



# **Amit Kumar & Co.**

## **(Cost Accountants)**

*A perfect blend of Tax, Audit & Advisory services*

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While a **forensic audit** may sound like something exciting you hear about on crime dramas like Law and Order disciplines, the truth is a little more mundane. A forensic audit is the process of reviewing a person's or company's financial statements to determine if they are accurate and lawful. **Whereas Forensic Accounting** is most commonly associated with the Treasury Revenue and tax audits, but it may also be commissioned by private companies to establish a complete view of a single entity's finances. (*Black Law Dictionary*)

*There was no mention of Forensic discipline in the Indian statutes prior to introduction of Companies Act 2013. Besides this, there are various provisions related to Forensic accountants/auditors in the statutes.*

**INVESTIGATION AND INSPECTION:** Forensic auditors may help the Police, ACB and other investigating authorities in collecting evidences and other investigation purposes. For example section 157 Cr.P.C, 1973; section 17, 18 of Prevention of Corruption Act, 1988; Section 6 of The Bankers Books Evidence Act, 1891; Section 78 of Information Technology Act, 2000; Section 143(12) of the Companies Act, 2013 etc. wherein the Court or Police may require the skills of Forensic accountants while inspecting any books in so far as related to the accounts of an accused.

**EXPERT OPINION:** Forensic accountants may see and carefully examine the accounts and balance sheets and use his skills to find out whether there is any fraud committed or any anomaly associated with it by giving his expert opinion. This finds place in for example Section 45, Section 118 of Indian Evidence Act, 1872; Section 293 of Cr.P.C, 1973.

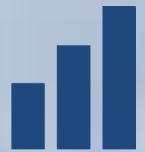
**FORENSIC ACCOUNTING UNDER CARO (The Companies (Auditor's Report) Order, 2015): REPORT ON FRAUDS:** whether any fraud on or by the company has been noticed or reported during the year; If yes, the nature and the amount involved is to be indicated.

# How Forensic Audit differs from other branches of auditing

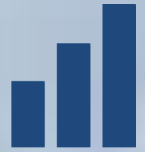


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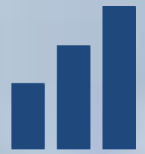




**BENFORD'S LAW:** It is a mathematical tool, and is one of the various ways to determine whether variable under study is a case of unintentional errors (mistakes) or fraud. On detecting any such phenomenon, the variable under study is subjected to a detailed scrutiny. The law states that fabricated figures (as indicator of fraud) possess a different pattern from random figures. The steps of Benford's law are very simple. Once the variable or field of financial importance is decided, the left most digit of variable under study extracted and summarized for entire population. The summarization is done by classifying the first digit field and calculating its observed count percentage. Then Benford's set is applied. A parametric test called the Z-test is carried out to measure the significance of variance between the two populations



**THEORY OF RELATIVE SIZE FACTOR (RSF):** It highlights all unusual fluctuations, which may be routed from fraud or genuine errors. RSF is measured as the ratio of the largest number to the second largest number of the given set. In practice there exist certain limits (e.g. financial) for each entity such as vendor, customer, employee and other balance sheet items etc. These limits may be defined or analyzed from the available data-if not defined. If there is any stray instance of that is way beyond the normal range, then there is a need to investigate further into it. It helps in better detection of anomalies or outliers. In records that fall outside the prescribed range are suspected of errors or fraud. These records or fields need to relate to other variables or factors in order to find the relationship, thus establishing the truth.



**COMPUTER ASSISTED AUDITING TOOLS (CAATs):** CAATs are computer programs that the auditor use as part of the audit procedures to process data of audit significance contained in a client's information systems, without depending on him. CAAT helps auditors to perform various auditing procedures

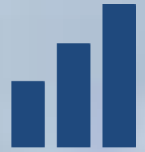
*Testing details of transactions and balances,*

*Identifying inconsistencies or significant fluctuations,*

*Testing general as well as application control of computer systems.*

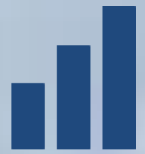
*Sampling programs to extract data for audit testing, and*

