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Essentials of Forensic Accounting

Second Edition

Michael A. Crain, DBA, CPA/ABV, CFA, CFE

William S. Hopwood, Ph.D.

Richard S. Gendler, J.D., LL.M., J.S.D.

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WILEY



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To my wife, Joan, and my late mother, Rita.
Mike Crain

To my friends, family, and colleagues.
William Hopwood

To my wife, Linda; my son, Justin; my daughter, Brittany; and my mother, Rebeca.
Richard Gendler

To my wife, Sherry; my sons, Joshua and Angelo; and my late parents, George and Wilma.
George Young

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PREFACE

Forensic accounting is a fascinating field of study and practice, encompassing knowledge from accounting, finance, law, psychology, criminology, and other disciplines. It involves the collection and evaluation of evidence, whether the forensic accountant is performing a fraud examination, providing litigation services, serving as a testifying expert or non-testifying consulting expert or determining the value of assets and liabilities. Forensic accountants can serve in a variety of roles, such as the prevention and detection of civil and criminal fraud, measuring economic damages in litigation matters, valuing business or intangible assets, and testifying as an expert in courts of law. Regardless of the particular service performed, forensic accountants generally need a diverse skill set, including the ability to think critically, use quantitative methods, conduct research and investigations, and communicate effectively.

The need for forensic accounting has existed for more than a hundred years and is now as important as it has ever been. One prominent area of forensic accounting is fraud prevention and detection. A reason for the ongoing need for forensic accountants in this area is that there will always be individuals who wish to exploit or gain an unfair advantage over other people. A second reason is that the world has changed in ways that facilitate the exploitation of others. For example, the proliferation of technology has made the perpetration of financial crimes easier and has decreased the risk of detection for the perpetrator. No longer do bank robbers have to physically appear at a bank with a gun to steal money; now they can sit in the safety of their homes and, with a few keystrokes, be unlawfully or unfairly enriched. On the other hand, technology is a tool in the arsenal of forensic accountants that can be used to expose many frauds. A third reason is that various markets have become increasingly complex. In these markets, financial assets, nonfinancial assets, and the structure of transactions have grown in sophistication and increased the demand for valuation services. In addition, the increased complexity of financial transactions has created opportunities for unscrupulous individuals to commit financial statement fraud.

To uncover fraud schemes, forensic accountants need knowledge of financial transactions, how they are recorded, and an awareness that fraud cannot always be found in business records and financial statements. They also need knowledge of types and sources of evidence, the process of evidence collection so as to preserve the chain of custody, and applicable laws and regulations. Also, forensic accountants must be able to think critically so they can assess situations, persons, and evidence to ensure that victims, to the extent possible, are made whole and fraudsters are brought to justice. Knowledge of forensic accounting can be used to recommend preventative strategies and measures that decrease the probability that fraud will be committed and increase the likelihood of early detection if it is committed.

Besides fraud investigation, forensic accountants engage in a wide variety of litigation services that include serving as a litigation consultant, expert witness, mediator, arbitrator, and bankruptcy trustee. Further, these services can involve many specialty practice areas. Examples of these specialty areas include due diligence in mergers or acquisitions, valuation of economic losses, the ability to resolve patent disputes, and assistance in the administration of estates and trusts. Business valuation is an especially broad practice area because almost any type of litigation or potential litigation can involve valuation issues. These issues include, for example, the value of intangibles in business acquisitions, asset values in divorce, economic damages in breach of contract cases, the value of complex options, and the value of businesses.

When measuring economic damages and business valuation, forensic accountants generally need a variety of knowledge and skills such as financial analysis, finance, economics, industrial organization, critical thinking, and good communication techniques. On many occasions, these kinds of services are needed for matters in dispute that may be decided by triers of fact, such as a court of law or an arbitration panel.

This book focuses on methods, techniques, strategies, and thinking processes utilized in forensic accounting along with professional standards of practice, ethics, and law applicable to subfields in forensic accounting. When appropriate, this book encapsulates information from AICPA professional standards, practice aids, and other AICPA publications. It consists of three major sections. Section I introduces the forensic accounting profession. Section II provides a thorough coverage of relevant legal issues and the practice of forensic accounting. Section III covers various forensic accounting areas, including fraud, bankruptcy, digital forensics, matrimonial forensics, economic

damages, and business valuation theory and applications. The overall coverage is consistent with the Content Specification Outline (CSO) for the Certified in Financial Forensics (CFF) examination at the time of our writing. Practitioners seeking the CFF certification may find our text useful when preparing for the exam. This book also expands on the CSO in many places, especially in the areas of digital forensics, expert witnessing, practice development, and fraud management.

The discussions about AICPA literature in this book are from the AICPA's perspective; other organizations, such as state boards of accountancy, may adopt AICPA requirements as necessary for their own licensees or members. Thus, licensed CPAs in certain states should be familiar with the requirements of AICPA literature, especially if these requirements are codified into state law.

Essentials of Forensic Accounting is designed for experienced and inexperienced forensic accounting practitioners and students who desire to enter the forensic accounting profession, as well as those who simply wish to know more about the comprehensive body of forensic accounting knowledge. Because the text covers many areas, it does not encompass the entire body of knowledge of particular topics. Some readers may peruse certain chapters and others may use the material contained in these pages as a springboard for the study of the various professional standards and AICPA practice aids. Extensive end-of-chapter materials make the book suitable for instructors and students of college and university courses that involve forensic accounting and fraud examination at the undergraduate and graduate levels. We hope that this book helps you understand the uniqueness of this fascinating area of study and encourages you to learn more about forensic accounting.

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SECTION I

Introduction

CHAPTER 1

The Forensic Accounting Profession

LEARNING OBJECTIVES

- Describe the nature of **forensic accounting** services
- Describe the different categories of forensic accounting services
- Analyze the different types of knowledge areas and skills required for forensic accounting
- Identify the different professional opportunities available to forensic accountants
- Identify three major organizations and credentials important to forensic accountants

INTRODUCTION

THE ESSENCE OF FORENSIC ACCOUNTING

Forensic accounting involves the application of special skills such as accounting, auditing procedures, finance, quantitative methods, research, and investigations. It also involves knowledge of certain areas of the law. This knowledge combined with these skills enable forensic accountants to collect, analyze, and evaluate evidential matter and to interpret and communicate findings.

Key elements of this definition include the following:

- *Accounting.* Forensic accounting is a branch of accounting. At its most general level, accounting involves the communication of financial information.
- *Special skills.* Forensic accounting requires special skills that are not required of accountants in general.
- *Law.* Forensic means pertaining to the law. Forensic accounting deals with financial issues that may come before a trier of fact in a court of law or other venue (such as arbitration).
- *Evidential matter.* Especially important to forensic accounting is evidential matter that may bear on the truth or falsity of an assertion made before a trier of fact.
- *Interpretation and communication.* In many cases, forensic accountants interpret evidence and communicate expert opinions to clients and a trier of fact.

