AN INTRODUCTION TO FORENSIC ACCOUNTING

Definition of Forensic Accounting
According to the Webster’s Dictionary, the word “forensic” is defined as “pertaining to, connected with, or used in the courts of law or public discussion and debate.” Thus, the nature of forensic accounting work is one which is closely connected to the legal process and has the potential to be involved in proceedings in the civil and criminal courts. In the case of the criminal courts, forensic accounting is valuable in the fight against white-collar crimes such as fraud, corruption and other illegal activities.

According to W. T. Thornhill, a prominent writer on forensic accounting, “The discipline is so relatively new that, up to now, there has been no formal definition accepted as the standard.” The best definition is probably given by Bologna and Lindquist (1995):

Forensic and investigative accounting is the application of financial skills and an investigative mentality to unresolved issues, conducted within the context of the rules of evidence. As a discipline, it encompasses financial expertise, fraud knowledge, and a sound knowledge and understanding of business reality and the working of the legal system. Its development has been primarily achieved through on-the-job training as well as experience with investigating officers and legal counsel.

Other definitions from other sources include:

- **Forensic accounting** is the application of investigative and analytical skills for the purpose of resolving financial issues in a manner that meets standards required by courts of law. (Textbook, page 5)

- **Forensic accounting** is ...“The use of intelligence-gathering techniques and accounting and business skills to develop information and express opinion used by attorneys involved in criminal and civil litigation; and to provide expert witness testimony if called upon......... Investigating and reporting on fraudulent financial activities. Verifying, sorting, extracting, reproducing, identifying, recording, and reporting past financial data or other accounting information for the purpose of settling civil or criminal legal proceedings.” (Robert K. Minniti)

- “A **forensic accountant** is a CPA who uses statistics, proven research and investigative methods, and proper documentation of evidence to research the facts of a situation; which are then presented in a formal report that can be defended in a court of law.” (Robert K. Minniti)

- **Forensic accounting** is the application of accounting principles, theories, and disciplines to facts or hypotheses at issue in a legal dispute, and encompasses every branch of accounting knowledge.

Forensic accounting consists of two major components: (1) Litigation services that recognize the role of the CPA as an expert or consultant and (2) investigative services that
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make use of the CPA’s skills, which may or may not lead to courtroom testimony. Forensic accounting may involve the application of special skills in accounting, auditing, finance, quantitative methods, certain areas of the law and research, and investigative skills to collect, analyze, and evaluate evidential matter and to interpret and communicate findings. Forensic accounting may involve either an attest or consulting engagement. (Technical Working Group on Education in Fraud and Forensic Accounting)

- A **forensic accountant** has extensive experience in investigations to determine solutions to disputed accounting matters, to write expert reports on their investigation, and to appear in court as expert witnesses. (Zeph Telpner and Michael Mostek)

- A normal accountant is like a guard dog (e.g., a bulldog); a **forensic accountant** is like a bloodhound; an internal auditor is like a seeing-and-eye dog (e.g., monitoring and guiding management), a corporate accountant is a mix breed, and a governmental accountant is an afghan. (Larry Crumbley)

**What does a Forensic Accountant do?**
A Forensic Accountant is often engaged 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 (and/or applying) 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.

In order to properly perform these services a Forensic Accountant must be familiar with legal concepts and procedures.

**What types of assignments does a Forensic Accountant perform?**
Detailed below are various areas in which a Forensic Accountant will often become involved:

1. **Criminal Investigations**
Forensic investigations often relate to criminal investigations carried out on behalf of law enforcement agencies. For example, a Forensic Accountant may be employed or engaged by organizations such as the PDRM, LHDN and JKDM to assist in investigation work.

At the end of such an investigation, a Forensic Accountant's report is prepared with the objective of presenting evidence in a professional and concise manner for the benefits of these agencies.

2. **Shareholders' and Partnership Disputes**
These assignments often involve a detailed analysis of numerous years accounting records to quantify the issues in dispute. For example, a common issue that often arises is the compensation and benefits received by each of the disputing shareholders or partners.

3. **Personal Injury Claims / Motor Vehicle Accidents**
A Forensic Accountant is often asked to quantify the economic losses resulting from a motor vehicle accident. A Forensic Accountant needs to be familiar with the legislation in place which pertains to motor vehicle accidents.

Cases of medical malpractice and wrongful dismissal often involve similar issues in calculating the resulting economic damages.

4. **Business Interruption / Other Types of Insurance Claims**
Insurance policies differ significantly as to their terms and conditions. Accordingly, these assignments involve a detailed review of the policy to investigate coverage issues and the appropriate method of calculating the loss.

A Forensic Accountant is often asked to assist from either an insured or insurer's perspective in the settlement of a case.

