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Forensic Accounting & Auditing: Is It the Same Thing?

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Abstract

Forensic Accounting has found its way to be distinguished as one of the accounting disciplines. Its ethical and moral purposes influenced economist around the globe to develop Forensic Accounting as a discipline and forensic accountant as profession. The increasing number of corporate frauds and white collar crimes paved way for this dynamic branch of accounting. The purpose of this paper is to educate readers about Forensic Accounting, its purpose and how it is different from Auditing practices. Forensic Accounting must play a great role to discover all those frauds and shape the future with scam free economies.

Keywords: Forensic Accounting, Auditing, Financial frauds and scams, white collar crimes.

Introduction

The innumerable cases of financial scams and white-collar crime have paved the way for forensic accounting field. Forensic Accounting is a technique used by experts for detection of a financial crime like embezzlement, money laundering, tax evasion etc.

Objectives of the study

- The study aims to focus on the meaning and purpose of Forensic Accounting.
- To elaborate the difference between Forensic Accounting and Audit.

Research Methodology

The study is qualitative in nature and sources of data are secondary data which are collected from various journals, research papers and other related websites on Forensic Accounting.

Meaning of Forensic

"Forensic" means application of scientific methods and techniques to the investigation of a crime. The adjective 'forensic' comes from the Latin word 'Forensis' meaning 'in open court' or 'public'. It literally means finding evidence to solve a crime. According to Webster's dictionary "Forensic" means "belonging to, used in or suitable to courts of judicature or to public discussion and debate". According to Zysman (2004), Forensic Accounting involves the integration of accounting, auditing and investigative skills.

Meaning of Accounting

"Accounting" is the art of systematic recording, classifying, summarizing in a significant manner and in terms of money, transactions and events which are in part at least, of financial character and interpreting the results thereof.

Meaning of Forensic Accounting

"Forensic Accounting" is a type of accounting that investigates financial information for potential evidence of crimes. Forensic accountants use accounting, auditing and investigative skills to understand whether a person or company has committed financial misconduct, such as embezzlement or fraud. Forensic Accounting provides an accounting analysis that is suitable to the court which will form the basis for discussion, debate and ultimately dispute resolution.

According to American Institute of Certified Public Accountants, "Forensic Accounting is the application of accounting principles, theories and disciplines to facts or hypothesis at issues in a legal dispute and encompasses every branch of accounting knowledge.''

Definition of Forensic Accounting

Forensic Accounting can be defined as assistance in disputes regarding allegations or suspicion of fraud, which are likely to involve litigation, expert determination, and enquiry by an appropriate authority and investigations of suspected fraud, irregularity or impropriety which could potentially lead to civil, criminal or disciplinary proceedings.

According to the Journal of Forensic Accounting, 'Forensic Accounting is sufficiently thorough and complete so that an accountant in their own professional judgement can deliver a finding as to accounts, inventories, or the presentation thereof that is of such quality that it would be sustainable in some adversarial legal proceeding, or within some judicial or administrative review.' The main objective of Forensic Accounting is to find proof of a crime and to present it in a way that can stand up in a court of law. The key areas of work for Forensic Accountants are quantification of damages and loss of profits and assessing the effect on profitability, cashflow, income or value, that a party claims to have incurred, or may incur, because of either a breach in a contract, personal injury, product liability, breaches of the Trade Practices Act or Fair Trading, etc.

Objectives of Forensic Accounting

The primary objective of Forensic Accounting is to find proof of a crime and to present it in a way that can stand up in the court of law. Forensic Accounting provides investigative services and litigation support to understand the magnitude of the financial scams happening in an economy. Therefore, the purpose of Forensic Accounting is to prove financial crimes, prevent it and anticipate future crimes. Thorough inspection of financial records of an individual, or an entire corporation requires specialized and appropriately qualified forensic accountants.

Scope of Forensic Accounting

A forensic accountant analyzes, interpret, summarize and present complex financial and business-related issues in a manner which is both understandable and substantially supported with documents. Forensic Accountant are trained to look beyond the numbers and deal with the business reality of the situation. They are primarily employed by insurance companies, banks, police forces, government agencies and other organizations. A forensic accountant is often involved in the following:

- **Fraud Detection**: Investigating and analysing financial evidence, detecting financial frauds and tracing misappropriated funds
- **Computer Forensics:** Developing computerized applications to assist in the recovery, analysis and presentation of financial evidence;
- **Fraud Prevention:** Either reviewing internal controls to verify their adequacy or providing consultation in the development and implementation of an internal control framework aligned to an organization's risk profile
- **Providing Expert Testimony**: Assisting in legal proceedings, including testifying in court as an expert witness and preparing visual aids to support trial evidence.

In order to properly perform these services a Forensic Auditor must be familiar with legal concepts and procedures and have expertise in the use of IT tools and techniques that facilitate data recovery and analysis. In addition, a Forensic Auditor must be able to identify substance over form when dealing with an issue.

Who can conduct Forensic Accounting?

