
Forensic accounting-Is it necessary for India?

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ABSTRACT

Purpose- *The purpose of this paper is to identify the need for so called Forensic accounting in India and to examine to what extent and what form forensic Accounting (FA) now exists in India.*

Design/Methodology/approach- *The paper is mainly written based on the analysis of the examples of Indian fraud cases, the reason for the same and their impact on the economy to understand the need for forensic accounting. The study being a conceptual analysis, it employed the secondary source of data collection by making use of available literature on forensic accounting and its application in modern corporate world.*

Findings- *Ineffective whistle-blowing systems, lack of objective and independent internal audit Functions with forensic skills, inadequate oversight of senior management activities by the audit committee and weak regulatory environment are the reasons for growing worries in respect of financial statement frauds. Hence forensic accounting is an urgent need in India to detect the frauds in companies that are suspected to be engaged in fraudulent transactions.*

Practical implications- *This research will lead to the awareness of the importance of forensic accounting. Ultimately this study hopes to protect the interest of shareholder*

Originality/value- *This is the first ever paper in Indian context to understand the need for Forensic accounting*

Keywords: *Forensic accounting, Indian industry, Accounting, Auditing Fraud, fraud detection, litigation support*

INTRODUCTION

Forensic accounting has existed since many years. In 1940 Maurice Paulobet coined the term Forensic Accounting. Worldwide Sherlock Holmes is considered to be the first Forensic Accountant; however the contribution of some of the historic characters in India cannot be ignored such as Kautilya who was the first person to mention the famous forty ways of embezzlement in his famous Kautilya Arthashastra during the ancient Mauryan Times one thousand years ago.

Birbal was the Scholar in the time of King Akbar. He used various tricks to investigate various crimes. Some of his stories give the fraud examiner a brief idea about the Litmus test of Investigation. Gem of Indian Fraud Examiners, Chetan Dalal can be credited with actually applying the stories of the Birbal to the Investigation of the frauds. In various articles published In BCAS Journal he has explained how Birbal's trap and Birbal's Litmus test approaches are significantly used while investigating the accounting frauds. The third scholar is Tenaliram who again emphasize on the investigative techniques used to find the perpetrators. So its use is not new to Indians but the term Forensic accounting will be a new subject which has been developed through years adapting the requirements according to the emerging problems of the world.

Forensic accounting is an area of accounting that requires the accountant to perform their work to a standard that is suitable to be used in a court of law. According to Crumbley and Apostolu (2002), Forensic accounting includes coverage in two areas: investigative accounting and litigation support (p. 17). Investigative accounting is working like a detective and looking for fraud, whereas the area of litigation support requires the accountant to become trained to be an expert witness. Therefore, the forensic accountant needs to be able to take a more "proactive, skeptical approach to examining the books of a company. Forensic Accountants work in most major accounting firms and are needed for investigating mergers and acquisitions, and in tax investigations, economic crime investigations, all kinds of civil litigation support, specialized audits, and even in terrorist investigations. Forensic Accountants work throughout the business world, in public accounting, corporations, and in all branches of government.

Due to the growing complexities of business environment and the growing number of Business related investigations, Forensic accounting professionals are in a great demand now a days as they are increasingly asked to assist in the investigation of financial and business related issues of fraud cases. So the purpose of writing this paper is to identify

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whether this new emerging field of accounting called Forensic accounting is really a need in Indian Scenario. An attempt has been made in this paper to identify the factors, which demand the forensic accountants in India.