Examples of these types of assignments include; business interruptions, property losses and employee dishonesty (fidelity) claims.

5. **Business/Employee Fraud Investigations**
Business investigations can involve funds tracing, asset identification and recovery, forensic intelligence gathering and due diligence reviews.

Employee fraud investigations often involve procedures to determine the existence, nature and extent of fraud and may concern the identification of a perpetrator. These investigations often entail interviews of personnel who had access to the funds and a detailed review of the documentary evidence.

6. **Matrimonial Disputes**
Matrimonial disputes from a Forensic Accounting point-of-view often involve the tracing, locating and evaluation of assets. The assets to be evaluated and valued may be businesses, property or other assets.

7. **Business Economic Losses**
Examples of assignments involving business economic losses include; contract disputes, construction claims, expropriations, product liability claims, trademark and patent infringements and losses stemming from a breach of a non-competition agreement.

8. Professional Negligence
These investigations are often approached from two different but complimentary perspectives, these being:

- Technical - has a breach of Generally Accepted Accounting Principles or Generally Accepted Auditing Standards or other standards of practice occurred; and
- Loss Quantification.

If the professional in question is an accountant then a Forensic Accountant could be involved with both perspectives. If the matter involves some other profession a Forensic Accountant will normally be retained to perform only a loss quantification.

9. Mediation and Arbitration
Because of their familiarity and comfort with legal issues and procedures some Forensic Accountants have sought out special training and become involved in alternative dispute resolution (ADR).

ADR services include both mediation and arbitration and are designed to help individuals and businesses resolve disputes with minimal disruption and in a timely fashion.

Overview of the Nature of Forensic Accounting Work
Following from the above definitions, forensic accounting refers to the whole process of investigating a financial matter, including potentially acting as an expert witness if the fraud comes to trial.

This process includes the ‘forensic investigation’ itself, which refers to the practical steps that the forensic accountant takes in order to gather evidence relevant to the alleged fraudulent activity. The investigation is likely to be similar in many ways to an audit of financial information, in that it will include a planning stage, a period when evidence is gathered, a review process, and a report to the client. The purpose of the investigation, in the case of an alleged fraud, would be to discover if a fraud had actually taken place, to identify those involved, to quantify the monetary amount of the fraud (ie the financial loss suffered by the client), and to ultimately present findings to the client and potentially to court.

Audit techniques are used to identify and to gather evidence to prove, for example, how long the fraud has been carried out, and how it was conducted and concealed by the perpetrators. Evidence may also be gathered to support other issues which would be relevant in the event of a court case. Such issues could include:

- the suspect’s motive and opportunity to commit fraud
- whether the fraud involved collusion between several suspects
any physical evidence at the crime scene or contained in documents
- comments made by the suspect during interviews and/or at the time of arrest
- attempts to destroy evidence.

Types of Investigation
The forensic accountant could be asked to investigate many different types of fraud. It is useful to categorise these types into three groups to provide an overview of the wide range of investigations that could be carried out. The three categories of frauds are corruption, asset misappropriation and financial statement fraud.

Examples of corruption fraud: conflict of interest, bribery and extortion.
Examples of asset misappropriation: cash theft, fraudulent disbursements and misuse of assets.
Examples of financial statement fraud: deliberate falsification of accounting records, omission of transactions and balances and deliberate misapplication of financial reporting standards.

Conducting an Investigation
The process of conducting a forensic investigation is, in many ways, similar to the process of conducting an audit, but with some additional considerations. The various stages are briefly described below.

Accepting the investigation
The forensic accountant must initially consider whether their firm has the necessary skills and experience to accept the work. Forensic investigations are specialist in nature, and the work requires detailed knowledge of fraud investigation techniques and the legal framework. Investigators must also have received training in interview and interrogation techniques, and in how to maintain the safe custody of evidence gathered.

Additional considerations include whether or not the investigation is being requested by an audit client. If it is, this poses extra ethical questions, as the investigating firm would be potentially exposed to self-review, advocacy and management threats to objectivity. Unless robust safeguards are put in place, the firm should not provide audit and forensic investigation services to the same client.

Commercial considerations are also important, and a high fee level should be negotiated to compensate for the specialist nature of the work, and the likely involvement of senior and experienced members of the firm in the investigation.

Planning the investigation
The investigating team must carefully consider what they have been asked to achieve and plan their work accordingly. The objectives of the investigation will include:

- identifying the type of fraud that has been operating, how long it has been operating for, and how the fraud has been concealed
• identifying the fraudster(s) involved
• quantifying the financial loss suffered by the client
• gathering evidence to be used in court proceedings
• providing advice to prevent the reoccurrence of the fraud.