Forensic accountants are experienced, trained and knowledgeable in all the different processes of fraud investigation including how to interview people effectively, how to write effective reports for clients and courts, how to provide expert testimony in court etc. For Certified Forensic Accountant it is necessary to be a student from a recognized institution, should have 3 years professional experience and has passed Certified Forensic Accounting Professional (CFAP) Exams of India Forensic Center of studies with minimum 75% of marks. The Institute of Chartered Accountants of India (ICAI) also provides training to become Certified Forensic Accountants (CFAs). It is providing a "Certificate Course on Forensic Accounting and Fraud Detection using IT and Computer Assisted Auditing Tools (CAATs).

The major contribution of Forensic Accountants is translating complex financial transactions and numerical data into terms that ordinary persons can understand. Areas of expertise of forensic accountants are not only in accounting and Auditing but in criminal investigation, interviewing, report writing, and testifying as expert witnesses. The forensic accountant draws on various resources to obtain relevant financial evidence and to interpret and present this evidence in a manner that will assist both parties.

A forensic accountant is often retained to analyze, interpret, summarize and present complex financial and business-related issues in a manner which is both understandable and properly supported. Forensic Accountants can be engaged in public practice or employed by insurance companies, banks, police forces, government agencies and other organizations. A Forensic accountant is often involved in the following :

- Investigating and analyzing financial evidence
- Developing computerized applications to assist in the analysis and presentation of financial evidence.
- Communicating their findings in the form of reports, exhibits and collections of documents and
- Assisting in legal proceedings, including testifying in court as an expert witness and preparing visual aids to support trial evidence.

To properly perform these services a Forensic Accountant must be familiar with legal concepts and procedures. In addition, a forensic accountant must be able to identify substance over form when dealing with an issue.

Techniques of Forensic Accounting

Some of the techniques involved in Forensic Accounting to examine the frauds are:

i) **Benford's Law**: It is a mathematical tool and is one of the ways to determine whether a variable under the study is a case of unintentional errors or fraud on detecting any such phenomenon the variable under study is subjected to a detailed scrutiny.

ii) **Theory of Relative size factor (RSF)**: It is a powerful test for detecting errors and measured as RSF = Largest Record in a Subset/Second Largest Record in a Subset. This test identifies subsets where the largest element is out of line with the other elements for that subset. It also highlights all unusual fluctuations which may be routed from fraud or genuine errors.

iii) **Computer Assisted Auditing Tools (CAATs**): These are computer programs that helps the auditor to perform various auditing procedures like testing details, identifying inconsistencies, sampling programs, redoing calculations etc.

iv) **Data Mining Techniques**: It is a set of computer-assisted techniques like discovery, predictive modelling and deviation and link analysis designed to automatically mine large volumes of data for new and unexpected patterns.

v) **Ratio Analysis**: This analysis gives indications of the financial health of a company, data analysis ratios report on the fraud health by identifying possible symptoms of fraud.

Meaning of Auditing

The term audit is derived from a Latin word "Audire" which means to hear. Audit is performed to ascertain the validity and reliability of information. Examination of books and accounts with supporting vouchers and documents, to detect and prevent error and fraud is the primary function of auditing. Auditor must check the effectiveness of internal control systems for determining the extent of checking out the audit. In short, Auditing implies an investigation and a report through scrutiny of the books of accounts. Its aim is to verify the financial position disclosed by the balance sheet and profit and loss accounts of a company.

Definition of Auditing

Auditing is a systematic and scientific examination of the books of accounts and records of business to enable the auditor to satisfy himself that the profit and loss account and the balance sheet are properly drawn up so as to exhibit a true and fair view of the financial state of affairs of the business and profit or loss for the financial period. Objectives of audit are broadly classified into a) primary objective and b) secondary objective. Primary objective of audit is to substantiate the accuracy of the financial statements prepared by the accountant while the secondary objective is to detect and prevent errors and frauds.

Audit is the examination or inspection of various books of accounts by an auditor followed by physical checking of inventory to make sure that all departments are following documented system of recording transactions. It is done to ascertain the accuracy of financial statements provided by the organization. Basically, Audit objective is to express a professional opinion on the accuracy and reliability of financial statements by a qualified auditor.

Objectives of Auditing

The basic objective of an audit is to express an opinion on financial statements. The auditor verifies the financial statements and books of accounts to certify the truth and fairness of the financial position and operating results of the business. Thereby the primary objective of Auditing is to form an independent judgement and opinion about the reliability of accounts and truth and fairness of financial situation and working results.

Scope of Auditing

The purpose of a statutory audit is to determine whether an organization provides a fair and accurate representation of its financial position by examining information contained in the accounting records, disclosed financial statements, and other relevant documents. The main aspects to be covered in audit practices are:

- An examination of the system of accounting and internal control
- Reviewing the system and procedures to find out whether they are adequate and comprehensive
- Checking the arithmetical accuracy of the books of account
- Verification of the authenticity and validity of transaction with relevant supporting documents
- Ascertaining that a proper distinction has been made between items of capital and of revenue nature
- Verification and valuation of the assets appearing in the balance sheet.