*Redoing calculations performed by accounting systems.*

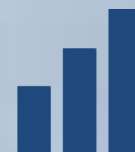


**DATA MINING TECHNIQUES:** It is a set of assisted techniques designed to automatically mine large volumes of data for new, hidden or unexpected informations or patterns. Data mining techniques are categorized in three ways: Discovery, Predictive modeling and Deviation and Link analysis. It discovers the usual knowledge or patterns in data, without a predefined idea or hypothesis about what the pattern may be, i.e. without any prior knowledge of fraud. It explains various affinities, association, trends and variations in the form of conditional logic. In predictive modeling, patterns discovered from the database are used to predict the outcome and to guess data for new value items. In Deviation analysis the norm is found first, and then those items are detected that deviate from the usual within a given threshold (to find anomalies by extracted patterns). Link discovery has emerged recently for detecting a suspicious pattern. It mostly uses deterministic graphical techniques, Bayesian probabilistic casual networks. This method involves “pattern matching” algorithm to „extract“ any rare or suspicious cases.





**RATIO ANALYSIS:** Another useful fraud detection technique is the calculation of data analysis ratios for key numeric fields. Like financial ratios that give indications of the financial health of a company, data analysis ratios report on the fraud health by identifying possible symptoms of fraud.



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**Record Assessment viz. various record to be examined including some from ROC, SEBI, Banks, Income Tax, Custom data, STP, Land Development Authorities and other relevant authorities.**

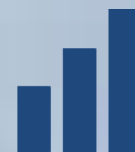
# Some success approaches to Forensic Audit & Accounting



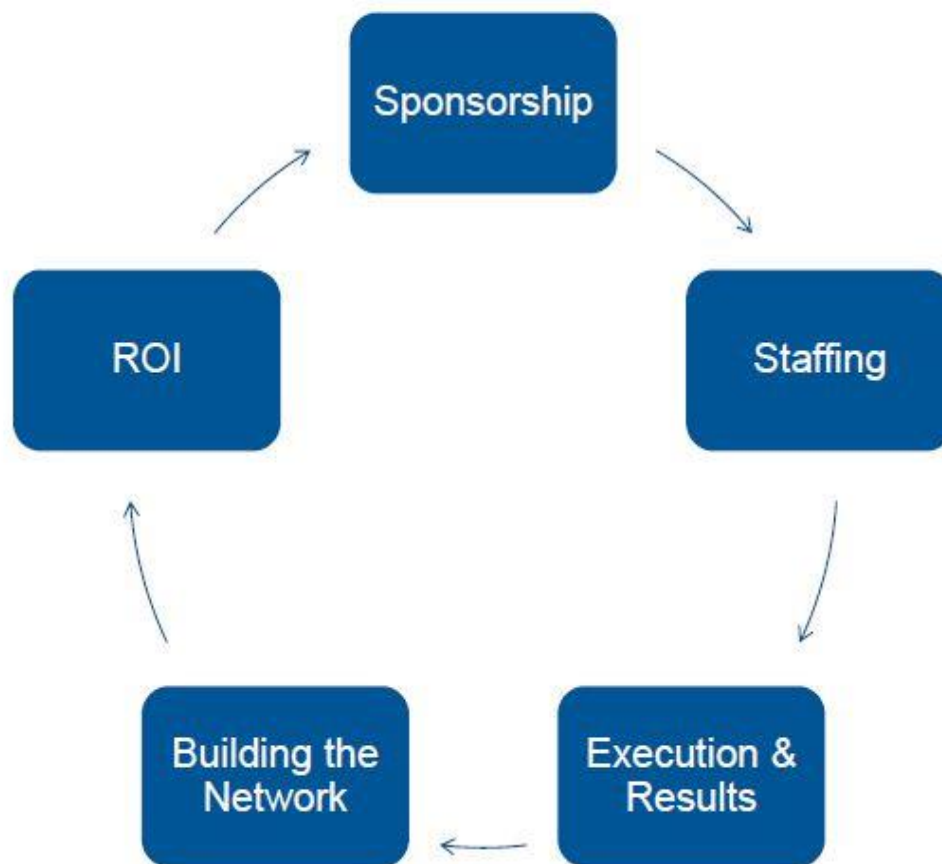
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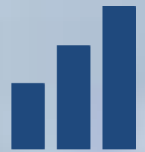
## Proactive Fraud Risk Management Approach





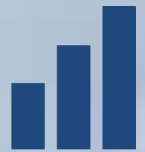
## Recipe for Success





## Sponsorship & Support

- Organizational policies and procedures
- Hotline
- Ethics and Compliance programs
- Code of Conduct
- Executive sponsorship
- Visibility to Board/Audit Committee
- Engagement by Business Segments/OpCo's
- Respect from Legal & Human Resources
- Clear understanding of roles and responsibilities
- Assignment of costs

