

FORENSIC ACCOUNTING

DEFINED AND DE-MYSTIFIED

PART 2

theSun Insights continues exploration of specialised practices in the accounting arena. **theSun** CMO, Prashun Dutt, pursued hours of research, interviews and expert inputs by prominent **Malaysia-based forensic accountant Prabhat Kumar and former auditor-general Tan Sri Ambrin Buang.**

FORENSIC Accounting (Part 1) had explained how investigative and financial forensics is now firmly established as a specialty practice in the accounting arena. It also defined the scope of work and special combination of skills required for examining, reviewing and analysing financial records/evidence resulting from actual or anticipated disputes; investigation; litigation; and evidentiary needs. [Refer **theSun** Tue Nov 7, pages 15 to 18.]

We now explore the forensic process pursued to determine and quantify the consequential damage/loss.

DAMAGE/LOSS QUANTIFICATION

Once the fraud, corruption, manipulation and other irregularities are established, forensic accountants are often tasked to assess the quantum of damage/loss incurred.

This is **fundamentally different from simple valuation and number crunching. It requires a factual, structured and strategic approach, correlating all relevant evidence to demonstrate HOW and WHY the suspects have benefitted.** Forensic accountants now focus **fact finding skills on developing a persuasive case, which can**

Former Auditor-General of Malaysia, Tan Sri Ambrin Buang shares vital insights on Forensic Accounting with **theSun**:

"Growing incidence of fraud, corruption and accounting manipulation have become a reality and are regularly being reported by media. Economic conditions are getting tougher and public-listed companies are now being more closely scrutinised. Therefore, it is becoming necessary to hire forensic accountants, not only to identify and prosecute the suspect, but to get the financial health checked as a pre-

emptive measure to prevent such incidences. In an attempt to keep fraud at bay, growing efforts are needed to detect and prevent fraud incidences and forensic accountants can play a significant role in this direction.

Forensic Accounting practice is in its early stages and has yet to make significant impact in the legal fraternity, especially in disputes that involve damages on account of breach of fiduciary duties, fraud

by executives and employees, defamation and infringement of copyright or patents.

As a major Southeast Asian economy, **Malaysia must lead by setting an example of good corporate governance and clean administration** for its own long-term interest and to play the role of a steward. A pool of skilled, experienced investigative and forensic accountants can serve as a catalyst, accelerating realisation of this ambition".



convince the judge regarding the interlinked issues of responsibility, blame and quantum.

- ▶ Valuation work concentrates primarily on determination of a company's fair market value.
- ▶ Quantification does not necessarily need the valuation of the entire entity unless the company is totally destroyed due to the defendant's alleged acts.
- ▶ In damage quantification, the valuation exercise is likely to focus on specific areas such as a particular part of the business, department or division, or product line, where damage has been caused.
- ▶ Quantification may also involve determining the loss in value of the plaintiff's business (due to the defendant's alleged acts), besides determining the

plaintiff's loss of profit(s).

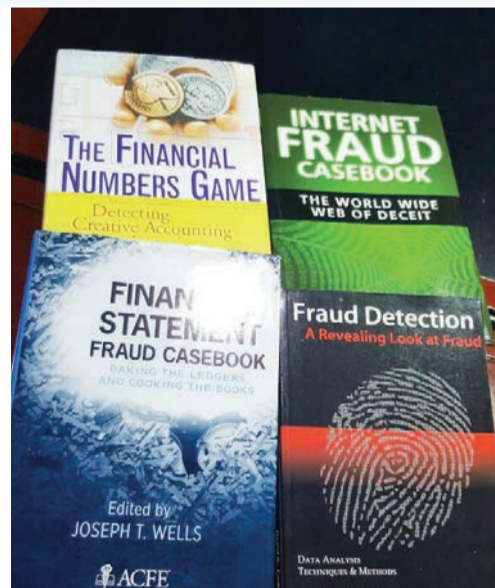
Damages can be basically described as compensatory and may also include exemplary or punitive damages. All of these require punctilious investigative and forensic perseverance for success in litigation claims

Courts demand a higher standard of proof as compared with insurance claims. However, on encountering forensically quantified damage reports, most insurance companies are likely to accept and pursue a reasonable settlement instead of risking a costly defeat.

DIFFERENTIAL SKILLS AND APPROACH

Forensic accountants may be called upon to quantify losses incurred through a wide range of irregularities. These include management fraud, employee fraud, income and accounting manipulation, tax avoidance, breach of fiduciary duty, breach of contract, infringement of copyright or patent, losses accruing through negligence and loss of business due to defamation.