LITERATURE REVIEW

Forensic accounting literature has emerged since 1990s. A number of articles focused on the Increasing demand for accountants to conduct forensic accounting activities and on the broadening definition of forensic accounting away from a narrow fraud detection definition (Cohen, Crain, & Sanders, 1996; Baron, 2006; Wells, 2003; Rezaee, Crumbley, & Elmore, 2006). The educational literature focused on descriptive studies of university offerings. Few universities teach forensic accounting (Rezaee & Burton, 1997). Some universities integrated fraud or forensic accounting throughout the accounting curriculum while others offered individual fraud or forensic accounting courses and/or entire fraud accounting programs (Buckhoff & Schrader, 2000; Peterson Reider, 2001; Rezaee, Crumbley, & Elmore, 2004; Seda & Kramer, 2008). Specific recommendations for model curriculums were developed (National Institute of Justice, 2005) as well as identification of the characteristics of developmental approaches for curriculum (Smith and Crumbley, 2009). Concurrently, researchers began to question what the important specialized skills and technical abilities of forensic accountants are (Cohen, Crain, & Sanders, 1996; Harris & Brown, 2000; Messmer 2004, Ramaswamy, 2005), and experience levels (Grippio & Ibex, 2003). DeGabriele (2008) extended these studies by surveying accounting academics, forensic accounting practitioners and users of forensic accounting services to further define the relevant skills of forensic accountants Christensen, Byington, and Blalock (2005) point out that forensic accountants have both the quantitative skills in researching numbers to uncover fraud and qualitative skills to determine the weaknesses of internal control systems. The forensic accountant has a mindset that takes a more active, and skeptical approach towards fraud (Crumbley & Apostolou 2002) and is more interested in exposing fraud compared to financial auditors (Apostolou & Crumbley 2008; Christensen, Byington, & Blalock 2005). Ramaswamy (2005) believes that forensic accountants have the expertise in untangling complicated accounting maneuvers that misrepresent financial statements. Empirical evidence from a study by Boritz, Kotchetova and Robinson (2008) confirms that forensic accountants could detect significantly higher number of fraud than auditors. Srivastava, Mock, and Turner (2003) in their study found that forensic audit procedures significantly lowered fraud risks. Furthermore, research has also proven that proactive forensic data analysis using computer based sophisticated analytical

tests can detect fraud that may remain unnoticed for years (Brown, Aiken, & Visser 2007). Nevertheless, these services are still underutilized by companies worldwide. Ernst & Young's (2003) worldwide fraud survey, which states that only 20% of organizations employed forensic accountants although the satisfaction level for the service 88% was the highest. As a going trend recent studies have analyzed the need for forensic accounting in a country specific context. Such as Xianghua Hao(2010) for China, Gunasegaran Muthusamy(2010) for large Malaysian Companies ,Real Labelle and Michele Saboly(2008) for France etc Tokikazu Konishi(2007) for Japan. As this type of study has not been done in Indian context, we have tried to bridge the gap by analyzing the need for forensic accounting in Indian context there by contributing to the existing literature of need for Forensic accounting.

ANALYSIS AND DISCUSSION

To search for the evidences for the need of forensic accounting in India we have done an exploratory study of the available literature on this field in Indian context. Searched through the available secondary database, the intellectual personals interviews and discussions, Indian governments published statistics and databases and have tried to link the theory or concepts of forensic accounting, weather they are applicable in India and tried to put it in a conceptual framework.

Evidences of Fraud Cases in India

A study called "Early Warning Signals of Corporate Frauds" conducted by the Pune-based India forensic Consultancy Services (ICS), a forensic accounting and education firm, from January 2008 to August 2008 has come out with shocking revelations about corporate frauds.

The study has revealed that at least 1,200 companies out of 4,867 companies listed on the Bombay Stock Exchange and 1,288 companies listed on the National Stock Exchange as on March 31, 2007, including 25-30 companies in the benchmark Sensex and Nifty indices, have massaged their financial statements.

The study investigated 11 sectors, viz. real estate, retail, banking, manufacturing, insurance, public sector undertakings, mutual funds, transport and warehousing, media and communications, oil and gas and information technology. The manufacturing sector, which contributes about 28 per cent of India's gross domestic product, is the one most ridden with fraud mainly due to the peculiar nature of the business and the procedural complexities inherent in this sector. Real estate and public sector undertakings came second.

The motive for committing accounting statement frauds,

according to 73 per cent of 340 chartered accountants who were respondents to the findings of the study, was to exceed expectations of stock market analysts. Other reasons for the fraud include credit-hungry firms manipulating application data in order to qualify for credit.

The KPMG India Fraud Survey Report 2008 showed that more than 80 per cent of respondents recognize fraud is a problem and 70 per cent believe it will increase over the next two years in India.

We can infer from the above statistics that fraudulent activities are increasing in India at a larger rate and specially the accounting frauds are on a rise and are going to rise in the near future, May be this is due to the human greed to earn a lot within the shortest period. To increase the share price by creating creative accounting of the financial statements to attract the investors is also main factor for the rise in fraud.