The investigators should also consider the best way to gather evidence – the use of computer assisted audit techniques, for example, is very common in fraud investigations.

Gathering evidence
In order to gather detailed evidence, the investigator must understand the specific type of fraud that has been carried out, and how the fraud has been committed. The evidence should be sufficient to ultimately prove the identity of the fraudster(s), the mechanics of the fraud scheme, and the amount of financial loss suffered. It is important that the investigating team is skilled in collecting evidence that can be used in a court case, and in keeping a clear chain of custody until the evidence is presented in court. If any evidence is inconclusive or there are gaps in the chain of custody, then the evidence may be challenged in court, or even become inadmissible. Investigators must be alert to documents being falsified, damaged or destroyed by the suspect(s).

Evidence can be gathered using various techniques, such as:
• testing controls to gather evidence which identifies the weaknesses, which allowed the fraud to be perpetrated
• using analytical procedures to compare trends over time or to provide comparatives between different segments of the business
• applying computer assisted audit techniques, for example to identify the timing and location of relevant details being altered in the computer system
• discussions and interviews with employees
• substantive techniques such as reconciliations, cash counts and reviews of documentation.

The ultimate goal of the forensic investigation team is to obtain a confession by the fraudster, if a fraud did actually occur. For this reason, the investigators are likely to avoid deliberately confronting the alleged fraudster(s) until they have gathered sufficient evidence to extract a confession. The interview with the suspect is a crucial part of evidence gathered during the investigation.

Reporting
The client will expect a report containing the findings of the investigation, including a summary of evidence and a conclusion as to the amount of loss suffered as a result of the fraud. The report will also discuss how the fraudster set up the fraud scheme, and which controls, if any, were circumvented. It is also likely that the investigative team will recommend improvements to controls within the organisation to prevent any similar frauds occurring in the future.

Court proceedings
The investigation is likely to lead to legal proceedings against the suspect, and members of the investigative team will probably be involved in any resultant court case. The evidence gathered during the investigation will be presented at court, and team members may be called to court to describe the evidence they have gathered and to explain how the suspect was identified. It is imperative that the members of the investigative team called to court can present their evidence clearly and professionally, as they may have to simplify complex accounting issues so that non-accountants involved in the court case can understand the evidence and its implications.

**Forensic Accounting Work not Limited to Fraud Investigations**

Students should take note that the work of a forensic accountant is not limited to fraud investigations alone. Forensic accounting services may also cover non-fraud investigations (for e.g., investigate hidden assets in a divorce, perform business valuation in a business dispute, determine value of damages to business assets and property for insurance purposes) and provision of litigation services (for e.g., acting as an expert witness in court, acting as a mediator in a dispute resolution between two parties in dispute).

The leading organization of CPAs – the American Institute of Certified Public Accountants (AICPA) – classifies forensic accounting into two categories:

1. Investigative services that may or may not lead to courtroom testimony.
2. Litigation services that recognize the role of the accountant as an expert, consultant, or other role (for e.g. as a mediator or arbitrator in a dispute resolution).

These two categories of services are defined below:

**Investigative service** – Function of searching for evidence that supports an objective and communicates the results of the search.

**Litigation services** – Function of a valuation and investigation service (including testifying as an expert) performed to assist the court in the determination of an equitable judgement.

**Differences between Auditing and Forensic Accounting**

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<tr>
<th>Issue</th>
<th>Auditing</th>
<th>Forensic Accounting</th>
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<tr>
<td><strong>Timing</strong></td>
<td>Recurring</td>
<td>Nonrecurring</td>
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<td></td>
<td>Audits are conducted on a regular, recurring basis.</td>
<td>Fraud examinations are nonrecurring.</td>
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<td>They are conducted only with sufficient predication.</td>
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<td><strong>Scope</strong></td>
<td>General</td>
<td>Specific</td>
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<td></td>
<td>The scope of the audit is an examination of financial data.</td>
<td>The fraud examination is conducted to resolve specific allegations.</td>
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Objective

An audit is generally conducted for the purpose of expressing an opinion on the financial statements or related information.

Affix blame

The fraud examination’s goal is to determine whether fraud has occurred or is occurring and to determine who is responsible.

Relationship

Non-adversarial

The audit process is non-adversarial in nature.

Adversarial

Fraud examinations, because they involve efforts to affix blame, are adversarial in nature.

Methodology

Audit techniques

Audits are conducted by examining financial data and obtaining corroborating evidence.

Fraud examination techniques

Fraud examinations are conducted by (1) document examination; (2) review of outside data such as public records; and (3) interviews.

Standard

Professional skepticism

Auditors are required to approach audits with professional skepticism.

