

THE ROLE OF FORENSIC ACCOUNTING IN THE CRIMINAL PROCEEDING

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Abstract: In this paper, the author attempts to highlight the role and importance of forensic accounting in criminal proceedings. Contemporary forms of crime are very complex. Because of that, the process of crime detection requires involvement of persons from different professions. Skills and knowledge of forensic accountants are very important for detection of the following offences: tax evasion, breach of duty, unlawful reimbursement and payment, misuse of budget funds and corruption offences (active bribery and passive bribery). Forensic accountants analyze accounting records and documents for the purpose of collecting criminal evidence. Because of that, forensic accounting is different from the other similar activities – financial inspection and audit. Subject of work of financial inspection is checking of financial regularity of work in the institutions which are subjects of inspections. Purpose of activities of internal audit is to help the management in improving work process. The objective of activities of the external audit is also determining the regularity and legality of operations. The auditors who during the audit process notice that there is evidence that constitute doubts about the existence of criminal acts, have to report it to the authorities. Forensic accountants are persons who are engaged by judicial authorities to collect criminal evidence.

Keywords: forensic accounting, criminal proceedings, evidence, offences.

INTRODUCTION

Managing a legal entity implies its continuous adaptation to ever changing business conditions. Business decisions must be based on timely, complete and adequate decisions that are in accordance with the information obtained. Accounting provides informational support to the management of enterprises. Therefore, it is often defined as a sub-function of management function. Many authors under the term accounting consider all procedures whose task is to, in terms of quantity and value, cover and control all cash flows and outputs arising in a legal entity.¹

In recent years, both in economic and legal theory and practice, one often speaks of forensic accounting. However, there is no unique definition of this term in science. The word “forensic” comes from the Latin word *forensis*, which means one that belongs to the forum (public), i.e. one concerning the court evidentiary proceedings.² Thus, forensic accounting can be defined as the analysis of accounting records and financial statements in order to collect evidence indicating the existence of a criminal offense, or as an interpretation of accounting procedures for the purposes of criminal proceedings.

Classic accounting does not have proper instruments or methods, and institutions dealing with economic and financial crime do not have properly trained personnel to collect evidence of the existence of financial crimes. That is why forensic accounting has developed as a new discipline that involves testing and interpreting evidence and facts in legal issues and providing expert opinions in court disputes.³

A certain form of forensic accounting dates back to 1817 and refers to a court decision in connection with the bankruptcy of a company. Scottish accountants in 1920s carried out expertise in arbitration cases. It is believed that Maurice E. Peloubet, one of the owners of an accounting house in New York, in his paper of 1946, first used the term forensic accounting. In theoretical sense, Bologna and Lindquist understood forensic accounting as a term to describe any financial investigation that could lead to legal proceedings. According to them, this discipline involves the use of financial information and facts in resolving legal disputes.⁴

1 К. Шкарић Јовановић, Р. Радовановић, Финансијско рачуноводство, Центар за издавачку делатност Економског факултета у Београду, Београд, 2005. р. 5.

2 И. Клајн, М. Шипка, Велики речник страних речи и израза, Прометеј, Нови Сад, 2006. р. 1341.

3 Т. Сердар, С. Врањеш, Откривање и спречавање финансијских превара у циљу јачања финансијских перформанси предузећа у Републици Српској, in: Аста економска, број 19, Економски факултет Универзитета у Бања Луци, Бања Лука, 2013. р. 180.

4 *Ibid.*, pp. 181-182.

Considering that this is a new discipline, forensic accounting is a branch of accounting that is under development, and it is influenced by globalization of the economy, the need for control of competencies in the accounting profession and the lack of specialized knowledge in investigations and clarification of facts relevant to criminal proceedings. Forensic experts have to implement all procedures with an attitude of professional scepticism, to inspect relevant documentation and are subject to continuous interdisciplinary education.⁵

Most of the pressures aimed at presenting financial information in a more favourable light than they really are, are of financial nature, however one should not neglect non-financial pressures on a company's management, such as challenges to "circumvent" the system or fear of showing unsatisfactory performances.⁶ Regardless of the motive for misrepresenting financial statements, such behaviour may represent both the act of committing misdemeanour and the act of committing the most serious criminal offences. Sometimes evidence collected by tax and budget inspectors and state auditors are not sufficient for the judicial authorities. In such cases, the help of forensic accountants is needed.