Forensic accounting is typically divided into two areas:

- *Litigation services.* The forensic accountant serves as a testifying expert or non-testifying consultant and provides assistance for actual or potential legal or regulatory proceedings before a trier of fact in connection with the resolution of disputes between parties. Litigation services include serving as an expert witness, a litigation consultant (that is, a non-testifying expert), and in various other roles in dispute-resolution or legal processes (for example, as a bankruptcy trustee).
- *Investigative services.* The forensic accountant serves as a consultant in cases that do not involve actual or threatened litigation, but do involve performing analyses or investigations that may require the same skills used in litigation services.

FORENSIC ACCOUNTING VERSUS TRADITIONAL ACCOUNTING

Traditional accounting involves recording, classifying, analyzing, and reporting financial data and information. The emphasis is on converting raw financial data into information useful for decision makers by using an **applicable financial reporting framework**. The useful information is typically presented to decision makers in the form of financial statements. In summary, the work product of the traditional accountant is one or more financial statements.

On the other hand, the typical work product of forensic accountants tends to be much different from that of traditional accountants. The scope of each forensic accounting project is unique and the work product flows from the scope of the particular project. Such work products often consist of a written or oral report of findings or recommendations or both. When testifying before a trier of fact as an expert witness, forensic accountants ordinarily express their findings as expert opinions. In this use, “opinion” is a term of art in judicial guidelines on evidence and the law, and differs from its use in the accounting literature.

FORENSIC ACCOUNTING VERSUS AUDITING

In some respects, forensic accounting is very much like auditing. Forensic accountants generally use procedures and exercise professional skepticism in a manner similarly used by auditors. For instance, both examine evidence (usually financial related) and form professional judgments on what they observe. But the overall objectives of these two kinds of engagements are very different. The objective of audit engagements usually is to express an **audit opinion** on whether financial statements, taken as a whole, are fairly presented. In contrast, forensic accounting engagements tend to be focused on one or more particular areas. Speaking simply, virtually all audit engagements have a single objective of expressing one opinion on a set of financial statements whereas each forensic accounting project is very uniquely focused on a client’s particular needs and the objective is usually to report recommendations or findings.

All forensic accounting work performed by CPAs¹ is subject to CS section 100, *Consulting Services: Definitions and Standards*.² In addition, forensic accounting services may be subject to other requirements such as applicable laws and regulations, rules of evidence, civil or criminal procedures, and other professional pronouncements such as other applicable professional standards. These other requirements are discussed in detail in subsequent chapters.

Forensic accountants sometimes engage in auditing work, but for purposes other than providing an opinion on an entity’s financial statements. For example, a forensic accountant may conduct a forensic engagement as part of an occupational fraud investigation. The result of such an investigation will likely be a report that identifies, for example, the amount of the fraud loss and any control weaknesses that led to the fraud. These fraud engagements are performed as consulting engagements and are governed by CS section 100.

Forensic accountants apply specialized skills (in the form of specialized procedures) that differ from those used by auditors of historical financial statements. For example, auditors may use observation techniques whereas forensic accountants may use surveillance techniques. The differences between techniques used by traditional auditors and forensic accountants are discussed in a subsequent chapter.

¹ For brevity, throughout the text we say that AICPA standards apply to CPAs. Strictly speaking, AICPA standards apply to CPAs who are members of AICPA or those who are licensed by state governments that require their licensees to comply with AICPA standards. Generally speaking, state regulators of CPAs in the U.S. have requirements that almost certainly refer to AICPA standards in some degree.

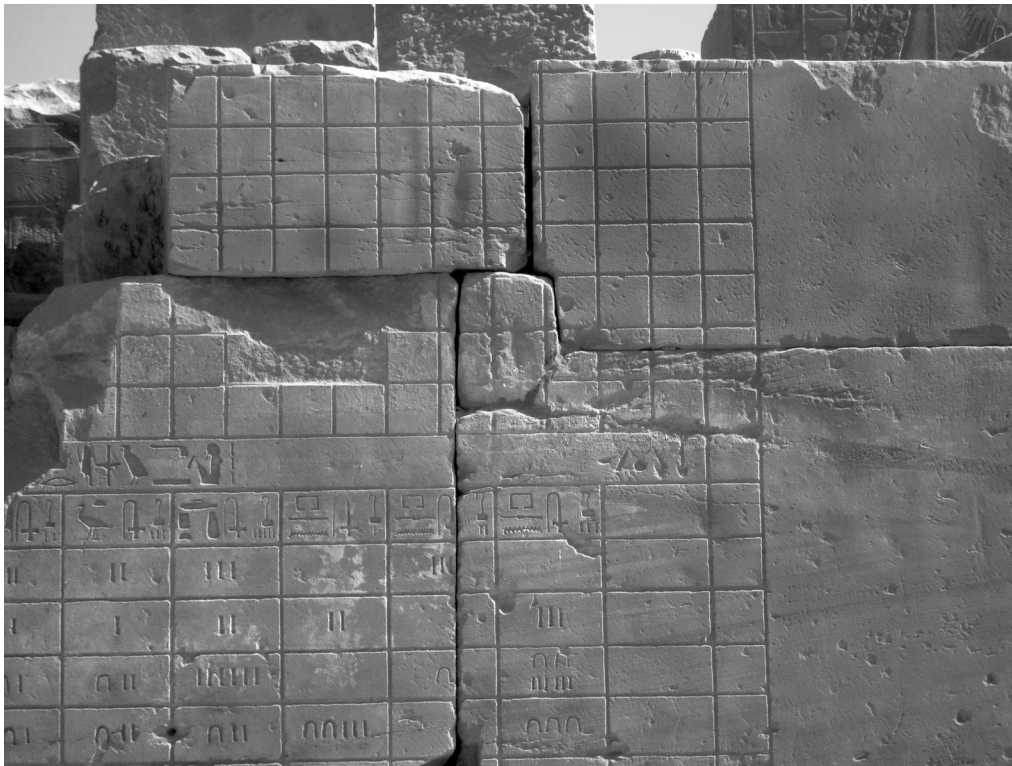
² CS section 100 can be found in AICPA *Professional Standards*.

Unlike traditional auditors, not all forensic accountants are required to be “independent” of their clients in the way the term is used in other accounting literature. Independence is required, though, when forensic accountants participate in **attest** engagements such as audits of financial statements for the purpose of opining on the fairness of their presentation and **reviews** of financial statements.

THE HISTORICAL DEVELOPMENT OF FORENSIC ACCOUNTING

Forensic accounting has existed for thousands of years. In ancient Egypt, accountants were known as the eyes and ears of the pharaoh. By some reports, ancient forensic accountants were adept at getting to the truth and, at times, they availed themselves of harsh interrogation techniques and even torture.

Accounting for Offerings at the Temple of Karnak



Source: Flickr/Becsh

No discussion of forensic accounting would be complete without at least a mention of Sherlock Holmes, a fictional character from the late 1800s, who is widely known for his astute observations, impeccable logic, powers of deduction, and use of forensic science. Throughout the development of modern forensic accounting, Sherlock Holmes has occasionally been held up as a role model for aspiring forensic accountants. Such veneration of Sherlock Holmes by the accounting community is completely appropriate, because forensic accountants frequently investigate the how, where, when, and why of financial frauds.

