

# **FORENSIC ACCOUNTING: NEEDS TO PROTECT INDIVIDUAL AND BANKS FROM ON-LINE FRAUDS**

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## **ABSTRACT**

In today's era, where every one of us is talking about digitalization on-line banking frauds can befall anyone, they can range from few thousands to lakhs of rupees. All have started using their digital mode of payment and here the chances of frauds are increasing due to lack of strong and unbreakable technical system support. Here, a forensic accounting can solve the problems of individual as well as of banks up to a certain extent. We all know that forensic accounting is an emerging discipline in response to an increase in financial crimes such as money laundering, embezzlement, bribery, bankruptcy, securities, bank fraud etc. The multi facet development of information technology has made these crimes easier and less noticeable, including banking frauds. This in turn results into increasing incidences of deceptive activities posing new challenges to the forensic accountants. In 2012 Deloitte conducted a survey on frauds which'' revealed that banks have witnessed a rise in the number of fraud incidents in the last one year, and the trend is likely to continue soon. The survey points to the increased difficult scenario for banks with increased fraud incidents and low recoveries, thereby directly affecting their bottom-line. With increased regulatory scrutiny, banks are under increased pressure to implement best practices and fraud risk management framework, to curse the situation forensic accounting can be a helping hand.

*Key words: Forensic Accounting, Digitalization, on-line frauds.*

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## **Introduction:**

As we all know that Forensic accounting is now not a new concept. It is the fastest growing area of accounting today. It is nothing but gathering, investigation and analysis o accounting information for the presentation as evidence in the court of law. Accountants all over the world have provided services to government and private enterprise in investigation of financial records and in litigation support for many years. Though the skills required for the preparation of financial statements, auditing and analysis are related in many ways in both academic and forensic accounting, between them. The practice of utilizing accounting, auditing and investigative skills to assist in legal matters makes the difference.

The Global Economy has witnessed declining pace of growth, sovereign debt crisis in European countries and stress in financial markets. Indian economy which already was suffering from weak macroeconomics fundamentals has been significantly affected by global turmoil. Financial

liberalization, emergence of innovative financial instruments and extensive use of banking technology has exposed banking system to a multiple risk where the need arise of forensic accounting to meet that challenges and risk.

Being financial intermediary, the bank is exposed to various types of risk including credit, market liquidity, legal compliance and reputation risks. Fro market participants it is important to have knowledge of Risk Management Framework adopted by the bank stating the techniques used to identity measure, monitor and control those risks in order to make assessment. For each separate risk area, banks are required to describe their risk management objectives and policies including strategies and processes, the structure and organization of the relevant risk management function, the scope and nature of risk reporting and measurement systems, policies for hedging and mitigating risk and strategies and process for monitoring the continuing effectiveness of hedges/mitigants.

### **Forensic Accounting:**

The combination of accounting, auditing and investigative skills yields the special field of

Accounting is known as forensic. It provides an accounting analysis that is suitable to the law. It also offers the basic evidence for discussion, debate and ultimately dispute resolution. Whereas other accountants are responsible for ensuring that financial statements are accurate, forensic accountants actually are trying to make sense of what is happening. Forensic accountants' role in telling the story behind accounting failures is demonstrative evidence of the profession's commitment to independence and objectivity. Effective forensic accountants should be both friendly and technically competent. They are trained to look further than the numbers and deal with the business reality of the situation.

### **Financial Crime: An overview**

The world of today is very complex and impersonal where white collar crime appear to be more common. Employees steal from their employers , tax avoiders become tax evaders, property owners file fraudulent insurance claims , business and banks are forced in to bankruptcy and so on. White collar crime is a violation of law committed by a person or group of persons in the course of an otherwise respected and legitimate occupation or business enterprise. Crimes that are committed by persons of high social status during their occupation are considered sophisticated crimes.