THE METHOD OF MANIPULATING ACCOUNTING DATA

The accounting frauds⁷ represent intentional misrepresentation or omission of accounting information in order to hide the real (mostly unfavourable) financial performances, resulting in a false image presented to the users of financial statements. An important feature of such behaviour is that the in this way perpetrator obtains certain benefits on account of balance sheet addressees. In other words, such actions result in transferring values to the perpetrators of frauds, at the expense of owner and other creditors of a company.⁸ The term "creative accounting" is used to describe this behaviour; theorists see it as a process of transformation of the financial and accounting information from the real state to the one wanted by the drafters of the financial statements. This is achieved by applying certain accounting rules in a way that suits management, as well as by ignoring certain rules. The most commonly used "creative accounting" methods are arbitrary manipulation and interpretation of accounting principles, overestimation of revenues from sales and property values, underestimation of the cost of goods sold, expenses and other liabilities, time-related manipulation while recognizing of revenues and expenditures, bookkeeping of fictitious transactions, imprudent assessments, incorrect measurements or assessments of the effects of events and transactions, misrepresentation or not presenting of important events, manipulating cash flows.⁹

Sometimes employees use their position to abuse resources of the organization, that is, take, appropriate and use material means of a legal entity for their personal needs. The most common forms of misappropriation of funds is done through multiple payments to the same vendor, not issuing invoices, payment of fictitious purchases, unrecorded sales, payment of wages to fictitious employees, fraudulent commissions etc.¹⁰ In addition, it sometimes happens that an employee, before recording the funds, charges the buyer for goods, and then takes money for him/herself.¹¹

False financial reporting may be one of the methods of committing criminal offense of causing false bankruptcy or criminal offence of fraud. False financial reporting implies deliberate issuing of altered and misleading financial statements in order to avoid a negative opinion on the financial stability of an organization. Positive effects are highlighted, and negative are minimized, relevant data are omitted from the statement, or even changed. The financial statements can display more profit compared to the profit generated, by increasing revenues and profit or decreasing expenditures and losses for the current period.¹² Moreover,

⁵ *Ibid.*, pp. 198-199.

⁶ *Ibid.*, p. 128.

⁷ Article 14 of the EU's Criminal Convention on Corruption, which was adopted in January 1999 in Strasbourg, stipulates the obligation for countries that ratified it, in national laws prescribe as misdemeanour or criminal offense, conduct consisting in: creating or using invoice or any other accounting document or record containing false or incomplete information, as well as unlawful omission to make a record of a payment that is associated with some of the corruption offenses. In other words, the said Article has prescribed obligation for the said countries to prescribe the accounting fraud as a criminal offense. The Federal Republic of Yugoslavia, whose legal successor is the Republic of Serbia, has ratified the said Convention in 2005 („Службени лист Савезне Републике Југославије-Међународни уговори“, број 2/2002 and „Службени лист Србије и Црне Горе-Међународни уговори“, број 18/2005). In the Republic of Serbia, the said offence has not been prescribed, given that legal description of the criminal offence of fraud from the Article 208 of the Criminal Code also includes the actions that can be considered accounting fraud within the meaning of Article 14 of the Convention. Given that manipulation of accounting data can be linked to corruption offenses (active bribery, passive bribery, influence padding), forensic accountants are of great importance for process of detecting and proving of these offenses.

⁸ Б. Савић, Манипулација финансијским извештајима: узрок или последица економско-финансијске кризе? *Ип: Економско-финансијска криза и рачуноводствени систем, Савез рачуновођа и ревизора Србије, Београд*, p. 123.

⁹ *Ibid.*, p. 124.

¹⁰ К. Шкарић Јовановић, Рачуноводство – Инструмент извршавања и откривања преваре, Београд, Економски факултет, p. 5, available at <http://www.ekof.bg.ac.rs>. Quoted from: Т. Сердар, С. Врањеш, Откривање и спречавање финансијских превара у циљу јачања финансијских перформанси предузећа у Републици Српској, *op. cit.*, p. 187.

¹¹ Т. Сердар, С. Врањеш, Откривање и спречавање финансијских превара у циљу јачања финансијских перформанси предузећа у Републици Српској, *op. cit.* p. 187.

¹² *Ibid.*, p. 188.

one may present lower profits compared to the generated one, by presenting lower income and profit, or higher expenses and losses for the current period.

Financial statements can: report on fictitious revenues, false time accruals (inadequate treatment of income), conceal liabilities and expenses, state improper recording or improper valuation of assets.¹³ In this way, criminal offense of tax evasion can be committed, if the goal of misrepresenting data in the financial statements is evasion of taxes, fees or other liabilities to the state. In such situations, it is sometimes difficult to find evidence pointing to the existence of criminal offences or their perpetrators. For this reason, judicial authorities have to engage forensic accountants. In addition to the above/mentioned criminal offences, by analysing and interpreting of accounting data and processes, it is also possible to detect corruption/related criminal offenses (active bribery, passive bribery, influence peddling).