In the United States and Canada, perhaps the first case of an accountant testifying in court as an expert witness was in the 1817 Canadian case *Meyer v. Sefton*. However, it was not until over a hundred years later that the term *forensic accounting* was coined by **Maurice Peloubet** (1892–1976) in 1946 when he published an article titled, “Forensic Accounting—Its Place in Today’s Economy.” Peloubet was a very prominent accountant in his era. Information about him can be found on the website of the New York State Society of CPAs (www.nysscpa.org).

Maurice Peloubet



Source: Find a Grave

Since Peloubet published his article, forensic accounting as a practice area has continued to flourish. During World War II, the FBI hired large numbers of accountants to help with intelligence and counter-intelligence operations. In the 1960s, J. Edgar Hoover, the head of the FBI, hired large numbers of accountants to fight organized crime. The need for forensic accountants increased dramatically with the financial scandals that began in the 1980s and continues to persist. The Sarbanes-Oxley Act of 2002 significantly increased the interest in forensic accounting.

Case in Point

In one of the most famous uses of forensic accounting skills, Frank Wilson of the Internal Revenue Service's Special Intelligence Unit was assigned to investigate Alphonse Gabriel "Al" Capone who, in 1930, had become Chicago's "Public Enemy Number One" due to his involvement in smuggling and bootlegging liquor and other illegal activities.

Prior to Frank's investigation, Mr. Capone had only served prison time for possession of a firearm. After the 1927 U.S. Supreme Court ruling in *United States v. Sullivan* (274 U.S. 259 [1927]) that clarified that income from illegal sources was taxable, the government was able to move forward in prosecuting the head of the Capone organization. Unfortunately, finding evidence was not easy; Capone had never filed an income tax return, owned nothing in his name, and had conducted business through front men. Until Wilson examined a cash receipts ledger that contained the organization's net profits for a gambling house and the name of Mr. Capone, no records had been discovered by the government to link Mr. Capone to income of any kind. In 1931, it was this document that led to a 23-count indictment including income tax evasion for the years 1925–1929, failing to file tax returns for the years 1928 and 1929, and conspiracy to violate Prohibition laws from 1922–1931.

Mr. Capone was found not guilty on 18 of the 23 counts. He was convicted on 3 counts of tax evasion (for years 1925, 1926, and 1927) and 2 counts of failing to file tax returns (for years 1928 and 1929). The judge sentenced him to a total of 10 years in federal prison and 1 year in the county jail. He was paroled on November 16, 1939, and shortly thereafter returned to his home in Palm Island, Florida, where he died, on January 25, 1947, from cardiac arrest.

Al Capone



Source: FBI

FORENSIC ACCOUNTING KNOWLEDGE AND SKILLS

Forensic accounting requires knowledge and skills in many different areas. Although these areas are discussed individually, keep in mind that they overlap each other.

ACCOUNTING

Forensic accounting spans many areas of accounting, therefore broad accounting knowledge and skills are required. However, certain accounting knowledge and skills are required within specialized areas of forensic accounting. For example, a forensic accountant specializing in investigating occupational fraud might not need to be an up-to-date expert in international accounting standards, but would likely need specialized knowledge and skills relating to accounting information systems, digital forensics, and accounting information systems auditing procedures. Similarly, a forensic accountant specializing in estimating economic damages may need **business valuation** skills. The many specialized areas within forensic accounting are discussed in subsequent chapters.

AUDITING

Auditors are specialists in collecting, interpreting, and evaluating data and information. Such skills are essential to forensic accounting. As previously discussed, when forensic accountants testify before a trier of fact as an expert witness, they ordinarily express their findings as expert opinions. Their findings must be based on evidence, and evidence must be collected and interpreted. Therefore, forensic accountants should be skilled in collecting and interpreting evidence. Finally, as previously mentioned, forensic accounting requires knowledge and skills using specialized evidence gathering procedures.

INVESTIGATIVE

Special skills and knowledge are required to conduct forensic accounting investigations. These special skills and knowledge include an understanding of how to structure and manage investigations, the types of evidence that may be collected, how to maintain the chain of custody, the legal rights of those under investigation, how to identify different types of fraud schemes, how to conduct interviews, and how to detect deception.

CRIMINOLOGY AND DIGITAL FORENSICS

For criminal investigations, the forensic accountant should have a basic understanding of the various roles played by crime scene investigators, digital forensics experts, forensic scientists, forensic laboratories, prosecutors, and attorneys.

Almost all crimes these days involve digital devices, including computers.³ Therefore it is helpful for the forensic accountant investigating fraud to have a basic understanding of digital forensics in both the areas of computer forensics and network forensics. In addition, advanced digital forensics are employed by, for example, using computer-assisted audit tools and techniques (CAATTs) to extract and analyze digital data from enterprise resource planning (ERP) and accounting systems.

ACCOUNTING INFORMATION SYSTEMS

Key elements of accounting information systems include internal control and business processes. Internal fraud schemes typically involve the violation of weak or nonexistent internal controls within specific business processes. Therefore, the forensic accountant must have a good understanding of internal control processes and how they interface with business processes and the accounting information system. For example, a sales-skimming fraud scheme may involve the absence of reconciliation controls in the revenue cycle.

³ See David W. Bennett, "The Challenges Facing Computer Forensics Investigators in Obtaining Information from Mobile Devices for Use in Criminal Investigations." *Forensic Focus*. August 20, 2011. articles.forensicfocus.com/2011/08/22/the-challenges-facing-computer-forensics-investigators-in-obtaining-information-from-mobile-devices-for-use-in-criminal-investigations/.

RISK ANALYSIS

Fraud risk management is an issue commonly dealt with by forensic accountants.⁴ Fraud risk management activities include fraud prevention, detection, and response. This type of management begins with fraud risk assessment.

COMMUNICATION

Communication skills are essential in all areas of accounting. However, such skills can become even more critical in the area of forensic accounting. Forensic accountants serving as testifying experts often write expert reports that are likely to be subject to intense scrutiny in depositions and cross-examinations at trial. Furthermore, forensic accountants may need to explain their opinions on direct examination at trial, which requires effective presentation skills.

PSYCHOLOGY

Understanding the suspect and, in particular, his or her motivations can aid forensic accountants who perform investigations. Motivation can, for instance, help identify the areas that should be investigated. For example, a CEO may be motivated to compete successfully with a sibling by attempting to increase the market price of stock by artificially inflating net asset values and income.

The law enforcement community has long known that one of the best ways to solve a fraud case is by obtaining a confession. The process of obtaining a confession in financial fraud cases is a very carefully orchestrated one that begins with collecting documentary evidence, proceeds to interviews with non-suspects, and often terminates with an interview with the prime suspect. The key to success in interviewing involves the ability to assess honesty versus deception. Consequently, forensic accountants, at times, are aided by the employment of techniques rooted in psychology, such as the analysis of body language and eye movements.