Proof

Fraud examiners approach the resolution of a fraud by attempting to establish sufficient proof to support or refute a fraud allegation.

Prerequisite Knowledge and Skills Sets for the Forensic Accountant

Forensic accounting is one of the most, if not the most, important tools in the fight against corruption and other criminal wrongdoing, both in the private and public sectors. It must be borne in mind that criminals are increasingly taking advantage of new technologies such as computers, e-banking, etc., to hide their crimes. Forensic accounting, together with expertise in other investigative tools and certain other areas, will then be an important tool to detect these activities.

Forensic accounting should therefore be seen as a multiskill or multi-disciplinary area. Expertise in accounting alone will not suffice without the complementary expertise in other investigative skills. Similarly, expertise in other investigative skills without knowledge of accounting will not assist the forensic accountant in uncovering the illegal activities.

According to Thornhill, the forensic accountant should be equipped with the following skills and knowledge:

- Knowledge of the relevant laws,
- Rules of evidence,
- Investigative competency,
- Knowledge of fraud,
- Interviewing and interrogation skills,
- An understanding of the psychological theories relating to criminal behavior,
- Literacy in the use of computers and information technology, and
• Communication and interpersonal skills.

Larry Crumbley suggests that the following knowledge, skills and abilities are needed by the forensic accountant:
• Law, legal system, courts, and courtroom procedure,
• Financial statement fraud,
• Corporate governance, shareholder rights and litigation, securities laws, and protections,
• Report writing and communication,
• Criminal law and procedure,
• Computer fraud and cybercrime,
• Human factors involved in intelligence gathering, interview techniques and understanding the motivations for fraud and other criminal activities,
• Ethical issues in business, and
• Business valuation.

Also, see textbook on pages 6-7.

Opportunities in Forensic Accounting
Employment opportunities are provided by many employers including the following firms/institutions:

• An accounting firms’ forensic division
• Government agencies
• Law firms
• Financial institutions
• Consulting firms
• Other firms/institutions

Also, see textbook on pages 7-8.

Organizations that Support the Work of Forensic Accountants

Organizations supporting the work of forensic accountants include the following:
• American College of Forensic Examiners (Certified Forensic Accountant)
• American Institute of Certified Public Accountants (AICPA)
• Association of Certified Fraud Examiners (ACFE)
• Association of Government Accountants
• Committee of Sponsoring Organizations (COSO)
• Forensic Accounting Society of North America
• Institute of Internal Auditors (IIA)
• IT Governance Institute
• Information Systems Audit and Control Association (ISACA)
Conclusion
In summary, forensic accounting and forensic investigation is a very specialist type of engagement, which requires highly skilled team members who have experience not only of accounting and auditing techniques, but also of the relevant legal framework.

There are numerous different types of fraud that a forensic accountant could be asked to investigate. The investigation is likely to ultimately lead to legal proceedings against one or several suspects, and members of the investigative team must be comfortable with appearing in court to explain how the investigation was conducted, and how the evidence has been gathered. Forensic accountants must therefore receive specialist training in such matters to ensure that their credibility and professionalism cannot be undermined during the legal process.

Forensic accounting work is not limited to fraud investigation work as forensic accountants also provide non-fraud investigative services as well as litigation services.

Discussion Questions for Tutorial
1. To what does the word forensic pertain? Following from this, explain the nature of forensic accounting work?
2. Explain the roles played by forensic accountants in areas besides those relating to fraud.
3. List and explain the most important skills required of forensic accountants.
4. Describe the areas of work that are available to a graduate trained in forensic accounting.
5. Describe the two types of services provided by forensic accountants.
6. What are the differences between auditing and forensic accounting.
7. Briefly describe the various stages of a forensic investigation.
8. What matters should the forensic accounting firm consider before accepting a potential engagement from a client.
9. Describe the main objectives of a forensic accounting investigation.

10. Why is it important for a forensic accountant to learn how to handle correctly with the evidence he has collected during an investigation?

11. What is the ultimate aim of a forensic accounting investigation if the evidence show that a fraud did occur and what is the main tool for achieving this aim?

12. You are a final year student at Universiti Tenaga Nasional. You told your parents that you are going to register for a forensic accounting class in the coming semester. You have told them about working as a forensic accountant as a future career. Your parents are intrigued by your career choice and are not entirely convinced by the idea. Hence, they want to know whether you will have job security and what kind of jobs you will get with such qualifications. Assuming that you are trying to convince your parents, how would you respond and what would you say to enlighten them?

References

4. Syed Noh Syed Ahmad, Chapter 6, Forensic Accounting Courses in Malaysia.
8. Dr. Larry Crumbley, Forensic and Investigative Accounting.