To provide for findings and recommendations regarding
  - cause and consequence of any instance, if any;
  - Detection of any criminal activity, illegal acts, and potential fraudulent activity or civil liabilities.

### Scope of Forensic Audit Report

- To provide for a written report on all discovered abnormal financial activities, past or present and their quantification
- To identify the names of persons involved with a view to take future legal action
- To report whether or not any financial benefit has been attained by way of presenting an unreal picture of the transactions

### Statutory Audit vs Forensic Audit

STATUTORY AUDIT	FORENSIC AUDIT
Express opinion as to 'true & fair' presentation	Determine correctness of the accounts or whether any fraud has actually taken place
Applies 'Substantive' and 'compliance' procedures for audit	Analysis of past trend and substantive or 'in depth' checking of selected transactions
Normally all transactions for the particular accounting period	No such limitations. Accounts may be examined in detail from the beginning
Relies on the management certificate/ representation of management	Independent verification of suspected/ selected items carried out

### Statutory Audit vs Forensic Audit

STATUTORY AUDIT	FORENSIC AUDIT
Used to vouch the arithmetic accuracy & compliance with procedures.	Regularity and propriety of these transactions /contracts are examined
Negative opinion or qualified opinion expressed, with/without quantification	Legal determination of fraud and naming persons behind such frauds.

### Forensic Audit – Requirements and responsibilities

- Credit decisions of the organization should be compared with RBI policies and guidelines, and the laws of the land;
- Investment decisions are compared with the objectives of investments made and actual returns are compared with anticipated returns;
- Connection between transactions involving income and expenditure are analysed;
- Systems and procedures followed by the organisation;

### Forensic Audit – Requirements and responsibilities

- Signing engagement letter with scope of work
- Planning of strategy
- Collecting evidence – locate assets, documents from company or other sources
- Interviewing concerned personnel
- Collating and evaluation of evidence
- Identifying the potential fraud and allegations
- Use of charts and drawings to present the analysis
- Making of detailed written report

### Applicable Reporting Standards

- Differs from country to country
- Adherence to
  - respective accounting standards and applicable laws
  - Generally Accepted Accounting Standards (GAAS)
- CPA Canada Standards and Guidance Collection
  - electronic reference source;
  - provides information on accounting and assurance standards, public sector accounting standards
- AICPA – American Institute of CPAs and provides for professional standards and professional code

### Applicable Reporting Standards - India

- Indian Accounting Standards
- Applicable Indian laws such as
  - Information Technology Act, 2000
  - Indian Penal Code, 1860
  - Indian Evidence Act, 1872
  - Companies Act 1956 and Companies Act, 2013
  - Income Tax Act, 1961
  - Code of Criminal Procedure, 1973; etc.

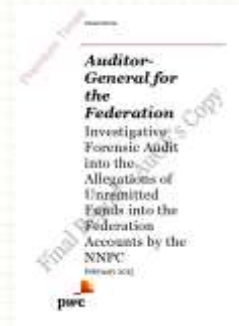
### Structure of Forensic Audit Reports

- Index
- Overview
- Executive Summary
  - Facts in Brief
  - Methodology in brief
  - Findings in brief
- Background and Allegations
- Detailed Methodology

## Structure of Forensic Audit Reports

- Main Report
  - Detailed Time-line
  - Scope reconciliation
  - Detailed methodology – collection of evidence and implementation
  - Procedure performed
  - Findings in detail – point-wise finding and analysis
- Limitations
- Disclaimers
- Glossary and Abbreviations
- Appendices and Exhibits

## Sample Forensic Audit Report



## Sample Forensic Report



## Companies Act, 2013

## Understanding Layout

- Divided in to 29 chapters
- Chapter I – Applicability & Definitions – Section 1& 2
- Chapter II – Incorporation, MoA, AoA – Sections 3 to 22
- Chapter III – Prospectus – Sections 23 to 42
- Chapter IV – Share Capital – Sections 43 to 72
- Chapter V – Public Deposits – Sections 73 to 76
- Chapter VI – Registration of Charges – Sections 77 to 87

## Understanding Layout

- Chapter VII – Management & Administration – Sections 88 to 122
- Chapter VIII – Dividend – Sections 123 to 127
- Chapter IX – Accounts – Sections 128 to 138
- Chapter X – Audit & Auditors – Sections 139 to 148
- Chapters XI, XIII, XIII – Directors, Board & Remuneration – Sections 149 to 205
- Chapter XIV – Inspection, Investigation – Sections 206 to 229
- Chapter XV – Mergers – Sections 230 to 240