INFORMATION TECHNOLOGY

The importance of information technology to forensic accountants is closely related to the importance of digital forensics and accounting information systems. Information technology is constantly evolving and is an inescapable aspect of many types of forensic accounting work. Not only do forensic accountants use the latest in technology in their investigations, they must also be aware of evolving technological advances to maintain up-to-date professional skills.

PROBLEM SOLVING

If there is any one skill that stands out among the others, it is problem solving. Forensic accountants constantly deal with puzzles and mysteries that offer opportunities to sharpen their critical-thinking skills. In fraud investigations and litigation and dispute resolution, there is always an opposing side, and in many cases the opposing side is highly intelligent and seeks to deceive and cover up the truth. The opposing side might, for example, be a fraudster in an embezzlement investigation, a spouse hiding assets in a divorce, a debtor hiding assets in a bankruptcy, or a potential corporate acquisition target providing false financial statements in order to inflate its value.

LEGAL

By definition, forensic work is affected by the legal system. In performing litigation services, forensic accountants assist in the legal and dispute resolution processes. Therefore, the forensic accountant is familiar with the court systems, applicable federal and state rules of procedure, and rules of evidence. The forensic accountant often needs a basic understanding of various types of common-law and financial crimes such as conspiracy, money laundering, and embezzlement.

⁴ See www.pwc.com/us/en/forensic-services.html.

PROFESSIONAL OPPORTUNITIES IN FORENSIC ACCOUNTING

Forensic accounting is an accounting specialty that is rich with many subspecialties. Forensic accountants tend to work in the subspecialties that interest them the most. Some of these subspecialties are discussed here in general terms and are discussed in greater detail in subsequent chapters.

INVESTIGATIVE SERVICES

As previously discussed, the two main areas of forensic accounting are litigation services and investigative services. The distinction between the two areas rests not so much on the work done but rather on whether or not litigation is contemplated or anticipated.

There is almost no end to the types of financial cases that involve investigation, including those of occupational fraud and other kinds of fraud. Besides fraud, there are many other types of issues that forensic accountants investigate. Examples include determining the value of a spouse's assets in a divorce case, investigating public corruption, tracing the sources of funds in a terrorism case, determining the extent of money laundering in narcotics trafficking cases, and ascertaining the validity of specific representations made by the target of a corporate merger.

From the FBI's Website: Looking for a Few Good Accountants⁵

Desired Education

- Bachelor's degree in accounting or bachelor's degree with 24 semester hours in accounting (6 out of 24 hours can be in business law)

Applicable Certifications

- Certified Public Accountant (CPA)
- Certified Financial Forensics (CFF)
- Certified Fraud Examiner (CFE)
- Certified Internal Auditor (CIA)

Relevant Work Experience

- Forensic accounting
- Public accounting—audit
- Government accounting

FRAUD RISK MANAGEMENT

Forensic accountants tend to be experts in investigating fraud because of their deep understanding of many types of fraud schemes. As a result, they are in an excellent position to identify fraud risks and recommend ways to prevent and detect fraud schemes. One example of the need for fraud risk management is the proliferation of digital technologies, which has opened the door to constant, devastating fraud attacks against even some of the largest and strongest companies. Consequently, fraud risk management has grown into an enormous industry and has strongly embraced the forensic accounting profession for its knowledge and skills in preventing and detecting fraud.

EXPERT CONSULTING

As **expert consultants**, forensic accountants give advice on a wide range of areas. Examples include fraud risk mitigation, internal dispute resolution systems, the value of an estate, and the financial impact of bankruptcies, mergers, or acquisitions.

EXPERT TESTIMONY

Generally speaking, **fact witnesses** are only permitted to testify in court to what they perceive through their senses (that is, touch, hearing, sight, and smell). On the other hand, qualified experts are permitted to give opinions on relevant issues before the trier of fact.

⁵ Source: "FBI Forensic Accountants: Following the Money" March 9, 2012. www.fbi.gov/news/stories/fbi-forensic-accountants

Qualified forensic accountants can serve as **testifying experts** in virtually any area of forensic accounting. Testifying experts usually provide a written report to the opposing side before the trial. They are then subject to depositions and at trial they state their opinions in direct examination, which is then subject to cross-examination by the opposing party. The legal system permits the use of experts as a way of assisting the trier of fact (usually a judge or jury) rather than as an advocate for a particular party.

BUSINESS VALUATION

Business valuation is a very important subspecialty area within forensic accounting. Forensic accounting and business valuation are so intertwined that they are in the same member interest area within the AICPA (the section is named Forensic and Valuation Services [FVS]).

Business valuation involves not only valuing businesses, but many kinds of assets or liabilities. Forensic accountants may measure or value economic damages, patents, assets owned by divorcing spouses, future medical expenses, loan portfolios, and stock options.

Business valuation is also applicable to financial reporting. Accounting standards have shifted towards valuing many assets at fair value. For example, goodwill listed on the balance sheet of a company is to be tested for impairment at least once a year; this impairment testing involves determining a value of the net assets that gave rise to the goodwill to arrive at a current fair value of goodwill. If the current value of goodwill is less than the carrying value of goodwill, goodwill is to be written down to its current value.

Therefore, a valuation expert may be engaged to value specific assets or groups of assets, or provide an opinion on an already determined fair value of assets.

OTHER

Other areas in which forensic accountants can serve include alternative dispute resolution, trust services, and bankruptcy. In dispute resolution, forensic accountants can serve as mediators or arbitrators. In trust services, they can serve as trustees or executors, and in bankruptcies they can serve as private trustees appointed by the U.S. Trustee Program, a component of the Department of Justice responsible for overseeing the administration of bankruptcy cases and private trustees.

PROFESSIONAL ORGANIZATIONS AND CERTIFICATIONS ---

There are many professional organizations and certifications applicable to forensic accountants. Membership in particular organizations that are most beneficial to individual forensic accountants depends on education, training, experience, and areas of professional focus. Five of the major professional organizations and certifications are discussed here. Various other organizations and certifications are included in the discussion in chapter 6, "Litigation Services."

As a general rule, individual professional organizations require credential holders to adhere to specific ethics codes and professional guidelines, and maintain their credentialed status by means of continuing education or work experience. The organizations presented in the following sections are representative of leading international forensic accounting associations and institutes.

ASSOCIATION OF INTERNATIONAL CERTIFIED PROFESSIONAL ACCOUNTANTS (WWW.AICPA-CIMA.COM)

The **Association of International Certified Professional Accountants** is the premier American organization for CPAs and the largest organization of CPAs in the world. It develops and determines answers to the Uniform CPA exam and the exam associated with the Certified in Financial Forensics (CFF) credential. The CFF credential can be earned by Association members who are CPAs by passing an examination of their knowledge of forensic accounting and business valuation. Education and experience requirements must also be met by those seeking this certification.

The Association also offers the Accredited in Business Valuation (ABV) credential. This credential is open to CPAs who are members of the Association and who pass the ABV examination and meet certain education and experience requirements. The ABV examination is waived for accredited members (AM) and accredited senior appraisers (ASA) of the American Society of Appraisers.



