

CORRUPTION AND FORENSIC ACCOUNTING

By

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While reading key note delivered by the Central Vigilance Commissioner of India, N Vittal at the at the Indian Oil Institute of Petroleum, Gurgaon, a few years ago, I was just forced to lament on all what has been lost due to the corruption in the poor nations of South Asia and specially how corruption has literally snatched the bread and butter of teaming millions who are forced to live under the poverty line and whose numbers are on the increase with every day passing by. Mr. Vittal interestingly pointed out the relation of corruption to the reduced levels of investment. If corruption levels in India were reduced to those in the Scandinavian countries, investment rates could increase annually by some 12 percent and the GDP growth rate by almost 1.5% each year¹. If Bangladesh were to improve the integrity of its bureaucracy to Uruguay's level, its yearly GDP growth would rise by half percentage point². And if Pakistan were to reduce corruption to the Singapore level, its annual per capita GDP growth over the period 1960-85 could have been higher by nearly 2 percentage points - implying per capita incomes almost fifty percent higher than existing levels³. Most worrying is that these growth losses have been increasing over time. A recent study in Pakistan has shown that the growth cost of corruption (as a percentage of GDP) may have increased from a quarter of one percent at independence in 1947 to just under 2 percent by 1997⁴.

Corruption acts as an additional tax on investment by lowering the potential return to an investor on both the initial investment and on subsequent returns. The secretive and illegal nature of bribes means that there is considerable uncertainty as to whether bribe takers will live up to their part of the bargain. Corrupt transactions are not enforceable in a court, and it is quite probable that the bribe taker reneges on his understanding with the investor or simply returns to demand another bribe. These considerations are reflected in the higher risk premium that foreign and domestic investors attach to investing in South Asia given the unpredictability of decision making. One recent study shows that investing in a relative corrupt country compared to a relatively honest one is equivalent to an additional 15 per cent private tax on investment⁵. In Pakistan, lower corruption levels would have meant that the implicit corruption tax on foreign investment would have been reduced by 28 percentage points⁶.

As per Transparency international report Pakistan is plagued by high level of corruption as other South Asian countries:

¹ Gandhi 1997

² Wei 1998

³ Wei 1998

⁴ Burki 1998

⁵ Kaufman 1997 and Klitgaard 1998

⁶ Wei 1998

- An analysis of the nature of corruption finds extortion to be the most prevalent form.
- Evidence of the economic costs incurred due to corruption suggests high levels of income erosion given the high frequency of bribery and the large sums paid.
- A lack of accountability and monopoly power are quoted as the major factors contributing to corruption in public services.⁷

A corruption Scorecard for the Sectors⁸

Countries	Education	Health	Power	Land Admin.	Tax	Police	Judiciary
<i>Bangladesh</i>	40	58	32	73	19	84	75
<i>India</i>	34	15	30	47	15	100	100
<i>Nepal</i>	25	18	12	17	25	48	42
<i>Pakistan</i>	92	96	96	100	99	100	96
<i>Sri Lanka</i>	61	92	Sample Too Small	98	Sample Too Small	100	100

Percentage of respondents reporting corruption in interactions with the sectors

Given the devastating effect of corruption on the micro and macro economy of any country and its impact on increasing poverty it is imperative that the fight against corruption should be taken up with a new resolve and as the corrupt take new ways of making and hiding illegal money so does the law enforcers and the stake holders move the professions to support with their expertise in the fight against corruption.

Accountants have a very special place in this fight as they can help unveil and detect various forms of state, corporate and personal frauds.

Apart from management accountancy and audit they have a role to play in the forensics. To define forensic accounting, we can use parts of the definition of forensic medicine and accounting taken from Websters' Dictionary. Forensic medicine is a "science that deals with the relation and application of facts to legal problems." "Accounting is the system of recording and summarizing business and financial transactions and analyzing, verifying and reporting the results." So a combination of the two definitions would yields: forensic accounting-an accounting method that deals with the relation and application of the system used to record and summarize business and financial transactions to a legal problem.

Forensic Accounting is the application of a transaction reconstruction methodology to legal issues. It is frequently associated with the analytical investigation of civil or criminal actions, such as:

⁷ Corruption in South Asia, Dec 2002, Transpaarency International

⁸ Corruption in South Asia, Dec 2002, Transpaarency International

- White-Collar crime- Fraud and Embezzlement;
- Insurance Casualty Claims;
- Loss Measurement;
- Accounting Malpractice, and;
- General Abuse of Trust Relationships

Within this area of accounting there are two broad classifications of accountant or areas of practice:

1. **Litigation support specialists** within the litigation support specialist there are the categories of business valuation, revenue analysis, expert witness testimony, and future earnings' evaluation.⁹
2. **Investigative or fraud accountant**¹⁰. The investigative or fraud accountant has two areas of emphasis- seeking out evidence of criminal conduct and dispelling or supporting of damages.

Litigation Support

In cases of litigation support work, the forensic accountant is asked to provide an opinion based on facts that can be known or as yet uncovered. In the case of the latter, the accountant may have to become an investigator of sorts, and on some occasions, prepare information as a model of how things should look if done correctly. Key areas of litigation support services include engagements in both professional liability claims as well as a variety of civil claims. Included in the professional liability claims category would be quantifying the impact of lost earnings from events such as construction delays, stolen trade secrets, insurance disputes, damage/loss estimates and malpractice claims¹¹.

Investigative Accounting

In this area the accountant is called upon to review of the factual situation and provision of suggestions regarding possible courses of action. Another area of work can be providing assistance in the protection and recovery of assets. Very often accountants can asked to undertake co-ordination of other experts, including private investigators, forensic document examiners, consulting engineers. This all will lead to an accountant providing assistance in the recovery of assets by way of civil action or criminal prosecution.

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

⁹ ("Forensics," New Accountant)

¹⁰ (Crumbly, New Accountant)

¹¹ Reinstan, Ohio CPA Journal

perpetrator. These investigations often entail interviews of personnel who had access to the funds and a detailed review of the documentary evidence.

Criminal Investigations

Forensic investigations often relate to criminal investigations on behalf of police. For example, a Forensic Accountant may be retained by the police and organizations such as the National Accountability Bureau

A Forensic Accountant's report is prepared with the objective of presenting evidence in a professional and concise manner.

Characteristics of Forensic Accountant

A capable Forensic Accountant should have the following characteristics:

- curiosity;
- persistence;
- creativity;
- discretion;
- organization;
- confidence; and
- sound professional judgement.

A Forensic Accountant must be open to consider all alternatives, scrutinize the fine details and at the same time see the big picture. In addition, a Forensic Accountant must be able to listen effectively and communicate clearly and concisely.

Accountants can play a very vital role and as fight against corruption and organized crime is gaining momentum in the developing countries the requirement of Forensic accountants is on the rise. ICMAP and other professional bodies should come forward in creating the requisite capacity in the sector, so that white-collar crimes are dealt with in a more professional manner.

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