The forensic approach to litigation accounting requires a **multi-dimensional approach, combining both science and art, plus dogged perseverance.**



Increasing corpus of reference texts are now available on commercial, financial and internet fraud.

Moreover, facts are rarely available in perfect order. They may be found internally or externally; some may not be available while others may require reworking. Missing information may have to be supported through appropriate, logical assumptions and acceptable professional pronouncements.

From macro to micro, forensic accountants then **review the entire corpus of collated facts, evidence and insights to construct possible hypothesis;**

Leading on to **precisely define the actual issues, behaviour and acts that have factually caused/precipitated the damage(s);**

Leaving zero scope for alternative interpretations and allegations regarding gaps and oversight.

Each and every component part of the loss must be established and quantified;

While **lawyers** normally establish **the Proximate Causation**, forensic accountants concentrate on **the Factual Causation.**

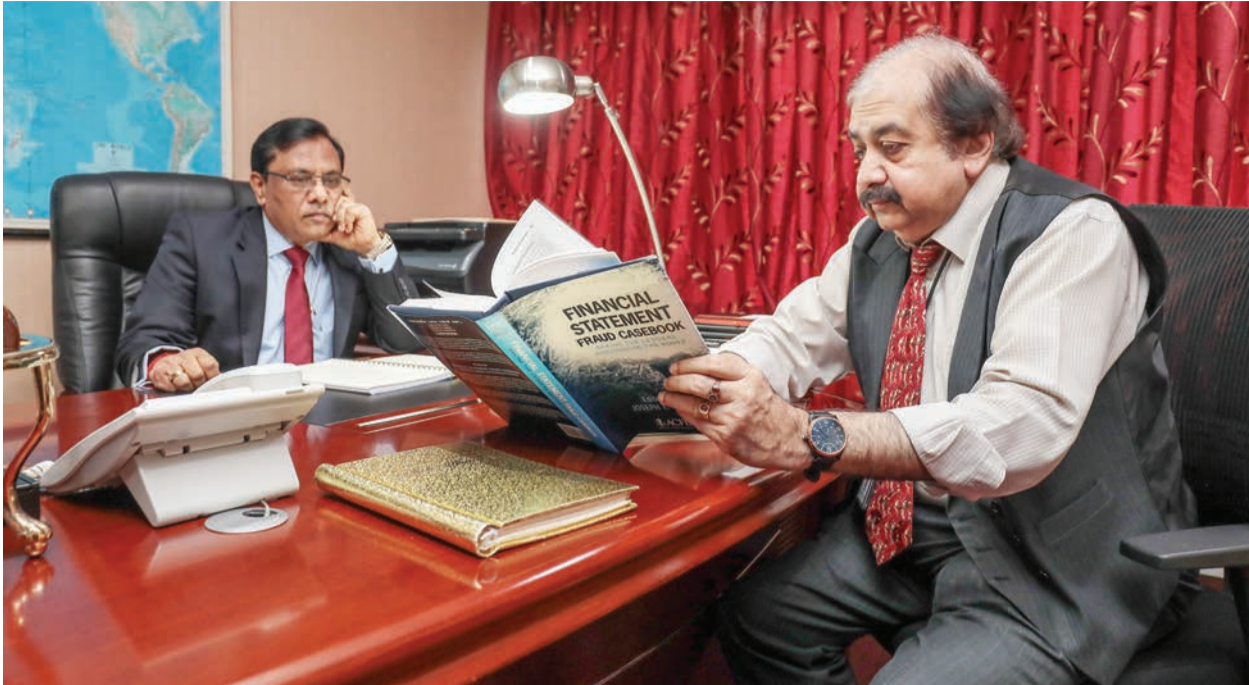
This also necessitates an **adequate understanding of the legal issues, torts and theories, under which the damages are being claimed.**

▶ **It is a SCIENCE** because litigation accountants use various analytical tools including computer forensics, regression analysis and other proven mathematical plus scientific methods to test and quantify the losses.

▶ **It is also an ART** because litigation accountants need to correlate multiple sets of actions:

- Across various dates, chronology of events, searching-matching exercises, historical records and business process, the prevalent facts at the time of the incident and consequent interpretation of all the retrieved data/facts.





Prabhat shares critical insights about commercial and financial fraud investigations with theSun CMO Prashun.