Case in Point

Richard A. Pollack, CPA, ABV, CFF, PFS, ASA, CBA, CFE, CAMS, CIRA, CVA, is the Director-in-Charge of Forensic and Business Valuation Services at Berkowitz Pollack Brant, Advisors and Accountants, LLP.

For more than 30 years, Mr. Pollack has served as a litigation consultant, expert witness, court-appointed expert, forensic accountant, and forensic investigator. His team has assisted bankruptcy courts, the Securities and Exchange Commission, school boards and government agencies, the FBI, and numerous other entities in proving or defending against allegations using a range of forensic and investigative strategies.

His areas of practice include accounting and auditing; management consulting; business and tax planning; business valuation; and litigation support (forensic services), including computation of economic damages, forensic investigations, special accountings, fraud prevention and detection, matrimonial disputes, contract cost and claims analysis, business interruption insurance claims, and bankruptcy or receivership matters. Mr. Pollack has been qualified in Dade, Broward, and Palm Beach counties as an expert in the U.S. District Court, U.S. Bankruptcy Court, and Circuit Courts. Additionally, Mr. Pollack has testified in various arbitration matters.

Mr. Pollack has experience in a variety of industries, including automotive dealerships, aviation, banking (including mortgage financing), construction, entertainment, health care, insurance, media, leisure and hospitality, manufacturing, not-for-profit, professional services, real estate, retail, securities (including broker dealers), technology, telecommunications, transportation, and wholesale distribution.

Throughout Mr. Pollack's career he has performed forensic investigations and audits of financial institutions and other enterprises. These investigations have included analyses of loan files and related documentation, check-kiting, uncovering employee embezzlement, and providing recommendations on proper policies and procedures.

Mr. Pollack also has performed peer reviews on other CPA firms on behalf of the Association and the Florida Institute of Certified Public Accountants.

Additionally, he has written articles on forensic accounting, business valuation, bankruptcy, finance, and other accounting topics. He co-authored the AICPA practice aid *Calculating Lost Profits*, which has been used by CPAs and courts nationwide, and provided assistance to the AICPA in publishing practice aids 06-1, *Calculating Intellectual Property Infringement Damages*, and 07-1, *Forensic Accounting—Fraud Investigations FVS (Formerly BVFLS)*.

One of the forensic accounting cases on which Mr. Pollack worked involved a Ponzi scheme perpetrated by Scott Rothstein of Fort Lauderdale, Florida. Mr. Rothstein, a now disbarred lawyer, pleaded guilty to 5 felonies in connection with his role in the \$1.2 billion Ponzi scheme and is serving a 50-year sentence. Mr. Rothstein built a prominent law firm of 70 lawyers and 150 employees on Las Olas Boulevard in Fort Lauderdale and became well known in south Florida because of his lavish spending on cars and homes and due to his close ties to politicians. (Besides an 87-foot Warren yacht and other vehicles, his cars included 4 Ferraris, a Bentley, a Rolls-Royce, a Maserati GT, 2 Lamborghini Murcielagos, and a \$1.6 million Bugatti Veyron.) His fraud included fabricating opportunities to entice investments in what Mr. Rothstein said were payouts from settlements of workplace discrimination lawsuits, having one of his attorneys pretend to be the head of the Fort Lauderdale office of the Florida Bar, and forging federal court orders in a lawsuit.

Mr. Pollack and his team spent three days visiting with Mr. Rothstein in prison at an undisclosed location, years analyzing transactions, and many hours deposing various parties. The results of their forensic accounting work, combined with work performed by the lawyers and receiver, resulted in a full recovery of monies invested by victims of the scheme.

ASA (WWW.APPRAISERS.ORG)

The **American Society of Appraisers (ASA)** is a nonprofit, international organization of professional appraisers that represents a variety of appraisal disciplines, including business valuation. Its mission is to encourage public trust of its members and the appraisal profession through compliance with high levels of ethical and professional standards by, for example, establishing and maintaining principles of appraisal practice and a code of ethics. It offers two designations for qualified candidates: Accredited Member (AM) and Accredited Senior Appraiser (ASA).

The ASA also promotes research and development in all fields of the appraisal profession through its American Society of Appraisers Educational Foundation (ASAEF), which is a separate, nonprofit corporation established by the ASA. The mission of the ASAEF is to conduct educational, research, and charitable activities related to the advancement of the appraisal profession.

ACFE (WWW.ACFE.COM)

The **Association of Certified Fraud Examiners (ACFE)** is the world's largest antifraud organization. Its mission is to reduce the occurrence of fraud and white-collar crime and to assist its members in their efforts to detect and deter fraud. The ACFE offers the Certified Fraud Examiner (CFE) credential. The CFE exam covers the fraud examination body of knowledge, which comprises four disciplines: fraud, prevention and deterrence, financial transactions, and fraud schemes, investigations, and law. The credential is maintained by engaging in continuing professional education and adhering to its code of ethics.

Every two years, the ACFE publishes its *Report to the Nations on Occupational Fraud and Abuse*, a study based on data compiled from worldwide cases of occupational frauds that occurred during the two years immediately prior to its publication and which were investigated by CFEs.

Although the ACFE is not an accounting association, many accountants are members and have the CFE credential, which focuses on one area within forensic accounting (fraud) and can be earned by those in accounting and non-accounting practice areas. A bachelor's degree is required for the CFE, but can be in any area. Subject to specific rules, relevant experience can substitute for the bachelor's degree requirement. A minimum of at least two years of relevant experience is required.

ISACA (WWW.ISACA.ORG)

According to ISACA's website

[a]s an independent, nonprofit, global association, ISACA engages in the development, adoption and use of globally accepted, industry-leading knowledge and practices for information systems. Previously known as the Information Systems Audit and Control Association, ISACA now goes by its acronym only, to reflect the broad range of IT governance professionals it serves.

ISACA offers three credentials of interest to forensic accountants. These include the Certified Information Systems Auditor (CISA) credential, the Certified in Risk and Information Systems Control (CRISC) credential, and the Certified Information Security Manager (CISM) credential. Of particular interest to the forensic auditor is the CISA credential.

Most fraud investigations involve computer systems, and the need to use digital forensics in fraud investigations is fairly common. However, basic computer forensics does not include the skills needed to investigate frauds and other issues in many company accounting systems, database systems, and ERP systems. The CISA credential is an exam-based credential that focuses on the advanced skills needed by the forensic accountant.

NACVA (WWW.NACVA.COM)

The **National Association of Certified Valuators and Analysts (NACVA)** is an association of professionals who provide valuation and litigation services for various types of business transactions. Its mission is to provide resources to its members in the fields of valuation, financial forensics, and related advisory services. NACVA provides training in valuing businesses, damage determination, and fraud detection and prevention and offers continuing professional education courses for members and nonmembers. In addition, its members must adhere to an established code of ethics.

NACVA offers the following credentials: Certified Valuation Analyst (CVA), Accredited Valuation Analyst (AVA), Accredited in Business Appraisal Review (ABAR), and Master Analyst in Financial Forensics (MAFF).