The Securities Scam of 1992

The securities scam of 1992 was called the mother of all Indian Financial Scandals. The man behind this Scam was Harshad Mehta known to be the Big Bull of Trading floor was alleged to have risen the BSE stock exchange in that year by transferring the funds from the inter bank transactions and bought the shares at heavy premium to the equity market exposed the scam of amount Rs5000 Crores with a heavy loss of burden to the investors.

The main reason of this scam can be inferred to be due the lack of control and supervision of the regulatory authorities in India whose negligence created such a scam.

The IPO Scam (1993-1996)

The entry of foreign institutional investors led to a massive bull run, which saw secondary market recover from the scam even though stock trading was banned. Soon thereafter, the Control over Capital Issues Act was abolished with a one-line order and it opened the floodgates for a massive scam in the primary market (or Initial public offerings). This scam had two parts – the first was perpetrated by existing companies which ramped up their prices in order to raise money at hugely inflated premium to fund green field projects and mindless diversifications, most of which have either failed to take off or are languishing. The other half of the scam had a multitude of small traders, chartered accountants and businessmen, who teamed up with bankers and investment bankers to float new companies and raise public funds. The botched up M. S. Shoes case, exemplifies the first type of scam while the second type, which caused losses of several thousand Crores of rupees was known as the ‘vanishing companies’ scandal. The IPO bubble, which lasted three years from 1993 to 96, finally burst when prices of listed companies began to crash. So huge was investors’

disappointment that the primary market remained dead for the next two years, almost until the beginning of 1999.

This case of fraud is mainly due to the competition among the firms to diversify and extend their investments in the green field projects. To fund the same they have raised the capital from the primary market by manipulating their books of accounts. Hence competition among the firms is also a reason for the rise in Fraud.

3.4 CRB Scam (1996): In 1996, Mr. Chain Kumar Bhansali, Chairman of CRB Capital markets Ltd was accused of taking off Rs.12 billion in the CRB scam. CRB was accused of using its State bank of India’s accounts to siphon off the bank funds by encashing interest warrants and refund warrants. Millions of investors lost through fixed deposits and mutual funds. The Unit trust of India and Gujarat government also incurred heavy losses.

This is the case where a single person was able to create a heavy loss; this shows the lack of proper control mechanism in the country.

Mutual Funds Disaster (1998-99): The biggest post liberalization joke on investors was the suggestion that small investors should invest in the market through Mutual Funds. Yet, over the decade, a string of government owned mutual funds had failed to earn enough to pay the returns ‘assured’ to investors. Starting with the scam-hit Canstar scheme, most mutual funds had to be bailed out by their sponsor banks, or parent institutions. Then came the big bail out of Unit trust of India. Since UTI set up under its own act, it was the tax- payers who paid for the Rs 4800 crores bailout in 1999. Just three years later, it was back buying recklessly into the Ketan Parekh manipulated scripts and suffered big losses in the process. The record of the private mutual funds has also been patchy – after hitting a purple patch in 1999-2000, many of the sector specific funds were down in the dumps. It will be a long time indeed before small investors consider mutual funds a reasonably safe investment.

We can make an inference from the case that Investors have lost the interest in Mutual funds or any other financial institutions as they are regularly being the sufferers.

3.6 The 1998 Collapse: In 1998, Harshad Mehta, Scamster of 1992, made a comeback by floating a website and writing columns in several newspapers giving tips on stocks. The result was the collapse of BPL, Videocon and Sterlite shares. This led to illegal opening of the trading system in the middle of the night by BSE officials to cover up this issue.

Ketan Parekh’s Case (1999-2000): Ketan Parekh, a Mumbai based stockbroker had large borrowings from

Global Trust Bank during its Merger with United Trust of India Bank. He got a loan of about Rs.250 Crores from Global Trust Bank's Chairman Mr. Ramesh Gelli who was asked to quit later. This rigged the scrips of Global Trust Bank, Zee Telefilms, HFCL, etc. The prices of the selective shares constantly increased due to rigging. The investors who bought the share at higher prices thought that the market prices were genuine. Soon after the discovery of the scam of 1999-2000, the price of the stocks came down to the fraction of value at which they were purchased. The investors lost heavily. Even the banks faced a tremendous loss. Ketan Parekh was arrested in the year 2002.