Some crimes are not easily identifiable and traceable because of the nature and status of people involved in them. Such crimes do not leave even a normal audit trail or the like. Hence, to trace and fix such crimes, special skills, i.e. forensic accounting skills are required. Different types of sophisticated crimes can classified as follow:

1. Individual and professional occupational crime.

2. Crimes against government by government officials.
3. Crime against government by private citizens.
4. Scandal with bank by different organizations.
5. Crimes against business by employees such as Embezzlement: Employees misappropriate the money or property of the organization.
6. Crimes against consumers.
7. Crimes against investors.
8. Exploiting or threatening an organization or individual for providing a service unless an additional payment or bribe is given.
9. Misuse of influence: People holding important positions may misuse their power and sell important information to outsiders who have an interest in it.
10. Corporate crimes: Engaging in restrictive trade practices thereby causing damage to the workers, society, environment or the other.
11. Clients cheating an organization for the monetary benefit.
12. Cyber crimes: Internet fraud, internet, pornography, use of computers for theft, destruction or harassment.

**On-line banking frauds:** As per the data released by the Reserve Bank of India showed that top banks including ICICI Bank and State bank of India (SBI) recorded most number of bank fraud incidents during April-December period of 2016.

- During the first nine months of the current fiscal for the year 2016, as many as 455 fraud cases involving Rs 1 lakh and above were detected in ICICI Bank, closely followed by SBI (429), Standard Chartered (244) and HDFC Bank (237).
- The other banks which reported large number of frauds to the apex bank during the period include Axis Bank (189), Bank of Baroda (176) and Citibank (150).
- However, in value terms, frauds involving Rs 2,236.81 crore were reported in SBI, followed by Punjab National Bank (Rs 2,250.34 crore) and Axis Bank (Rs 1,998.49 crore).
- The data provided by RBI to the Finance Ministry also revealed the involvement of bank staffs in fraud cases.
- In the case of SBI, 64 employees were involved in fraud cases, while it was 49 for HDFC Bank and 35 for Axis Bank.
- In all, 450 employees were involved in fraud cases in different public and private sector banks during April-December 2016, in 3,870 cases involving a total value of Rs 17,750.27 crore.

Many have become victims of online banking frauds. Here the question of banks' accountability and liability comes in to the picture.

**Liability and Accountability of banks:** Safety of bank accounts and credit cards line both with the account holder and concerned bank. However, considering the surge in complaints related to unauthorized transactions from bank account and credit cards in July 2017, the Reserve Bank of India reviewed the criteria for determining customer liability in these circumstances and issued some guidelines.

**RBI Guidelines:** According to RBI's guidelines, a customer has zero liability where the unauthorized transaction occurs because of two reasons; first contributory fraud, negligence, deficiency on the part of the bank irrespective of whether or not the transactions is reported by the customer and second third party breach where the deficiency lies neither with bank nor the customer but lies elsewhere in the system and the customer notifies the bank within 3 working days of receiving the communication from the bank regarding the unauthorized transaction. "Banks have been held liable for frauds that have occurred either solely due to their negligence, or due to contributory negligence. However customer is liable if loss is due to her/his negligence, such as because she shared payment credentials. In such cases, customer bears all the losses till the unauthorized transaction is reported to the bank. This is why ' it is important for consumers to not share any account related information over phone. Further RBI has advised banks that on being notified by the customer, the bank shall credit the amount involved in the unauthorized electronic transactions to the customer's account within 10 working days from when the incident was reported. Banks may also as it's discretion, waive any customer liability in case of unauthorized electronic banking transactions even in case of customer negligence.

**Areas of Forensic Accounting:** Forensic accounting deals with using accounting evidence to assist in various financial matters. It includes two main areas;

- **Litigation Support:** Litigation support or service can be explained as any professional assistance that non-lawyers provide to lawyers in the litigation process. It represents the accurate presentation of economics and financial issues related to existing or pending damages of issues to parties involved in. They assist in resolving disputes, even before they go to the court of law. If a disputes goes to the court of law, forensic accountants may give evidence as expert witness. Litigation support provides assistance of an accounting nature in a matter involving existing or pending litigation. It deals primarily with issues related to the qualification of economic damages. A usual litigation support job would be calculating the economics loss resulting from a breach of contract and the like issues. Forensic accountants can extend their assistance of litigation support in the following specified ways:
  - a. Reviewing relevant documents to form an initial assessment of the case and identify areas of loss.
  - b. Assisting in formulation of questions to be asked regarding the financial evidence.
  - c. Assisting in obtaining documents necessary to support or disprove a claim and

- d. Extending assistance in settlement discussions and negotiations.
- **Investigation and Dispute Resolution:** Forensic accounting provides an accounting analysis suitable to the court of law which will form the basis for discussion, debate and ultimately dispute resolution. It involves looking further than the numbers and understanding the substance of situations and deal with the business reality. In short, it requires the most important quality of ability to think. Investigation is the act of determining whether criminal matters such as employee theft, securities fraud, insurance fraud, etc. have occurred. Forensic accountants may recommend actions to be taken to minimize the future risk of loss as well. Regarding investigation and dispute resolution, they can extend their assistance in the following specified ways:
  - a. Reviewing the actual situation and provision of suggestions regarding possible courses of action.
  - b. Assisting in the protection and recovery of assets.
  - c. Assisting in securing co-ordination of other experts such as forensic document examiners, private investigators etc.