ORGANIZATION OF THIS BOOK

This text is organized into three major sections:

- Section I introduces the forensic accounting profession.
- Section II provides a thorough coverage of relevant legal issues and the practice of forensic accounting.
- Section III covers various forensic accounting areas, including fraud, bankruptcy, digital forensics, matrimonial forensics, economic damages, and business valuation theory and applications.

Generally speaking, the overall coverage is consistent with the Content Specification Outline (CSO) for the CFF exam. The text expands on the CSO in many places, especially in the areas of digital forensics, expert witnessing, practice development, and fraud management.

SUMMARY

Forensic accounting involves the application of special skills in accounting, auditing, finance, quantitative methods, research, and investigations. It also involves knowledge of certain areas of the law. These skills and knowledge enable forensic accountants to collect, analyze, and evaluate evidential matter and to interpret and communicate findings.

When practicing litigation services, the forensic accountant serves as an expert or consultant and provides assistance for actual or potential legal or regulatory proceedings before a trier of fact in connection with the resolution of disputes between parties. When performing investigative services, the forensic accountant serves as a consultant in cases that do not involve actual or threatened litigation, by performing analyses or investigations that may require the same skills as used in litigation services.

In many respects, forensic accounting is very much like auditing. Like the forensic accountant, the auditor generally gathers evidence and exercises professional skepticism; is subject to certain standards, laws, and regulations; and applies specialized skills. The auditing skills of collecting, interpreting, and evaluating data and information are also essential to the practice of forensic accounting. These skills are used to obtain evidence on which the findings, recommendations, and expert opinions of forensic accountants are based. But the overall objectives of these two kinds of engagements are very different. The objective of audit engagements usually is to express an opinion on whether financial statements, taken as a whole, are fairly presented. In contrast, forensic accounting engagements tend to be focused on one or more particular areas. Furthermore, forensic accountants apply specialized skills (in the form of specialized procedures) that differ from those used by financial statement auditors.

In addition to possessing auditing skills, the forensic accountant is knowledgeable as to how to structure and manage investigations, the types of evidence that may be collected, how to maintain the chain of custody, the legal rights of those under investigation, how to identify different types of fraud schemes, how to conduct interviews, how to detect deception, and other skills and abilities.

The forensic accountant should also have a basic understanding of the various roles played by crime scene investigators, digital forensics experts, forensic scientists, forensic laboratories, prosecutors, and attorneys. When performing litigation services, forensic accountants assist in the legal and dispute resolution processes. Therefore, the forensic accountant has familiarity with the court systems, applicable federal and state rules of procedure, and rules of evidence.

Because the key elements of accounting information systems include internal control and business processes, forensic accountants can benefit from a good understanding of internal control processes and how they interface with business processes and the accounting information system. Weak or nonexistent internal controls within specific business processes are often present in internal fraud schemes.

Although communication and problem solving skills are essential in all areas of accounting, these skills can be even more critical in the area of forensic accounting. Understanding psychology is another important skill required

in forensic accounting and affects the forensic accountant's success when determining the motivations of perpetrators and assessing the likelihood of deception during interviews.

Forensic accounting is an accounting specialty that comprises many subspecialties. The two main areas of forensic accounting are litigation services and investigative services. The primary distinction between the two areas is whether or not those knowledgeable of the case contemplate or anticipate litigation.

There are many professional organizations and certifications applicable to forensic accountants. Five of the major professional organizations and certifications are the AICPA (with the CPA, CFF, and ABV credentials), the ACFE (with the CFE credential), the ASA (with the AM and ASA credentials), ISACA (with the CISA, CRISC, and CISM credentials), and NACVA (with the CVA, AVA, ABAR, and MAFF credentials).

REVIEW QUESTIONS

1. As consultants, which of the following services do forensic accountants not provide?
 - a. Advice on fraud risk mitigation.
 - b. Valuation of an estate.
 - c. Opining on the fair presentation of financial statements.
 - d. Financial impact of mergers and acquisitions.
2. When performing dispute resolution services, forensic accountants can serve as _____ or _____.
 - a. Facilitators; advocates.
 - b. Mediators; arbitrators.
 - c. Judge; jury.
 - d. None of the above.
3. Internal fraud schemes typically involve weaknesses in _____.
 - a. Accounting.
 - b. Internal controls.
 - c. Leadership.
 - d. Assessment.
4. Having knowledge in which of the following areas is important for a forensic accountant?
 - a. Information technology.
 - b. Psychology.
 - c. Criminology.
 - d. All of the above.
5. The use of an expert witness is primarily to do which of the following?
 - a. Settle disputes out-of-court.
 - b. Assist the trier of fact.
 - c. Be an advocate for the defendant or plaintiff.
 - d. Fulfill the court's obligation of due diligence.
6. According to professional standards, forensic accountants are engaged only to assist lawyers as they prepare for litigation and to testify in court.
 - a. True.
 - b. False.
7. To work effectively, a forensic accountant should have a basic understanding of all of the following except _____.
 - a. Rules of evidence.
 - b. Law applicable to conspiracy crimes.
 - c. Court systems.
 - d. Enharmonic equivalents.
8. Whereas traditional accounting has many subspecialties such as cost accounting, forensic accounting has relatively few sub-specialties.
 - a. True.
 - b. False.

9. Auditors and forensic accountants are similar in that they both _____.
 - a. Use the auditing standards issued by the AICPA to guide their work.
 - b. Are required to be independent of their clients.
 - c. Are allowed to formulate opinions to assist their clients and others.
 - d. Must be licensed to practice by the states in which they practice.

SHORT ANSWER QUESTIONS

1. What are the key elements of the definition of forensic accounting?
2. What does the word “*forensic*” mean?
3. What are the two areas into which the practice of forensic accounting is typically divided?
4. How does auditing differ from forensic accounting?
5. By whom and when was the term *forensic accounting* coined?
6. What are some of the knowledge and skills required in forensic accounting? (Name at least four.)
7. What are two examples of types of financial cases that require investigation?
8. What is the difference between fact witnesses and expert witnesses?
9. What are the three management activities associated with fraud risk management?
10. What special skills and knowledge are required to conduct forensic accounting investigations? (Name at least three.)
11. Are communication skills critical in forensic accounting? Why or why not?
12. What are two areas in which forensic accountants, as expert consultants, can give advice?
13. What are the names of three organizations that are applicable to forensic accountants and what factors play a role in determining the organizations to which forensic accountants belong?
14. What are the names of four credentials that are specific to the forensic practice of valuation?
15. Why is the skill of problem-solving so important in forensic accounting?

BRIEF CASES

1. You have just graduated from college with an accounting degree. During your degree program you took two courses in forensic accounting. You find forensic accounting to be a fascinating area and your ultimate goal is to start your own practice with a specialty in fraud investigation and business valuation. How might you go about developing a career in forensic accounting?
2. You are contemplating a career in forensic accounting. Write a brief report suggesting the advantages of starting your career in each of the following ways: a staff member in a private forensic accounting firm, an employee in law enforcement, the owner of your own fraud investigation firm.
3. You work as a staff accountant in a large manufacturing firm. Your company is considering a merger with another company in the industry. You have suggested to your boss that she consider hiring a forensic accountant to assist with the due diligence work associated with the proposed merger. Write a brief memo to your boss supporting your position.
4. Some say that a high degree of ethics is required to be a forensic accountant. Write an essay in which you agree or disagree with this proposition. Justify your position.