DSQ Software Scam (2001): Mr. Dinesh Dalmia, Managing Director of DSQ Software was accused of dubious acquisitions and biased allotment in the year 2000 and 2001. The amount involved in the Scam was Rs.595 Crores. Dalmia was arrested in the year 2006.

Satyam Computers Case (2008): Mr. Ramalinga Raju, the former Chairman and Chief Executive had admitted that he had manipulated the balance sheet for several years to show huge inflated profits and fictitious assets. The estimated fraud was Rs.700 Crore billion, one of the highest committed frauds since 1996. Mr. Ramalinga Raju is in Jail for committing fraud, cheating and forgery.

The 2G-spectrum scam (2008): The 2G spectrum scam involved officials in the government of India illegally undercharging mobile telephony companies for frequency allocation licenses, which they would use to create for 2G subscriptions for cell phones. It is alleged that A Raja arranged the sale of the 2G spectrum licenses below their market value. Swan Telecom, a new company with few assets, bought a license for Rs. 1537 crore. Shortly thereafter, the board sold 45% of the company to Etisalat for Rs. 4200 crore. Similarly, a company formerly invested in real estate and not telecom, the Unitech Group, purchased a license for Rs. 1661 crore and the company board soon after sold a 60% stake in their wireless division for Rs. 6200 crore to Telenor. The nature of the selling of the licenses was that licenses were to be sold at market value, and the fact that the licenses were quickly resold at a huge profit indicates that the selling agents issued the licenses below market value. The 2-G Spectrum case is still on and the approximate figures that this scam involves Rs 60,000 crores

Madhu Koda Scam 2009: Madhu Koda (born January 6, 1971) is an Indian politician who was Chief Minister of Jharkhand from 2006 to 2008. He was sworn in as the fifth Chief Minister of Jharkhand on September 18, 2006 and remained in office until he resigned on 23 August 2008. He is alleged to have involved in Money laundering and mining scam. He was charged with laundering money worth over

Rs. 4000 crores. In nationwide raids by the Enforcement Directorate, assets allegedly worth Rs. 4000 crore — almost a fifth of the annual budget of the state he once ruled — were unearthed. Among others, these assets were reported to include hotels and three companies in Mumbai, property in Kolkata, a hotel in Thailand, and a coalmine in Liberia.

IMPLICATIONS OF FRAUDS IN INDIA

After the US\$1.45 billion in accounting fraud admitted by India's Satyam Computers Services foreign institutional investors are now asking brokerages to run forensic accounting checks on the numbers reported by major companies in India. Many of which, they believe, may be practicing "creative accounting" to window-dress their books

Due to the heavy loss of reputation and wealth, India has taken several steps towards combating these frauds "Forensic Research Foundation" was created, which provides support for investigation of fraud. They publish one bi-monthly journal named as "White Crimes". It relates to forensic and economic crimes. Another international organization named as KPNG has set up investigation detection center in India Networks Limited, a Delhi based organization, working in the similar field; they are also trying to innovate ways and means to detect financial irregularities and crimes in India. Serious Investigation Fraud Offices (SIFO) has been established in India for the same reason, i.e. detection and prevention of economic irregularities and crimes.

In India serious fraud office and IRDA have special focus on the frauds however there is no specialized education provided by any of the universities in the country for Forensic accounting.

There are few agencies in India, which are dedicated to the mission of combating frauds. Serious Fraud Office looks into violations of Income Tax, FEMA, RBI Act, etc.; CBI (Economic Office Wing) deals with big financial frauds; Central Vigilance Commission deals with corruption. These are the major government agencies that combat frauds of different types. Recently, TCS has also come out with software to combat money laundering and Subex Systems have designed software to combat the telecom frauds. Thus, combating the frauds with software has started picking up in India, with few big companies like ACL and IDEA, joining the race.

The Ministry of Company Affairs (MCA), first enlarged the scope of work (and hence responsibility and liability) of statutory auditors by issuing a 22 point questionnaire called the MAOCARO Order, 1975. This made internal audit compulsory and the statutory auditor was bound to comment on the efficacy and extent of internal controls

and review the internal audit. Such internal audit is not mandatory internationally. By its very nature, internal audit is extensive in relation to accounting system, internal controls' review and transaction checking.

