What's the Difference Between Financial Accounting & Forensic Accounting?

Sherry Rahbar, Partner, CFO Edge, LLC

Incidences of financial fraud have been growing in both frequency and sophistication among many Los Angeles and Southern California businesses, especially as the economic recovery drags on and some employees give in to the temptation to embezzle funds from their employers. This is one factor that has given rise to the field of forensic accounting.

But it's often not clear what the difference is between forensic accounting and financial accounting. Forensic accounting is a specialty practice area of accounting that focuses on uncovering financial fraud. It also encompasses other types of engagements resulting from disputes and litigation between parties. In fact, the term "forensic" means "suitable for use in a court of law."

A forensic accounting engagement often involves a detailed assessment of a company's accounting system and processes to determine whether or not the numbers that are presented do, in fact, reflect reality. Following is a more detailed look at the main differences between forensic accounting and financial accounting.

Financial Accounting: Following FASB Rules and Guidelines
Financial accounting is the preparation of financial statements based on Generally Accepted Accounting Principles (GAAP). It follows a set of rules and guidelines prescribed and regulated by the Financial Accounting Standard Board (FASB). For publicly held companies, financial accounting also follows standards set by the Public Company Accounting Oversight Board (PCAOB). A financial accountant will review a company's historical data and form an opinion under GAAP and GAAS guidelines, applying a well-defined set of procedures to the financial statements.

Publicly held companies are required to have their financial statements audited by a financial accountant on an annual basis. Depending on their size, most privately-held companies have either an annual audit or review of their financial statements performed. In either case, the company's personnel know about the dates of the audit or review and, in most cases, are aware of the procedures followed by the financial accountant.

The reports and financial statements prepared by the financial accountant are typically used for a wide range of purposes by several different corporate audiences and stakeholders. These typically include senior management, the audit committee, the board of directors, owners, shareholders, investors, suppliers, and the company's bank or financial institution.

Forensic Accounting: Performing a Financial Investigation
Forensic accountants use their accounting skills to perform a financial investigation. But unlike financial accounting, forensic accounting usually isn't black and white, which means that things can often be more subjective. While forensic accounting follows the basic rules prescribed under GAAP, it may depart from all

or parts of what is stated under GAAP or FASB. In other words, there are no set guidelines when it comes to forensic accounting.

The forensic accountant will use the historical data on a company's financial statements as a start, but will then move to other procedures that are deemed necessary. Forensic accountants are trained to look beyond the numbers and deal with the business reality of a situation, especially in cases of fraud. Forensic accounting is based heavily on observation and following a series of events that has occurred in the company. The forensic accountant will interview a wide range of company personnel, from the clerical staff to the senior management, as necessary. Every forensic accounting case is handled differently, using procedures that are appropriate to fit the requirements of the case.

Following the review of the company's historical data, a forensic accountant will start by identifying "red flags" that are based on interviews conducted, observations, accounting and procedures, or a review of the total number of related entities. An example of the latter is when several corporations or LLCs are formed that show little or no activity and most of these entities are mainly used to transfer cash among the entities (especially cash transactions or transfers to bank accounts in a foreign country).

Typically, the forensic accountant will work with a legal team. Depending on the engagement, he or she might testify as an expert at legal proceedings, including depositions, mediation, arbitrations and trials.

A good forensic accountant will always work under the assumption that he or she will have to testify as an expert in front of a jury. The education level of jurors will run the gamut, from the highly educated to not educated at all, so the forensic accountant must be able to explain complex topics in a simple and easy-to-understand way. It's important for the forensic accountant to build credibility by being neutral at all times.

Unlike financial accounting, forensic accounting is not performed on a routine basis, but only when special circumstances like those noted earlier warrant it. Consequently, it's important for the owner and the executive management team to know when a forensic accountant is needed or should be consulted. A forensic accountant's investigation will usually require less time, and cost less money, if he or she is brought in at an earlier stage of the case. And the recovery, whether full or partial, will usually be greater.

Concluding Thoughts

Growing incidences of financial fraud have given rise to the field of forensic accounting, a specialty practice area of accounting that focuses on uncovering fraud, among other things. A forensic accounting engagement often involves a detailed assessment of a company's accounting system and processes to determine whether or not the numbers that are presented reflect reality. Unlike financial accounting, forensic accounting is not performed on a routine basis, so it's important for the owner and the executive management team to know when a forensic accountant is needed or should be consulted.

About CFO Edge

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