5. Write a brief essay explaining the limitations of investigating fraud without possession of an accounting degree. Specifically, what types of fraud might require an accounting education?
6. Write a brief essay explaining how auditing skills contribute to the work of a forensic accountant.
7. Your boss wants an explanation of what is involved in forensic accounting. Write a brief memo explaining what is involved.
8. According to the ACFE Code of Conduct, a person conducting a fraud examination is not to express an opinion regarding the guilt or innocence of any person or party. Write a brief essay explaining why such a rule is needed.
9. Write a brief essay explaining several different types of cases in which a forensic accountant might serve as a testifying expert.
10. Write a brief essay explaining the basic areas of law with which a forensic accountant is familiar. For each area, explain why the legal knowledge is important to the forensic accountant.
11. Provide a written response to the assertion that the process of obtaining a confession should begin with collecting documentary evidence and that interviewing the suspect should be one of the last steps performed.
12. Provide a written discussion about whether you think that all forensic accountants should be experts in digital forensics or whether each forensic accountant should have at least a fundamental understanding of digital forensics.

INTERNET RESEARCH ASSIGNMENTS

1. Find the Forensic and Valuation interest area at the AICPA website. What benefits does the FVS section provide to its members?
2. Find the Consulting Services section online. What does CS section 100 say about professional judgment with respect to estimating value?
3. Find information on Scott Rothstein of Fort Lauderdale, Florida, the person mentioned in the profile of Richard A. Pollack. Name three of the five felonies to which he pled guilty.
4. Use a search engine to search using the phrase “forensic accounting services.” Choose a couple of firms and click through their pages to determine descriptions of forensic accounting services they provide.
5. Use a search engine to find information on the kidnapping and murder of the son of the famous pilot Charles Lindbergh. What did President Franklin D. Roosevelt do that aided the FBI in determining the location of the person eventually convicted of the kidnapping and why did this help? Explain.
6. Research the role of forensic accounting in narcotics trafficking investigations.
7. Find information on the topic areas covered in the Certified in Financial Forensics (CFF) exam.
8. Search for information on the role of forensic accounting in counter-terrorism work.

CHAPTER 2

Professional Ethics and Responsibilities

LEARNING OBJECTIVES

- Identify the process through which authoritative guidance is created
- Describe the organization of the AICPA Code of Professional Conduct
- Cite the AICPA Code of Professional Conduct appropriately
- Interpret use of words such as “should consider” used in the AICPA Code of Professional Conduct
- Evaluate threats to compliance by using the AICPA Code of Professional Conduct
- Create examples of threats to compliance defined by the AICPA Code of Professional Conduct
- Respond to an ethical conflict
- Describe and identify the sections of the AICPA Code of Professional Conduct most applicable to forensic accounting
- Explain the disciplinary procedures used by the AICPA, state CPA societies, and state boards of accounting
- Create examples of codes of conduct of other organizations
- Describe the requirements of CS section 100, *Consulting Services: Definitions and Standards* and VS section 100, *Valuation of a Business, Business Ownership Interest, Security, or Intangible Asset* in *AICPA Professional Standards*
- Analyze the relative importance of non-authoritative guidance and provide examples of practice aids and other non-authoritative guidance

INTRODUCTION

Certified public accountants who offer **forensic accounting services** are required to be knowledgeable about their responsibilities and to act according to professional standards that specify these responsibilities. Responsibilities of these practitioners are governed by **authoritative guidance** issued by the AICPA, other professional organizations to which the practitioner belongs, and governmental agencies that license them or exercise regulatory oversight. **Non-authoritative guidance** is also provided by the AICPA and by other organizations. In this chapter, we will discuss the various authoritative standards and non-authoritative guidance that apply to the practice of forensic accounting.

Note that some state boards of accountancy and other entities may adopt AICPA requirements as requirements of licensure or membership. Thus, licensed CPAs in certain states should be familiar with the requirements of AICPA literature, especially if these requirements are codified into state law.

AUTHORITATIVE GUIDANCE

Authoritative guidance promulgated by the AICPA that pertains to forensic accounting services includes the AICPA Code of Professional Conduct, CS section 100, and VS section 100.¹ In certain situations, standards such as the Statements on Standards for Attestation Engagements may apply. Guidance is authoritative if issued only after following a process that includes deliberation in meetings open to the public, public exposure of proposed statements, and a formal vote by the appropriate body designated by the AICPA to issue such guidance. Over the years, various bodies have been designated by the AICPA to issue authoritative guidance, such as standards and interpretations of standards, in specific areas. See box 2.1 for a list of these bodies and the areas for which they have been granted authority to issue guidance.

Box 2.1

Bodies Designated by AICPA Council to Establish Guidance

Authoritative Body	Areas in Which Authority Is Granted to Issue Guidance
Non-AICPA Bodies	
Federal Accounting Standards Advisory Board	Accounting standards for the federal government
Financial Accounting Standards Board	Accounting principles and interpretation on disclosure of financial information for entities other than governmental entities
Governmental Accounting Standards Board	Standards of financial accounting and reporting for state and local governmental entities
Public Company Accounting Oversight Board	Auditing and related attestation standards, quality control, ethics, independence, and other standards under the Sarbanes-Oxley Act of 2002
International Accounting Standards Board	Standards with respect to international financial accounting and reporting principles
AICPA Bodies (Committees and Boards)	
Accounting and Review Services Committee	Standards applicable to unaudited financial statements or other unaudited financial information of an entity not required to file financial statements with a regulatory agency pursuant to the sale or trading of its securities in a public market; attestation standards in their respective areas of responsibility
Auditing Standards Board	Auditing, attestation, and quality control standards and procedures
Management Consulting Services Executive Committee (commonly known as Consulting Services Executive Committee)	Standards with respect to offering of management consulting services (but not standards that address the question of proscribed services); attestation standards in their respective areas of responsibility
Tax Executive Committee	Professional practice standards for tax services
Forensic and Valuation Services Executive Committee	Professional standards for forensic and valuation services
Personal Financial Planning Executive Committee	Professional standards for personal financial planning services

¹ VS section 100 and CS section 100 can be found in AICPA *Professional Standards*.

In addition to the bodies listed in box 2.1, one other body deserves mention. The Professional Ethics Executive Committee (PEEC) is a senior committee of the AICPA charged with interpreting and enforcing the AICPA Code of Professional Conduct, promulgating new interpretations and rulings, and monitoring those rules and making revisions as needed by, for example, proposing amendments to rules. The AICPA bylaws state that the committee is also to investigate potential disciplinary matters that involve AICPA members and to present a case before a trial board when it finds prima facie evidence of infractions of the bylaws or the code.