FORENSIC ACCOUNTING AND CRIMINAL PROCEDURE

Accountants are often invited as witnesses or experts in both criminal and civil proceedings. In civil proceedings, they are invited to give their opinions on the damage that has occurred for a specific legal person, while in criminal they are invited to give statement on the existence of a criminal offense or to collect evidence that point to its existence.

Sometimes forensic accountants can be engaged by the management of a legal person in order to determine whether a criminal offense was committed by employees. In such case, they analyze accounting records for the purpose of filing criminal charges against responsible persons and prevention of further commission of prohibited acts in this legal person. Forensic accountants may reveal the existence of not only those criminal offences for which they were engaged, but also other offences. Of great importance for instituting proceedings against responsible persons are evidence collect by forensic accountants when performing accounting analysis and verification of data. In some large enterprises (often insurance companies), there are separate organizational units employing persons engaged in forensic accounting. The goal of their work is to reveal frauds related to insurance, i.e. collection of evidence relevant to the prosecution of criminal crimes and their perpetrators. In addition, forensic accountants may also be employed in the police. Their work is of great importance in detecting money laundering, which can be connected with the activities of terrorist organizations.

The criminal procedure is usually defined as a legally regulated system of procedural actions of the court and other entities, which they undertake within their rights and responsibilities in order to determine whether substantive criminal law can be applicable in a particular case (i.e., whether committed act was defined in the law as a criminal offense, who is the perpetrator, whether the perpetrator is guilty and whether there are conditions for the application of criminal sanctions.¹⁴ Proving also represents a procedural action. Serbian positive law is introducing a combination of prosecutorial and "party" investigation in which, in addition to the prosecutor, the evidence can also be collected by the accused party. Accused party has the right to do so, because the parties in the proceedings are "equal" according to the law. As in reality parties can not be equal, because the whole state apparatus stands behind the prosecutor, the need for the introduction of such a "hybrid form of investigation" remains an open question.¹⁵

Not all facts are being proved in a criminal procedure. The subject of proving are those facts that constitute the element of criminal offense, or those upon which the application of other provisions of the Criminal Code depends, as well as facts upon which the application of the provisions of the of Criminal Procedure Code depends.¹⁶ Those facts that the court finds commonly known, sufficiently discussed, which defendant admits in a way that they require no further proof, or consent of the parties on those facts is not inconsistent with other evidence, are not being proved.¹⁷

Forensic accountants may be criminal procedural subjects, activated by the prosecution or the court.¹⁸ They may appear in the criminal proceedings in the role of a witness, expert or professional advisor. Their role is of great importance in evidence procedure.

13 К. Јовановић Шкарић, Рачуноводство – Инструмент извршавања и откривања преваре, Београд, Економски факултет р. 7, available at <http://www.ekof.bg.ac.rs>. Quoted from: Т. Сердар, С. Врањеш, Откривање и спречавање финансијских превара у циљу јачања финансијских перформанси предузећа у Републици Српској, *op. cit.*, р. 189.

14 В. Бурђић, Покретање и контрола јавнотужилачке истраге (са посебним освртом на кривични поступак у Србији), in: Тужилачка истрага регионално кривичнопроцесно законодавство и искуства у примени (Ур: Иван Јовановић и Ана Петровић Јовановић), Мисија ОЕБС-а у Србији, ОЕБС, Београд, 2014. р. 141.

15 Д. Николић, Начела тужилачког концепта истраге као основ њене разраде (са посебним освртом на нови ЗКП Србије) in: Тужилачка истрага регионално кривичнопроцесно законодавство и искуства у примени (Ур: Иван Јовановић и Ана Петровић Јовановић), Мисија ОЕБС-а у Србији, ОЕБС, Београд, 2014. р. 37.

16 Article 83 of the Criminal Procedure Code.

17 Article 88 of the Criminal Procedure Code.

18 З. Јекић, Кривично процесно право, Правни факултет Универзитета у Београду, Београд, 2003. р. 34.