Difference between Auditing and Forensic Accounting

Auditing and Accounting are two important aspects of smooth running of a business. There is a popular misconception that the two terms are interchangeable and are one and same thing. Although Forensic Accounting and Auditing seem like similar branch of study, significant differences exist between them. The misconception exists because of some similarities between the two disciplines. The first similarity between them is that both disciplines require a thorough knowledge and understanding of accounting principles and basics, they both involve producing reports to determine whether a firm's financial records provide a fair representation of its current position.

However, Auditing is a wholly different term that needs to be distinguished from Forensic Accounting. A normal audit is designed to provide assurance that the financial statements are accurate and reliable. Forensic Accounting is a general term used to describe any financial investigation that can result in a legal consequence. Whereas Auditing typically refers to the process of evaluating compliance of financial information with regulatory standards, usually for public companies, by an external independent entity. The focus of financial audit is concerned with providing reasonable assurance that a material misstatement to financial statements has not occurred, regardless of the reason. On the other hand, Forensic Accounting is designed to uncover potential fraud or misappropriation of funds. Unlike normal accounting which focusses on recording and analyzing financial transactions, forensic accountants are focused on detecting potentially fraudulent activities such as money laundering, embezzlement, and other white-collar crimes. Forensic accountants also work with attorneys to provide expert advice in civil litigation cases related to financial matters.

A financial Audit helps the investors and lenders to know the current financial position as well as the current operations of the firm, they can use such reports in order to make future investment decisions whereas Forensic Accounting enables to identify or detect any malpractices or fraudulent activities that may be carried out in the firm. Moreover, a financial audit can be considered as a routine process that a firm must conduct at least once a year but a Forensic Accounting must be conducted only when there is a need for it such as if there is any suspicion about any malpractices within a firm. Hence financial Audit provides general information about the activities of a firm whereas Forensic Accounting provides specific and accurate information about the departments and other particular activities of the firm.

Forensic Accounting engagement applies accounting and Auditing techniques post which examination, analysis and reporting of financial information is carried out in a manner suitable to the court of law. It is required when there is a disagreement between parties, or a lawsuit has been filed. The objective of forensic accountant is to evaluate information report and assist the court in understanding the financial aspects of the case. Whereas an audit is simply performed by an auditor by adhering to a certain set of standards established by the Institute of Chartered Accountants of India (ICAI). While conducting audit engagements, the teams examine and evaluate the financial statements of any organization and provide assurance that the information contained in declared financial statements is a fair and accurate representation of the organization.

Forensic accountants are those who by virtue of their skills, attributes and experience are experts in uncovering and documenting fraud in financial transactions. Forensic accountants search specifically for fraudulent activity within organizations, they need to have knowledge of how to gather evidence of and document fraud for criminal and civil purposes, how to interview third parties and how to testify as an expert witness should go to court. On the other hand, auditors verify that organizations are compliant with federal regulations and organizational policies. Auditing attempts to enable the auditor to render an opinion as to whether a set of statements upon which the opinion is rendered are always the representations of management. The auditor is primarily concerned with qualitative values and generally is not concerned about whether the financial statements communicate the policies, intentions or goals of management. Auditors are tasked with determining whether a company's financial statements offer a fair assessment of its current position. Nevertheless, forensic accountants are specifically deployed to uncover cases of fraud. Their primary objectives are to find out who committed the fraud, how it took place, how much money was taken and how to stop it from happening again in the future. Auditors owe primary allegiance to the investing public to ensure that the shareholders are not duped into parting with their cash based on falsified financial statements. Forensic accountants, however, are not concerned with reaching a consensus on a firm's financial status. The following table has summed up the main differences between the two branches of investigation.

Particulars	Audit	Forensic Accounting
Objectives	Express an opinion as to “true and fair” presentation	Whether fraud has taken place in books
Techniques	Substantive and compliance, sample based.	Investigative, substantive and in-depth checking
Period	Normally for a particular accounting period.	Whenever required
Verification of Stock/Assets/Liabilities etc.	Relies on the management certificate	Independent verification of selected items where misappropriation is suspected.
Adverse Findings	Qualified opinion expressed with/without quantification.	Legal determination of fraud impact and identification of perpetrators depending on scope.

Conclusion

Forensic accounting in India has come to limelight only recently due to rapid increase in Frauds, scams and white collar crimes. The demand for forensic accountants is exceeding the supply which has given a wide scope to the professionals in this field. The primary agenda of Forensic Accounting is to find proof of a fraud and to present it as evidence in a court of law. Forensic investigations are non-recurring, reactive and unforeseen.

Nonetheless auditing will typically have a well-structured plan from the start that does not diverge in any shape or form. Moreover, audits are planned events occur on a regular basis. In contrast, a forensic accountant’s investigation is not linear at all and may require several pivots depending on the information that has been uncovered. Only a forensic accountant will have the specific training, knowledge and skills required to carry out the work and bring the case to a satisfactory conclusion. Thereby concluding that they are not the same thing and should never be used interchangeably.

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