Thus, forensic accounting is more than conventional accounting more than detective work and it is a blend of all that is required to conduct the business safely.

## PROCESS OF FORENSIC ACCOUNTING

At times financial crimes are detected accidentally but these can also be identified systematically in a variety of ways including by audit investigation, data-mining enquiries and internal controls and testing or by conducting special investigation on suspicion.

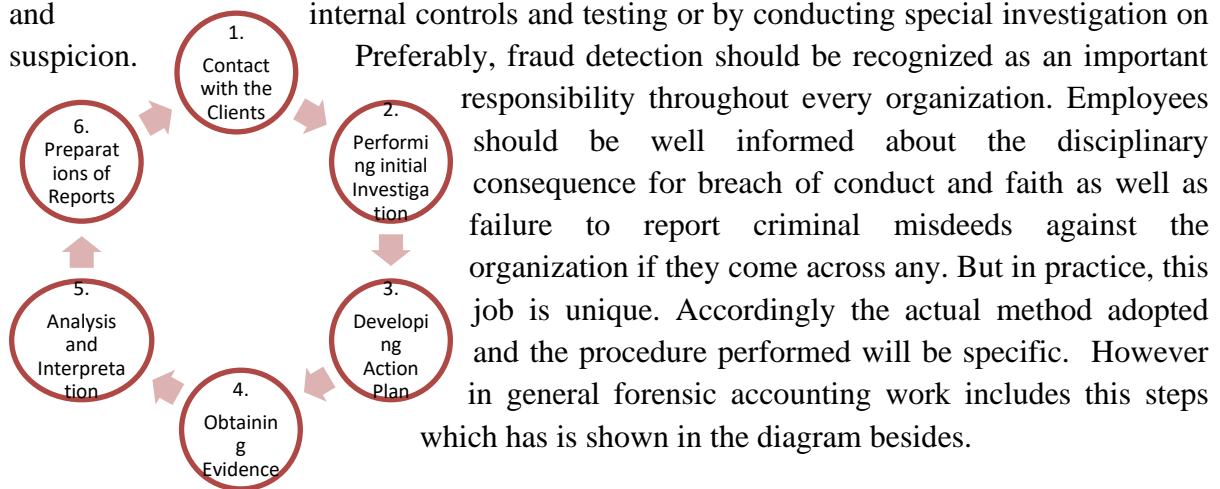


Figure 1 CYCLE OF FORENSIC ACCOUNTING

Now let us see each step in detail;

- 1) **Contact with the Clients:** When received request from clients, it is important to contact the clients before starting investigation. Contacting the clients is very helpful in the understanding of information and issues. After establishing contact, the most important step is the prudence to check the information collected from legal advisers. It is to be

done before forensic accountants start a financial investigation. There are special procedures for approaching and collecting evidence.

- 2) **Performing Initial Investigation:** The initial investigation is useful in both the understanding of issues and in preparation for subsequent explorations. It starts with initial doubts or assumptions. To analyze the model of past crimes and extend it to the possibility of future crimes, forensic accountants follow possible doubts or assumptions. Once they understand the method of past crimes, they may visualize the same for the current issue on hand.
- 3) **Developing Action plan:** A strategic plan provides overall direction on the long path from where things are now to where we hope they will be. The main purpose of action plan is to develop in detail, who will do what, when and how to achieve a specific outcome. The plan takes in to account the facts obtained by contacting with clients by carrying out the initial investigation, the objectives to be achieved and the methods to achieve the objectives
- 4) **Obtaining Evidence:** Before collecting relevant evidences, forensic accountant should confirm whether standard procedures in the field are followed in this regard. Nowadays standardized formats are used for interviews with employees or others. When observation method is used it is very much important to keep proper logs. Documentation has to be made cautiously for anything that might affect or involve employees' privacy or privileges which includes obtaining evidence on economic information and other proofs for the occurrence of the event. The best evidence must be carefully logged and should be kept in proper custody to ensure no misappropriation.
- 5) **Analysis and Interpretation:** The next step is analyzing the evidence gathered. Understanding how data is gathered, accumulated, used and reported is helpful in the evaluation process of conflicting information sources. It involves reasoning out the evidence collected and meticulously analyzing the facts obtained. It includes classifying and summarizing the facts collected in a systematic manner to measure the damages in economic perspective.
- 6) **Preparation of Reports:** The final report is prepared according to the nature, scope and approach of the current assignment on hand. The report will be prepared in such a way that it can explain the findings clearly and authentically.