Engaging Forensic Accountant as a Witness

The forensic accountant may be engaged in criminal proceedings as a witness, if the authority conducting proceedings believes that his/her statement will provide information on criminal offence, perpetrator or other facts that should be determined in proceedings.¹⁹ Thus, a person engaged in forensic accounting, which was engaged by the management of a legal person in order to collect evidence of the existence of illegal activities of employees, can appear in criminal proceedings as a witness. In addition, a person engaged in forensic accounting, which is employed in a separate organizational unit of a company that deals with detecting frauds made by both employees and persons connected with the business activity of the company, can be engaged in court. In such a case, a forensic accountant doesn't have the role of an expert or professional advisor. He/she is not engaged for possessing expert knowledge necessary for a decision on the existence of a criminal offense and its perpetrator, but because he/she possesses certain information on a criminal offense or perpetrator, which he/she came to in the analysis of accounting data at the time when he/she was engaged by the management of a specific legal person.

Engaging Forensic Accountant as an Expert Witness

Expertise represent an important source of knowledge on criminal offense and its perpetrator given to the judicial authorities by certain professionals. Legal regulation of these activities is limited to determining the conditions for its application, the role of the court and parties, as well as the rights and duties of the expert witness in criminal proceedings, while the very expertise is subordinated to the rules of a particular scientific discipline or skill (*lege artis*). There are formal and material conditions for implementation of this investigative action.²⁰

As an expert, forensic accountant may participate in criminal proceedings, if the authority conducting proceedings prescribes expertise in order to determine or assess the facts in the proceedings, for which professional knowledge is necessary. If, for a particular type of expertise, there are experts from the permanent expert list, other experts may be appointed only if there is a risk of delay, if permanent experts are prevented from participating or if other circumstances require so.²¹ Bearing in mind that the knowledge and skills of forensic accountants almost haven't been used in court proceedings so far, it is impossible to engage a person from the list of permanent court experts. The problem may be related to the fact that a small number of accountants possess the knowledge necessary to perform the so-called forensic accounting. In a particular court proceedings, independence and objectivity of an accountant who will be engaged as an expert, must be taken into account. Considering that in such cases accountants from accounting houses are often engaged, the problem of high costs of expertise occurs, since judicial authorities are budget beneficiaries, and various restrictions are imposed to the use of budgetary funds.

If a forensic accountant has already been questioned as a witness, as a rule, he/she will not be questioned as an expert. The authority conducting proceedings may determine the expertise by a written order, either *ex officio*, or on motion of a party and defence counsel. However, if there is a risk of delay, expertise can also be done orally, with mandatory written note.²² Given that forensic accountants are persons who are not legal professionals, in written order on the expertise, it is necessary to precisely mark the subject of the expertise, questions to be answered, and the obligation to submit to the authority conducting proceedings impugned and secured evidence, traces and suspicious substances, the deadline for the submission of findings and opinion, obligation to submit findings and opinion in a sufficient number of copies to the court and the parties, warning that the facts found in expertise are secret, warning of the consequences of giving a false finding and opinion.²³ In order to specify what questions need to be answered, it is necessary that the authority conducting proceedings knows capabilities of forensic accountants. This can be achieved only through professional training.

In the course of criminal proceedings, forensic accountant must fulfil the obligations specified in the order on the expertise. Before the commencement of expertise, he/she is warned that giving false findings and opinion constitutes a criminal offense, and is asked to carefully consider the case of the expertise, to accurately present everything he/she observes and finds, and to present his/her opinion without bias and in accordance with the rules of science or arts. Additional explanation may be required from him/her by the authority conducting proceedings. Of course, he/she also has the right to ask and get from the authority conducting proceedings and the parties additional explanations, to examine objects and examine the records, to propose collecting of evidence or obtaining objects and data that are of importance to the opin-

19 Article 91 of the Criminal Procedure Code.

20 З. Јеквић . Кривично процесно право, *op. cit.*, p. 269.

21 Article 114 of the Criminal Procedure Code.

22 Article 117 of the Criminal Procedure Code.

23 Article 118 of the Criminal Procedure Code

ions and findings, to propose clarification of particular circumstances or asking of certain questions to the person giving the statement.²⁴

After completing the expertise, authority conducting proceedings informs parties that did not attend the expertise, that they may view or copy expertise record, or written findings and opinion, and determines the period within which they can voice their objections.²⁵ Once the expertise is determined, the second forensic accountant may be engaged by the defendant or his/her counsel. In such case, that person has the status of a professional advisor in criminal proceedings.

Engaging Forensic Accountant as an Expert Advisor

A person dealing with forensic accounting can be engaged in criminal proceedings as an expert advisor possessing knowledge in the field in which specific expertise is ordered. This person may also be elected and authorized by the party or defendant, when authority conducting proceedings orders expertise. The defendant and injured party, as prosecutor, have the right to submit a request to the authority conducting proceedings for appointing expert advisor.²⁶ This means that expert advisor can be engaged either by the injured party as prosecutor (if it comes to criminal offenses for which the perpetrator is prosecuted under a private lawsuit) either by injured person.