The Securities and Exchange Board of India (SEBI) and the Department of Corporate Affairs (DCA) thereafter made it mandatory to have audit committees where independent directors were in a majority and whose chairman had to be an independent director; they would be (a) obliged to review and implement internal controls; (b) observe accounting standards; (c) review and approve accounts; (d) review financial management and; (e) appoint internal auditors and recommend statutory auditors. Their recommendations are binding on the Board unless the Board discloses to the shareholders its reasons for non-agreement. My own experience in three cases is that a strong knowledgeable audit committee and its chairman are the best bulwark whenever promoters' opinion differs from that of the auditors

The Institute of Chartered Accountants of India (ICAI) [and Institute of Company Secretaries of India (ICSI)] has been strongly supportive of moves for quality improvement and quality controls. ICAI issued 32 Accounting Standards, 34 Auditing Standards, 6 Internal Audit Standards and several External Quality Control Standards. It has moved for harmonization of standards with the International Federation of Accountants (IFAC). ICAI also brought in monetary limitations on the non-audit work that auditors could provide to the audit company directly or through related parties. Where the partners of the audit firm or their relatives have a 20 per cent beneficial interest, the fee from all such assignments cannot exceed the audit fee.

The responsibility also rests with the Chief Executive Officer (CEO), the Chief Financial Officer (CFO), internal auditors and the audit committee. Their roles should be examined by a joint special study group of the MCA and ICAI so that remedial steps can be taken. The Vivian Bose Commission in India and the Sarbanes Oxley Act in the US have strengthened the system of audit and corporate regulation in the public interest.

Legal Consequences: Legal jurisprudence with reference to auditors has evolved substantially in Europe, the US, Australia and India increasingly recognizes the social responsibility of the auditor. However, almost every precedent recognizes that (a) an auditor is expected to exercise a high degree of reasonable care and skill; (b) he is not expected to be a bloodhound unless there are circumstances to arouse his suspicion; and (c) the law has now evolved to ensure that he is liable for damages for not faithfully discharging his duties not only to the contracting party but to everyone who, in the normal course, would use the audited accounts.

In the current scenario, career in forensic accounting has emerged as a lucrative option in India. Several institutions are offering training and education to become a good forensic accountant. The Institute of Chartered Accountants of India is among the few, which conduct certificate course on forensic accounting and fraud detection. The Institute of Chartered Financial Analysts of India University Tripura also offers postgraduate diploma program in forensic accounting.

There are three courses on frauds in India. India forensic is the only formal body that provides formal education about forensic accounting in India. India forensic is however not affiliated to any of the Universities.

Certified Forensic Accounting Program – (CFAP) is the course dedicated to Corporate Frauds in India. It speaks about the classification of the Corporate Frauds and the ways to investigate the frauds in various different sectors.

Certified Bank Forensic Accounting – (CBFA) is the course dedicated to Bank Frauds in India.

Certified Anti-Money Laundering Expert – CAME is dedicated course on Anti-Money Laundering. It also focuses on the various aspects that good software should detect in its AML solution. Basic concepts are also explained in the same course.

Forensic accounting is one of the highly paid jobs in India. A beginner can earn a salary between Rs. 25,000-30000 per month, while an experienced person can earn a lot more than that, probably in six figures.

FINDINGS

The desire to achieve / exceed targets and earnings of senior executives linked to Financial performance is the reasons for senior management involvement in frauds

Forensic accounting which is a combination of accounting Knowledge and legal Knowledge could effectively solve problems and fulfill the demand of social and economic development

Forensic intelligence involves the work of gathering and due diligence reviews. These investigations often entail interviews of personnel who had access to the funds and a detailed review of the documentary evidence.

Forensic accounting is needed in India to overcome the deficiencies of accounting practices itself

There is a lack of professional institutions in India, which would provide Forensic accounting services to Indian companies to seek out irregularities in their companies' financial statements.

The lack of respect and belief in India's law enforcement

agencies and the rate at which white-collar crimes have increased has prompted the need for Forensic Accounting in India.

The certificates of the auditors are hardly scrutinized carefully especially when the reports are unclear and qualified. They are trained to deal with real world business and do have the sufficient expertise to look beyond the numbers

Many accounting firms believe that the market is sufficiently large to support an independent unit devoted strictly to forensic accounting.