#### **PRESENT SCENARIO:**

- **According to the survey done by Deloitte Indian Banking Fraud Survey conducted in the year April 2015** 93% of respondents indicated that there has been an increase in fraud incidents in the banking industry in the last two years.
- More than half of the respondents indicated that the banking industry has seen more than a 10% increase in fraud incidents in the last two years due to following reasons;
  - a. Lack of oversight by line managers/ senior management on deviations from existing processes
  - b. Business pressures to meet unreasonable targets

- c. Lack of tools to identify potential red flags Collusion between employees and external parties
  - **1** in every **4** institutions has witnessed more than **100** fraud incidents in the retail banking segment. The majority of retail banking segment respondents claim they suffered an average fraud loss of **INR 10 lakhs**. In contrast, the average fraud loss in the non-retail segment was in the region of **INR 2 crore**.

### **Future trends:**

To **prevent this kind** of banking frauds the following steps has been suggested in the report.

**Technology to fuel fraud in the future:** The top three fraud risks that are currently the highest concerns for banks: Internet Banking and ATM fraud E-banking (credit card, debit card etc.) & Identity fraud. In Greater investment towards the adoption of anti-fraud measures **83%** of the respondents foresee an increase in their investments in adopting anti-fraud measures, especially in the areas of;

- Fraud detection and monitoring systems
- Up gradation of technology to combat cybercrime
- Fraud risk assessments and investigations

(Source: India Banking Fraud Survey Edition II)

### **Fraud risks: Banking**

#### ***A. Fraudulent documentation***

Fraudulent documentation involves altering, changing or modifying a document to deceive another person. It can also involve approving incorrect information provided in documents knowingly. Deposit accounts in banks with lax KYC drills/ inoperative accounts are vulnerable to fraudulent documentation.

Some examples:

- An individual illegally obtains personal information/ documents of another person and takes a loan in the name of that person.
- He/she provides false information about his/her financial status, such as salary and other assets, and takes a loan for an amount that exceeds his eligible limits with the motive of non-repayment.
- A person takes a loan using a fictitious name and there is a lack of a strong framework pertaining to spot verifications of address, due diligence of directors/promoters, pre-sanction surveys and identification of faulty/incomplete applications and negative/criminal records in client history.
- Fake documentation is used to grant excess overdraft facility and withdraw money.
- A person may forge export documents such as airway bills, bills of lading, and Export Credit Guarantee Cover and customs purged numbers/orders issued by the customs authority.

#### ***B. Multiple funding/diversion/siphoning of funds***

Siphoning of funds takes place when funds borrowed from financial institutions are utilized for purposes unrelated to the operations of the borrower, to the detriment of the financial health of the entity or of the lender. Diversion of funds, on the other hand, can include any one of the following occurrences:

- Use of short-term working capital funds for long-term commitments not in conformity with the terms of sanction
- Using borrowed funds for creation of assets other than those for which the loan was sanctioned
- Transferring funds to group companies
- Investment in other companies by acquiring shares without the approval of lenders
- Shortage in the usage of funds as compared to the amounts disbursed/ drawn, with the difference not being accounted for.

### ***C. Identity theft***

Fraudsters are devising new ways to exploit loopholes in technology systems and processes. In case of frauds involving lower amounts, they employ hostile software programs or malware attacks, phishing; SMS is hang and whaling (phishing targeting high net worth individuals) apart from stealing confidential data.

In February 2013, the RBI advised banks to introduce certain minimum checks and balances such as the introduction of two factor authentication in case of ‘card not present’ transactions’.