FINANCIAL FORENSICS

Forensic and investigative accountants are usually engaged because fact finding for such damages are done in complex surroundings. Consequential damage quantification also requires special skills.

To develop the theory of how losses accrued, forensic accountants must first understand the specific (business) environment and examine all related facts. This empowers gathering of all relevant and essential evidence, which helps link the causation (of loss) to the actions of the defendant(s).

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DAMAGE ANALYSIS – EXPERT TESTIMONY

It is *de rigueur* for a forensic accountant that his reports and testimony should reflect his specialised knowledge. Ensuring that all conclusions are supported by rigorous analysis, tests and inspections. Decisions are better persuaded by definitive statements like “...my analysis indicates” and “market analysis reveals...” or “the collated data supports the conclusion...” rather than vague assertions.

To generate higher impact and convincing testimony, such expert work must necessarily be communicated through:

- well-structured, skilfully crafted reports and presentations;
- animated flow-charts; and
- appropriate audio-visual presentations.

During cross-examination, forensic accountants should be prepared for open-ended questions that aim to extract details regarding the work and the rationale for the conclusions.

Questions beginning with “who”, “what”, “where”, “when”, “why” and “how” are designed to extract information from the expert in a manner such that a simple

“yes” or “no” response would circumvent.

To provide compelling testimony in court, forensic accountants should be prepared, *inter alia*, to answer questions regarding:

- 1) the assumptions which the expert has made;
- 2) the factual basis for the expert’s opinion(s), and how these facts lead to the expert’s conclusion(s);
- 3) the information which was relied upon; and who provided the same (lawyer or client);
- 4) if the expert harbours any concerns regarding his own conclusion(s);
- 5) under what circumstances would the expert have used a different methodology;
- 6) alternative hypothesis that can explain the expert’s observations; and
- 7) what other work, analysis or investigation would the expert have liked to pursue but was unable to do so.

Again, forensic accountants should constantly evaluate their own work to confirm that the given mandate has been accomplished in a manner, which opposing lawyers and defendants will find difficult to dismantle or challenge.

FORENSIC QUANTIFICATION OF DAMAGE

- Put simply, this should accurately estimate the difference between the plaintiff’s economic status before and after the anomaly. The forensic process should *inter alia* establish:
 - Lost revenue/income;
 - Lost cash-flows;
 - Loss of future earnings;
 - Loss of opportunity;
 - Loss of goodwill;
- That the type-of-loss suffered is entitled for compensation;
- That the loss is not too remote;
- The level of proof required for quantification of the potential damage(s);
- The actual loss caused by the breach, fraud or irregularity;
- This could cover a wide range of issues including:
 - Lost profits;
 - Lost value;

ACKNOWLEDGEMENT

- Prominent investigative and forensic accountant, **Prabhat Kumar**, founded his specialised practice in 2006. Alliance IFA provides clients with a wide range of investigative and forensic accounting services, including expert help in fraud risk assessment, forensic due diligence, restructuring, loss/damage quantification and litigation support.
- A member of the Malaysian Institute of Accountants, he is a qualified Chartered Accountant with a Diploma in Forensic Accounting (Toronto, Canada), besides being a Certified Fraud Examiner (Texas, USA).
- He contributes expert articles on this subject to international publications and shares his unique experiences at seminars and specialised courses.
- **theSun CMO, Prashun Dutt**, pursued hours of research, interviews and interaction with experts to collate and co-write this feature.
- Creative visualisation, art and design by **Ashley Seow**.

Investigative and forensic accounting begins from a point where conventional auditing ends.

Alliance IFA Forensics

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- Insurance claim which are under disputes
- IT Audit, Infrastructure & Cyber Security
- Business Process Improvement
- Business Restructuring
- Acquisition & retrieval of lost data
- Computer / Mobile Forensic Analysis
- All types of digital crime forensic analysis

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- Fraud Risk Assessment
- Fraud Awareness Training
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- Expert Witness
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- Forensic Due Diligence
- Solutions to complex disputes for individuals / companies
- Review & analysis of financial statements
- Forecasting
- Internal audit & assessment of weaknesses in the system
- Reconstructing accounts where documents are partially or totally destroyed

Panel of Experts include:

- Tan Sri Dato’ Setia (Dr.) Haji Ambrin Bin Buang
- Prabhat Kumar
- Bhavesh Lalwani
- Prakash Chetwani



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