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**"FORENSIC AUDIT - A Quick fix for Fraudulent Accounting Practices"**

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**ABSTRACT**

Accounting is the language of Business. Every accounting transaction reflects the performance of people within the organization. Though book-keeping is the method of maintaining Journal and Ledger along with Trial Balance, accounting elaborates with Preparation of various subsidiary books and presentation of Final Accounts at the end of each year. It created a systematic way to present all business transactions under double entry system. It contents with the principle of Simple, Moral, Accountable, Responsiveness and Transparency (SMART) and facilitates the stakeholders to get all information in right time. To ensure the credibility of business transactions, Auditing was introduced. In simple terms Book-keeping ends Accounting starts; and Accounting ends Auditing starts. Due to numerous transactions of all corporates lot of scams such as embezzlement of cash, theft of goods, fraudulent management and other financial crimes were emulated. Forensic accounting is the application of accounting knowledge and investigative skills to identify and resolve the legal issues. To improve the public trust and investors confidence apart from conventional functions of accounting Forensic accounting focuses on corporate misconduct and fraudulent financial crimes. United States and Canada are the pioneers in implementation and development of forensic accounting. In India, Forensic accounting is still in crawling stage. In order to through light on the areas of corporate financial crimes and to find the need of Forensic accounting this study was made.

**1. INTRODUCTION:**

In general,Fraud means any intentional mistake committed to deceive others. It is considered as criminal activity. According to Sec 17 of Indian Contract Act 1872 "Fraud means and includes any of the following acts committed by a party to a

contract or with his connivance or by his agent , with an intent to deceive another party thereto or his agent or to induce him to enter into the contract”

Kautilya in his famous treatise”Arthashastra” penned down around 300 BC., about forty five ways of cash embezzlement. In Modern times we termed as ‘Fraud’. Enron, Worldcom, Libor manipulation scandals have caused major upheavals in western nations and their impact has been felt not only in the individual institutions or countries but across the Global financial system. India too has witnessed a spate of fraudulent activities in the corporate sector over the last decade in form of satyam, Reebok, Adidas, Kingfisher airlines etc.,

According to Cressey a sociologist and criminologist in 1940’s wrote a book titled ‘Theft of the Nation’ The author developed a Fraud Triangle after interviewed 200 incarcerated individuals charged with embezzlement of cash and pointed the three causes of fraudulent behavior.

1. Perceived pressure
2. Perceived opportunity
3. Rationalisation

**1.1. Perceived Pressure:** The employees are find themselves pressurized when their incentives or remuneration is attached with their performance. Sometimes the management also got pressure from their stakeholders to meet unrealistic expectations of investors ,bankers and suppliers. For example to avail working capital from banks they may boast up their sales and collection from debtors in their statement of working capital requirements.

**1.2. Perceived Opportunity:** Opportunities within the organization is also major reason for committing frauds. For example there may be inadequate internal control over assets, chance of Teaming and lading and inadequate segregation of duties etc.,

**1.3. Rationalisation:**

These frauds are committed due to the ethical values differ from person to person. People acts over smart and they wish to show their intelligence. Here Attitude plays the vital role of people’s fraudulent activity.

**2. SIGNIFICANCE OF FORENSIC ACCOUNTING:**

As per recent survey in 2021 India scores 41th place in corruption making countries. many of the corporate frauds/ white collar crimes are done within the organization. Forensic accounting in India comes to limelight only recently due to rapid increase in corporate scams. The companies Act 2013 has plays a significant role in fighting and preventing of frauds. Under sec245(1g) of the new companies Act , Depositors and members of a company can claim damages from the auditors and management and other executives who are all the part of it.

Further Sec 140 of the auditors and their firm would be jointly liable for any frauds in the books of accounts and many auditors are likely to become forensic accountants in the days to come to avoid being caught.

Under Sec 149(12) independent auditors would be held liable for the frauds if it is known to them.

**3. DETECTING RED FLAGS**

Buddhism refers to three kinds of poisons in human ‘ anger, greed and ignorance.

If it is not properly handled it will lead to some wrong doing.

Red flags are 'indicia of fraud, are nothing but symptoms or indicators of situations of frauds. Forensic investigating involves looking beyond the obvious. Normal investigator acts like a watch dog, but forensic accountant acts like a blood hound.

### **Types of Red Flags:**

The following are the red flags through which the forensic auditor/ investor smell the situations or persons causing the fraudulent activities.