## Understanding Layout

- Chapter XVI – Oppression and Mismanagement – Sections 241 to 246
- Chapter XVII – Registered Valuers – Section 247
- Chapter XVIII – Removal of Names of Companies – Sections 248 to 252
- Chapter XIX – Revival – Sections 253 to 269
- Chapter XX – Winding –up – Sections 270 to 378
- Chapter XXI – Companies Authorized to Register Under the Act – Sections 366 to 374
- Chapter XXII – Foreign Companies – Sections 379 to 393

## Understanding Layout

- Chapter XXIII - Government Companies – Sections 394 & 395
- Chapter XXIV – Registration Offices & Fees – Sections 396 to 404
- Chapter XXV – Companies to furnish Information – Section 405
- Chapter XXVI – Nidhis – Section 406
- Chapter XXVII – NCLT – Sections 407 to 434
- Chapter XXVIII – Special Courts – Sections 435 to 446
- Chapter XXIX – Miscellaneous - Sections 447 to 470



## Understanding Layout

- Schedule I – Table A to I
- Schedule II – Depreciation
- Schedule III – Balance Sheet
- Schedule IV – Code for Independent Directors
- Schedule V – Managerial Personnel
- Schedule VI – Infrastructural Projects
- Schedule VII – Activities for CSR Policy

## Fraud (S. 447, Companies Act, 2013)

- Fraud in relation to affairs of a company or any body corporate, includes
  - any act, omission, concealment of any fact or abuse of position,
  - Committed by any person or any other person with the connivance in any manner,
  - with intent to deceive, to gain undue advantage from, or to injure the interests of,
  - the company or its shareholders or its creditors or any other person,
  - whether or not there is any wrongful gain or wrongful loss

## Fraud (S. 447, Companies Act, 2013)

- Punishment
  - Imprisonment  $\geq$  6 months, but  $\leq$  10 years, and
  - fine  $\geq$  the amount involved in the fraud, but  $\leq$  3 times the amount involved in the fraud
  - Where fraud involves public interest, minimum imprisonment is of 3 years

## Indian Contract Act, 1872

## Indian Contract Act, 1872- Status

- Enacted on 25<sup>th</sup> April, 1872
- Commenced on 1<sup>st</sup> September, 1872
- Based on the principles of English Common Law
- Extends to whole of India except the state of Jammu and Kashmir
- Act contains XI Chapters, 266 Sections and I Schedule

## Fraud (S. 17, Indian Contract Act)

- Fraud means and includes any of the following acts committed by a party to a contract, or with his connivance, or by his agents, with intent to deceive another party thereto his agent, or to induce him to enter into the contract;
  - the suggestion as a fact, of that which is not true, by one who does not believe it to be true;
  - the active concealment of a fact by one having knowledge or belief of the fact;
  - a promise made without any intention of performing it;
  - any other act fitted to deceive;
  - any such act or omission as the law specially declares to be fraudulent

## Indian Penal Code, 1860

## Fraud under IPC

- Not defined under IPC
- Sec. 25, IPC defines term 'fraudulently'
  - Intent to defraud
- 'defraud' involves two elements
  - Deceit or intention to deceive, and
  - Actual or possible injury

## Fraud – Judicial Interpretations

- *S P Chengal Varaya Naidu vs. Jagannath*, AIR 1994 SC 853
  - A fraud is an act of deliberate deception with the design of securing something by taking unfair advantage of another. It is a deception in order to gain by another's loss. It is a cheating intended to get an advantage.
- *Ram Chandra Singh vs. Savitri Devi*, (2003) 8 SCC 319
  - As is well-known, the term 'fraud' vitiates every solemn act. Fraud and justice never dwell together. Fraud is a conduct either by letter or words.

## Legal assistance to client/company

## Legal Assistance to Client/Company

- Forensic investigation mostly leads to legal proceedings
- Members of investigative team to be involved in court proceedings
- Expert witnesses
- Proper description and presentation of evidence in court

## Legal Assistance to Client/Company

- Presentation of evidence in court
  - As per applicable laws
  - In a manner that non-accountants involved in case can understand evidence and its implications
  - Corroborated with facts and findings