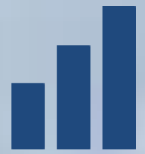


## Staffing

- Proper background and experience
- Recruit internally and externally
- Combined set of skills (CFE, CIA, CPA, M.B.A.)
- Invest in training
- Previous corporate investigative experience a plus
- Law enforcement versus auditing
- Proper headcount
- Strong external relationships
- Well networked
- Data Analytics & Computer Forensics skills a plus

## Execution & Results

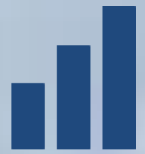
- ▶ High-quality results
- ▶ Build a brand (think like a consultant)
- ▶ Regionally based
- ▶ Training and awareness programs
- ▶ Be proactive
- ▶ Think beyond investigations (Compliance, Internal Controls, ERM, etc.)
- ▶ Avoid territorialism
- ▶ Solicit feedback (example: have legal review your reports)
- ▶ Network, network, & network



## Build the Network

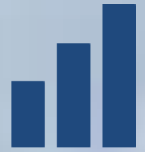
- › Litigation Support
- › Audit Committee presentations
- › Executive Management visibility
- › Regional awareness of the team
- › Attend training and awareness programs
- › ERM
- › Corporate Compliance
- › Information Systems
- › Think Big!
- › Temporary assignments (rotation program)
- › Develop policies and procedures





## Return on Investment

- Recovery of assets
- Remediation of losses
- Internal controls/root cause analysis feedback
- Informal feedback on people and processes
- Increased transparency of reporting fraud and misconduct
- Reduction in fraud
- Greater credibility from external agencies (DOJ, Auditors)
- Stronger control environment
- Audit Committee assurance
- Consistent approach to managing fraud risk



## Roadblocks

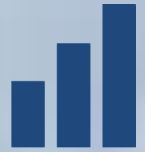
- Lack of policies and procedures
- Lack of a champion or executive management support and sponsorship
- Improperly positioned/located within the organization
- Improperly staffed (headcount & skillsets)
- No budget
- Failure to embed AFPC within organizational framework
- Fear of travel
- Myopic thinking
- Failure to network
- Being reactive

## Applicable Case Studies including some investigated case studies by SFIO

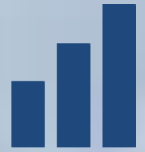
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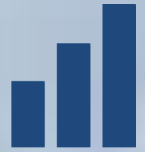
**Insurance Scam:** This scam had originated and prospered in the period immediately following Independence in 1947. At that time, the insurance sector was not nationalized, and a handful of private companies ruled the roost. These companies were more concerned with providing benefits to selected industrialists, and ignored the interests of the common man. The government responded by nationalizing the insurance sector, and the LIC was founded under a special Act passed by the Parliament. This scam laid the foundation of the nationalization culture in India



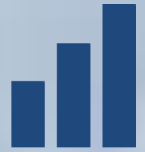
**Securities Scam:** This is perhaps the most well known of all financial scams probably because it happened in a highly visible period economic reforms had just been started in 1991. Harshad Mehta was quick to understand the weaknesses of the banking system, and exploited these weaknesses to the hilt. He managed to procure huge amounts of money using the so called “Ready Forward” deals, and used this money to purchase large amounts of shares at hugely inflated prices. He earned the sobriquet of “Big Bull” due to this penchant. Later, the banks got a clue of his shady deals, and demanded their money back. The house of cards collapsed, and the rest, as they say, is history.



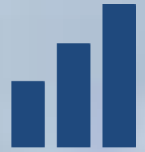
**CRB Scam:** This scam took place in the years 1992-1996, the period immediately following the Harshad Mehta fallout. This makes the scam even all the more daring and surprising. CR Bhansali, the perpetrator of this scam, floated more than 100 companies, such as CRB Mutual Funds and CRB Capital Markets. The primary purpose of these companies was to attract huge funds from the public by promising high rates of interest. This interest was later paid from further borrowings, and so on. In 1995, the stock market collapsed, and this proved to be the undoing of CR Bhansali. He was investigated, and later arrested. After a brief 3 months stint in jail, he has disappeared without a trace, and nobody is asking.