Some examples:

- Un authorized emails asking for account information for updating bank records are sent by fraudsters. The customer information is then misused for misappropriating funds.
- Access rights for making entries are given to unauthorized people.
- ***Debit card skimming:*** A machine or camera is installed at an ATM in order to pick up card information and PIN numbers when customers use their cards.
- ***ATM fraud:*** A fraudster acquires a customer’s card and/or PIN and withdraws money from the machine.
- ***Social engineering:*** A thief can convince an employee that he is supposed to be let into the office building, or he can convince someone over the phone or via e-mail that he’s supposed to receive certain information.
- ***Dumpster diving:*** Employees who aren’t careful when throwing away papers containing sensitive information may make secret data available to those who check the company’s trash.
- ***False pretences:*** Someone with the intent to steal corporate information can get a job with a cleaning company or other vendor specifically to gain legitimate access to the office building.
- ***Computer viruses:*** With every click on the internet, a company’s systems are open to the risk of being infected with nefarious software that that is set up to harvest information from the company servers.

(Source: ASSOCHAM *Current fraud trends in the financial sector, June 2015*)

### **Fraud Prevention--What needs to be done?**

**Training** at regular intervals especially to the staff handling advances and loans. The emphasis of training should be on the appraisal of the loan proposal. Barnes (1995) has pointed out that quality training to bankers helps not only in developing job related skill but also maximizes the performance potential of bankers and provides them the sound knowledge and understanding of banking practices and principles. Imparting training is of paramount importance in this regard.

**Customer awareness** needs to be intensified. Seminars/ short duration training programmes for the employees on KYC and AML .Short ads in the print and digital media may help. As per Commercial Angels Newsletter (2001), the best way of preventing fraud was to understand why it happened. Fraudster generally identifies loopholes in control procedures and then assess whether their potential rewards will outweigh the penalties should they be caught. A regular control is most effective for



prevention of frauds and normally requires little management time or effort. Prevention of frauds starts with identification of weakness in current systems of the organization. Next the organization must improve those systems with new or better controls. The introduction and enforcement of controls will reduce the opportunities for frauds. The control warns potential fraudster that the management is actively monitoring the business and in turns deters frauds. Education, training and awareness programmes are informal intervention measures that should be implemented to prevent frauds.

China has executed bankers in the past for fraudulent activity Harris and William (2004) examined the reasons for loan frauds in banks and emphasized on due diligence program. This is a proactive approach, with each business line within the institution establishing policies and procedures for conducting due diligence investigations for both new and existing customers .They indicated that lack of an effective internal audit staff at the company, frequent turnover of management or directors, appointment of unqualified persons in key audit or finance posts, customers reluctance to provide requested information or financial statements and fictitious or conflicting data provided by the customers are the main reasons for loan frauds. Fraud thrives when conditions are right. A "fraud-friendly environment" is characterized by lax corporate culture on the enforcement of internal controls; deficient and/or absence of requisite risk controls, staff apathy and overconfidence.

A Fraud Disaster Management Authority (FDMA) on the lines of the NDMA may also be thought of. What happens is when banks refer cases to the investigating agencies, searches and raids are conducted by them. They seize whatever goods, articles, vehicles etc they find during the raids. The process of investigation is a long one which may take up to 3-5 years, or more. Till the investigation is complete, the seized items can't be disposed off. During this period the seized goods start deteriorating and may fetch only scrap value. At times the value of the stocks seized runs in crores. The effort should be to recover whatever can be salvaged instead of allowing the goods to die a natural death.

**Conclusion:** Banking frauds are no longer a rich man's problem. Forensic science is a vital instrument for the detection or investigation of crime and the administration of justice, providing crucial information about the evidence found at crime scene, it is especially important that the training and education of forensic scientists provide a solid scientific background and a broad base in criminalities. Frauds can't be eliminated as such. It is a necessary evil. The effort lies in trying to contain the menace. Its effect can be widespread, causing long term financial and reputational damage. Fraud risk is something that no bank would like to deal with. Internal controls need to be strengthened as they can weaken over time due to technological advances or human intervention or because of the rise in new fraud schemes. Nonetheless, having anti-fraud measures in an organization's control environment can go a long way in deterring individuals from perpetrating fraud because the message going down the line is that the senior management is cognizant of this crime and is committed to preventing it within the organization. Remember the fraudster is always a step ahead!!

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