#### **3.1. Lack of Corporate governance**

- a) Absence of rotation of duties, in such case a same employee may work for long period without any replacement
- b) Poor internal control within the organization
- c) Related party transactions
- d) Close relationship with suppliers, customers, Bankers and other external parties.
- e) There is no expressed procedures or policies

#### **3.2. Sceptic Accounting Activities**

- a) Unreconciled book entries and ledger accounts
- b) Management overrides the internal controls
- c) Continuous adjustments in book entries related to stock
- d) Topside journal entries
- e) Excess purchases & Fictitious payees
- f) Excessive credit memos
- g) Duplicate Payments
- h) Ghost employees
- i) Inventory Shortages
- j) Increased Scrap
- k) Write-off Accounts Receivable

#### **3.3. Sudden Losses:**

Future is uncertain. So due to unexpected losses or pandemic some companies may window dress their accounts.

#### **3.4. Tgtbt syndrome:**

TGTBT Syndrome means **Too Good To Be True**. Even in gloomy conditions glossy report may be furnished.

**3.5. Generation of 'orphan funds':** Funds which are held in fiduciary capacity and for which there is no accountability are thriving places for frauds. Funds collected by trusts and donations are the examples of orphan funds. Neither the donor nor the beneficiary have direct claim on those funds. This may lead to malpractices.

**3.6. Abnormal situations:** Accidents where books have been lost, or damaged or catastrophes such as fire, earthquake, floods etc are other places where the fraudsters can feast.

**3.7. Behavioural issues:** Failure to take vacations, living beyond one's means, insider trading, early arrival and later departure are the major behaviours of fraudsters.

## **4. PROCESS OF FORENSIC ACCOUNTING**

Each Forensic accounting is unique like wise its procedures also. Forensic audits

are highly specialized. The forensic auditor must ensure that his firm has necessary knowledge and skill in the concerned areas.

#### **Process I: INITIALISATION**

Forensic audit begins with initialization. It is significant to clarify all doubts and to ensure the real motive of the transaction. It is helpful to meet the client to obtain an understanding of the important facts, players and issues at hand. A conflict check has been made with parties who are regularly connected to it. Preliminary investigation is important before a detailed plan is prepared. Incompetent accounting preparation does not necessarily indicate fraud but intent may be the reason for fraud exists.

#### **Process II: DEVELOP PLAN**

The forensic auditors after initial investigation with the client makes a detailed plan if they are ensuring the scope for fraudulent activities within the organization. In order to develop the plan forensic auditors must fix their objectives which includes:

- a) Identifying the type of fraud and fraudsters involved.
- b) Quantifying the financial loss suffered by the client.
- c) Gathering evidence to be used for court proceedings
- d) Providing advice to the client to prevent the reoccurrence of fraud

#### **Process III: INTERVIEWS**

Forensic interviews may be conducted to gather information from the witnesses, victims, suspects or other sources to determine the facts regarding suspicions, allegations or specific incidents. The success of the forensic audit depends on how well the information is gathered, fair and impartial.

#### **Process IV : OBTAIN RELEVANT EVIDENCE**

Evidence may be obtained through analytical procedure by comparing trends over time and by comparing different segments of business. By applying computer assisted techniques the timing of frauds and location of fraud may also be identified clearly.

#### **Process V: PERFORM THE ANALYSIS**

The actual analysis performed will be dependent upon the nature of the assignment and may involve calculating damages, summarizing a large number of transactions, performing present value calculations and applying regression or sensitivity analysis.

**Process VI: REPORTING:** Every client is expecting to get a right report from the Forensic auditor. The report must include the scope of the investigation and findings and opinions. It may also include schedules and graphics to give necessary explanation. The Report should fortify the types of fraud, number of fraudsters involved and circumstances under which the fraud was committed. The report also includes strong recommendations of the Forensic auditor to further steps to be followed by the organization to nonoccurrence of frauds.

#### **Process VII: COURT PROCEEDINGS:**

The investigating team submit the evidence collected by them before the court. It is imperative that the members of the investigative team may be called at any time and explain the fact in simple sentences. It will be helpful to the non-accountants to understand the nature of fraud.

## **6. CONCLUSION:**

Fraud is generally concealed and often occurs through collusion. Documents supporting omitted transactions are not kept in company files. False documentation is often created and legitimate documents are altered to support fictitious transactions. Forensic investigation related to Finance and Information technology. Both provides an incisive analysis of how fraud occurs within an organization and explains the latest techniques for fighting it. So undoubtedly Forensic Audit is the Key to fix fraud and a great solace to overcome the white collar crimes.

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