**UTI Scam:** The UTI scam involved the flagship US-64 scheme of UTI, which was meant to channel the funds of small investors into instruments bearing high returns. Gradually, US-64 developed an investor base of around 2 crore investors. The economic liberalization in India, coupled with the absolute opacity in the operations of UTI, led to a situation wherein the Government was forced to announce a huge bailout of about Rs 3,500-4,000 crores in an order to prevent default in payments to the investors. The consequences of such a situation are unimaginable. But the story does not end here. Later, it turned out that the UTI Chairman appointed at this time, Mr P S Subramanyam, along with a couple of executive directors, acted wrongly to selectively benefit a powerful coterie of brokers and industrialists, while at the same time, jeopardizing the interest of lakhs of small investors.

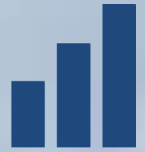


**Home Trade:** Around the year 2000, a finance portal emerged on the financial landscape, and gained quick recognition on the back of endorsements by personalities like Hrithik Roshan, Sachin Tendulkar and Shahrukh Khan. The portal, owned by Sanjay Agarwal, claimed to deal in gilts. Soon, RBI got suspicious of activities of some cooperative banks in the gilt market, and a scam was uncovered. The same old saga brokers and bankers combining to rob people of their hard earnings were repeated. Funds from Seaman's Provident Fund and PPF were affected. The total scam size was reported to be around Rs 300 crores, and more than Rs 200 crores were spent on publicity costs alone.

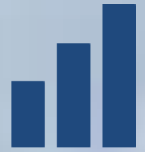


**Securities Scam:** That our system never learns its lessons was proved by this scam. Ketan Parkekh, a qualified CA, and a stock broker, identified a number of stocks (popularly called the K-10), and took up huge positions in these. For this purpose, he used a large number of Benami accounts and smaller stock exchanges, such as the Kolkata and Ahmedabad stock exchanges. He also borrowed heavily from banks such as Global Trust Bank and Madhavpura Mercantile Cooperative Bank. Unfortunately, he was stuck in a bear cartel, and was soon pounded to pulp on the stock exchange. The extent of the scam was estimated to be around Rs 1,500 crores.





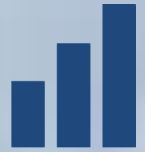
**Fake Stamp Papers:** This scam promised to be the mother of all scams in India, with the initial reports quoting a figure of Rs 30,000 crores as the scam size. Later, RBI clarified that this figure was “rather exaggerated”, and the “correct” figure was around Rs 200 crores. Again, this scam exposes how the India system works – Mr Abdul Karim Telgi, the scam kingpin, paid bribes to get access to the security press in Nasik, where stamp papers and currency notes are printed. He later used this knowledge to print fake stamp papers. At the height of the scam, Telgi’s network spanned 14 states, 125 banks and more than 1,000 employees.



**DSQ Software:** Though this scam was modest in terms of money involved (only Rs 600 crores), and did not affect the general public to a great extent, yet it is notable for how it came into being. The main player in the scam was Mr Dinesh Dalmia, who was the MD of DSQ Software Ltd. This company issued around 1.3 million shares in 2001, and these shares were allotted to four companies on a preferential basis. NSDL, a stock depository, dematerialized and helped in delivering the shares. Nothing wrong in that, except that the shares were not even listed on any stock exchange.

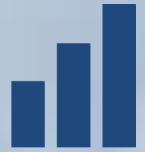


**IPO Scam** – A number of key operators, including corporate stock brokers such as Karvy and Indiabulls, were involved in the IPO scam that spanned the years 2004 – 2005. The modus operandi was simple – the operators would open thousands of fake accounts to purchase shares in IPOs, in the hope of selling later at huge profits. A spate of IPOs issued during this period was heavily oversubscribed due to this scam, sometimes by as much as 40 times.



**Satyam:** On a cold January morning in 2009, Ramalinga Raju, chairman of Satyam Computer Services, admitted to falsification in the company accounts and various other irregularities, and sent a chill down the collective spine of the Indian financial system. Coming on the back of the global recession, this incident promised to bust the Indian outsourcing industry and the stock market, but for some deft bailout work by the government. The matter is still under investigation and litigation, and the true extent of the scam will be known in the future, perhaps. Mr Raju himself had admitted to irregularities worth around Rs 12,000 crores.

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# Thank You CMA Amit Kumar