He/she must be informed on the day, hour and place of expertise and attend the expertise, to which defendant and his/her attorney also have the right to attend, to view documents and subject of the expertise, and propose to the expert undertaking of certain actions, to give objections on finding and opinion of the expert, to question the expert at the main hearing and be questioned. Before questioning, he/she must also take the oath. He/she is obliged to submit to authority conducting proceedings the power of appointment immediately, and provide help to the party that engaged him/her in a professional, and timely manner. He/she must not abuse his/her rights or delay the proceedings.²⁷ This very introducing of expert advisor as a kind of "private expert" of the defendant, indicates that the Serbian criminal law adopted a mixture of prosecutorial and "party" investigation. However, considering that this is a kind of "private expert", very few people can bear the costs of his/her engagement.

CONCLUSION

Forensic accounting encompasses the analysis and interpretation of accounting records, documents and reports for court purposes, either in order to detect criminal offences and other illegal conduct for which court proceedings will be initiated, either for the ongoing court proceedings. Although this discipline is still developing in our country, a particular form of forensic accounting dates back to the nineteenth century, although the term "forensic accounting" was first used in the twentieth century.

Development of forensic accounting is influenced by many factors. One of them is the lack of specialized knowledge important for clarifying relevant facts in the proceedings. Today, more and more criminal offences of financial nature are carried out by extremely skilful and intelligent perpetrators, and this both detection of offenses, and proving of facts, is not possible in some cases without having knowledge in the field of accounting.

Forensic accountants may be appointed by the management of legal persons in order to detect the existence of criminal acts committed by employees, and in large companies there are separate organizational units in which forensic accountants are employed. Their activity is focused on the detection of frauds committed by employees or persons whose business is associated with the company. Often these specialized units are formed in insurance companies in order to detect frauds in connection with insurance. In these cases, forensic accountants collect evidence that they submit to the accounting service, for the purpose of filing criminal charges against perpetrators of specific offence. It may occur in court proceedings that these persons are required to provide additional information on the facts and circumstances relevant to the proceedings, which they observed when undertaking their activities. Their powers are different from the powers of the internal auditor. The aim of the forensic accountant is to determine existence of illicit behaviour, and the purpose of internal audit is determining the legality and regularity of business operations and giving recommendations towards their improvement.

Persons dealing with forensic accounting must possess special knowledge not only in the field of accounting, but also in the field of law. The manipulation of accounting data may be committed in order to conceal corruption criminal offenses. Therefore, of great importance is the role of forensic accountants

24 Article 120 of the Criminal Procedure Code.

25 Article 123 of the Criminal Procedure Code.

26 Article 125 of the Criminal Procedure Code.

27 Article 126. of the Criminal Procedure Code.

when presenting their findings and forming opinions on connection of certain offenses with corruptive offenses (active bribery, passive bribery, influence padding). Therefore, forensic accountants may be engaged in criminal proceedings as experts, as well as expert advisers. Their role is of particular importance in the investigative procedure when it is necessary to collect evidence of the existence of a criminal offense.

Bearing in mind that the forensic accounting is a relatively new discipline in our country, one can ask the question "who are the persons that can be engaged as expert witnesses in criminal proceedings?" The Criminal Procedure Code stipulates that when engaging an expert witness, preference is given to those who are on the list of permanent expert witnesses. During the process of engaging a forensic accountant, the said criterion cannot be fulfilled. Judicial officials should receive training, where they would get familiar with the capabilities and achievements of forensic accounting, in order to better define what the object and task of expertise. Considering the fact that the judicial budget is very limited, it is necessary for them to know in which cases it is justified to engage a forensic accountant and which certifies these persons should possess as proof of their expertise, i.e. which certificate which is recognized by the authorized by relevant professional associations. Of great importance is also training of a greater number of accountants in the said area.

The Criminal Procedure Code stipulates the possibility of engaging an expert advisor. This is a person who, as a sort of "private expert" can be engaged by the injured party and the defendant. Thus, the forensic accountant in criminal proceedings may be engaged as an expert advisor by the said persons. In these cases, the costs of engaging forensic accountant are borne by the injured party or the defendant. since a small number of persons is engaged in forensic accounting, and high cost of their expertise, one can assume that these persons could be engaged exclusively by rich persons.

However, a question of justification of employment of forensic accountants in the police may occur. Such stance is justified. They would have great significance for the detection of money laundering, which may be associated with the activities of terrorist organizations. In addition, their impact would be huge in the detection of criminal offenses of organized criminal groups.

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