Online financial transactions are on an increase and due to countless cases of investors being seeking the need of criminal investigations for padding of their money by various entities.

There are frauds in Insurance settlement claims where a forensic accountant is essentially needed to assist from either an insured or insurer's perspective in the Settlement of a case.

RECOMMENDATIONS

To set up investigation detection centers in India to detect financial irregularities and crimes in India, as there are few trained professionals available in India

Serious Investigation Fraud Offices (SIFO) has to be established in India "Fraud detection committee" needs to be established. The main aim of such committee should be to prevent the interest of the stakeholders. Forensic Accounting Trainers in India should be motivated to evolve in a large Scale to build a career.

Fraud investigation requires competence in 'forensic audit' and also technical transactional expertise. Banks and corporate should have to take immediate steps to

Suitable penal action should then be initiated against the directors of the company and all others involved in cases where special audits reveal frauds

Identify staff with proper aptitude and provide necessary training to them in forensic audit so that only such skilled staffs are deployed for investigation of large value fraud

Forensic accounting and auditing should be introduced as a paper in the various professional examinations conducted by the various accounting bodies in India

Government and ICAI should take initiatives to promulgate this niche accounting area thereby creating employment opportunities and fast redressal of crimes and frauds.

Researcher should do more detailed study to draw a fair and unbiased framework in India. The Journal of forensic accounting to be published in India.

SEBI should start investigations of transactions in the shares of the fraud companies to detect cases of insider trading. Needless to say that penal action must follow all cases where insider trading is detected.

Besides all these, the proposal of the Ministry of Finance to make it mandatory for companies to publish their balance sheets every quarter (which is presently done once a year), along with the profit and loss account, which will help the investors to know the liquidity and solvency of the companies, needs to be implemented urgently. This will, incidentally, bring India closer to international disclosure standards

One of the keys to detecting and preventing financial irregularities is to develop, implement, publicize and enforce strong, effective deterrent programs that let employees at all levels know that fraud, embezzlement, etc., will not be tolerated

It require the audit committee to be more active and vigilant; (b) increase substantially the coverage and intensity of internal audit and, sometimes, even an investigative audit may be required; (c) force the statutory auditors to rely much more on external evidence directly obtained by them; (d) the DCA will have to strengthen the Board with information and enforce its earlier system of tri-annual inspection of listed companies which has been implemented lackadaisically in the last few years; (e) encourage the ICAI to strengthen all quality control measures including peer review and develop a system of inspection of auditors as in Canada; and (f) require companies to introduce an effective whistle-blower policy.

Internally, the professional firms have to introduce partners' audit review and partner-rotation programmes; some have done so already. It is not without logic that the entire developed world has, after a great debate, not opted for mandatory rotation of auditors but has opted for rotation of partners instead.

The proposal to rotate auditors every three years has to be carefully reviewed. The auditor has to understand the business, its risks, its internal controls etc. A system of joint audit and of quality inspection of audit firms by the ICAI is the best answer.

To combat the frauds and introduce a new field for Forensic accounting effectively one needs the active support of government at every stage.

CONCLUSION

Forensic accounting, in fact, integrates accounting, auditing, and investigative skills to conduct an examination into a company's financial statements. Broad-based knowledge is crucial to the success of entry-level forensic accountants.

Because forensic accounting is relatively a new area of study, a series of working definitions and sharing of corporate experiences should be undertaken and encouraged to ensure a common understanding. Indeed, there is great future in forensic accounting as a separate “niche” consulting. On account of global competition, the accounting profession must convince the marketplace that it has the “best-equipped” professionals to perform such services.

While majority of CAs have excellent analytical skills, they need to acknowledge that ‘forensic’ services require ‘specialized’ training as well as real-life ‘practical’ corporate experience.

Armed with combination of skills, these financial detectives are today important assets to modern legal teams. In the backdrop of increasing levels of frauds, the demand for forensic accountants is bound to substantially increase in the Future.

So it is beyond doubt that the role of forensic accountant is an immediate requirement in Indian Scenario to prevent further loss due to the hidden frauds in corporate field, public accounting and awareness of government in future. Hence, proper attention to be required by the regulators, Government and the educational Institutes to support Forensic.

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