PROFESSIONAL ETHICS

The code was created to maintain quality of practice and provide guidance to all members of the AICPA, including those in public practice, industry, government, and education. Although the code applies to members of the AICPA, some state and federal courts have extended its applicability to all CPAs, even those who are not AICPA members, on the basis that it has become the standard of expected behavior within the profession. In addition, other organizations and state boards of accountancy may adopt AICPA requirements for their own licensees and members; thus, requirements contained in the code may be applicable to those who are not members of the AICPA.

Organization

The code is organized by line of business and consists of four major parts: the preface, which applies to all members and which includes the principles of professional conduct; part 1, which applies to members in public practice; part 2, which applies to members in business; and part 3, which applies to other members, such as those who are retired or not currently employed.

The parts of the code and the topics within each part are shown in box 2.2. See box 2.3 for the corresponding code section numbers used prior to December 15, 2014.

Box 2.2		Code of Professional Conduct
Preface		
	0.100	Overview of the Code of Professional Conduct
	0.200	Structure and Application of the AICPA Code
	0.300	Principles of Professional Conduct
Part 1: Members in Public Practice		
	1.000	Introduction
	1.100	Integrity and Objectivity
	1.200	Independence
	1.300	General Standards
	1.310	Compliance With Standards
	1.320	Accounting Principles
	1.400	Acts Discreditable
	1.500	Fees and Other Types of Remuneration
	1.600	Advertising and Other Forms of Solicitation
	1.700	Confidential Information
	1.800	Form of Organization and Name
Part 2: Members in Business		
	2.000	Introduction
	2.100	Integrity and Objectivity
	2.300	General Standards
	2.310	Compliance With Standards
	2.320	Accounting Principles
	2.400	Acts Discreditable
Part 3: Other Members		
	3.000	Introduction
	3.400	Acts Discreditable
Source: AICPA Code of Professional Conduct		

Box 2.3**Revised AICPA Code of Professional Conduct and Corresponding Pre-Revision Rule Numbers**

Revised Code of Professional Conduct	Corresponding Pre-Revision Section and Rule Numbers and Titles
Preface	
0.100 Overview of the Code of Professional Conduct	ET Introduction
0.200 Structure and Application of the AICPA Code	ET section 91 Applicability
0.300 Principles of Professional Conduct	ET sections 51–57 (covers responsibilities, due care)
Part 1: Members in Public Practice	
1.000 Introduction	
1.100 Integrity and Objectivity	Rule 102 Integrity and Objectivity
1.200 Independence	Rule 101 Independence
1.300 General Standards	Rule 201 General Standards
1.310 Compliance With Standards	Rule 202 Compliance With Standards
1.320 Accounting Principles	Rule 203 Accounting Principles
1.400 Acts Discreditable	Rule 501 Acts Discreditable
1.500 Fees and Other Types of Remuneration	
1.600 Advertising and Other Forms of Solicitation	Rule 502 Advertising and Other Forms of Solicitation
1.700 Confidential Information	Rule 301 Confidential Client Information
1.800 Form of Organization and Name	Rule 505 Form of Organization and Name
Part 2: Members in Business	
2.000 Introduction	
2.100 Integrity and Objectivity	Rule 102 Integrity and Objectivity
2.300 General Standards	Rule 201 General Standards
2.310 Compliance With Standards	Rule 202 Compliance With Standards
2.320 Accounting Principles	Rule 203 Accounting Principles
2.400 Acts Discreditable	Rule 501 Acts Discreditable
Part 3: Other Members	
3.000 Introduction	
3.400 Acts Discreditable	Rule 501 Acts Discreditable

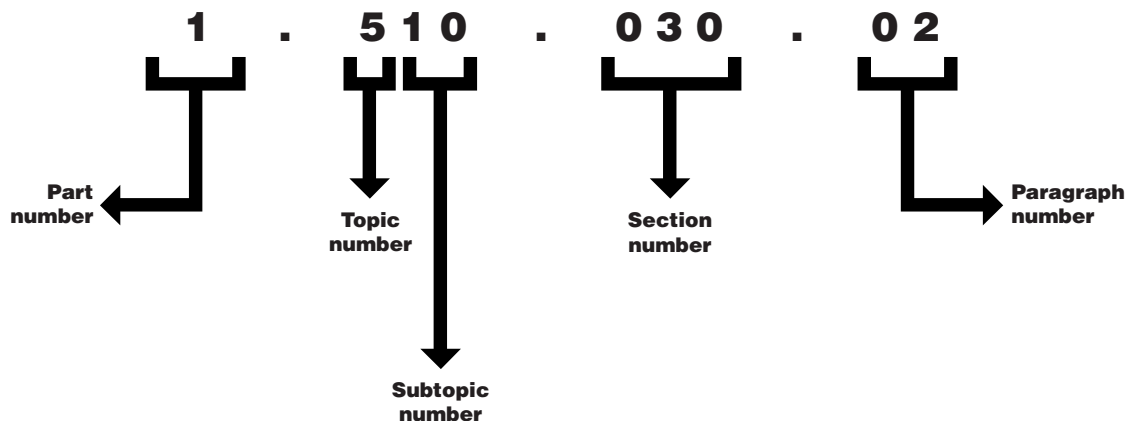
Source: www.aicpa.org/InterestAreas/ProfessionalEthics/Community/Pages/ethics-codification-implementation-tools.aspx

Each part of the code is organized by topic and, if necessary, each topic is organized by subtopics (however, some topics do not have any subtopics, such as the General Standards topic). Next are the sections, which are also referred to as *interpretations*. When interpretations (that is, sections) cannot be grouped by an intuitive subtopic, they are simply listed under the topic. See box 2.4 for an illustration of the “Integrity and Objectivity Rule” (ET sec. 1.100.001)² and its interpretations (for example, the “Conflicts of Interest for Members in Public Practice” interpretation [ET sec. 1.110.010]).³

When citing the code, the part number, topic number, subtopic number, and section number are to be used. For example, the appropriate citation to the ET section addressing the situation in which a spouse provides services for a contingent fee is ET section 1.510.030.02. (See figure 2.1 for an illustration of the part number, topic number, subtopic number, and section number for this section.)

Box 2.4	Integrity and Objectivity
Part 1: Members in Public Practice	
1.100 INTEGRITY AND OBJECTIVITY	
1.100.001 Integrity and Objectivity Rule	
1.100.005 Application of the Conceptual Framework for Members in Public Practice and the Ethical Conflicts Interpretation	
1.110 Conflicts of Interest	
1.110.010 Conflicts of Interest for Members in Public Practice	
1.110.020 Director Positions	
1.120 Gifts and Entertainment	
1.120.010 Offering or Accepting Gifts or Entertainment	
1.130 Preparing and Reporting Information	
1.130.010 Knowing Misrepresentations in the Preparation of Financial Statements or Records	
1.130.020 Subordination of Judgment	
1.140 Client Advocacy	
1.140.010 Client Advocacy	
1.150 Use of a Third-Party Service Provider	
1.150.010 Use of a Third-Party Service Provider	
Source: AICPA Code of Professional Conduct	

Figure 2.1
Illustration of Part Number, Topic Number, Subtopic Number, Section Number, and Paragraph Number



From left to right, the number 1 refers to part 1, which pertains to members in public practice; the number 5 indicates a topic in the 500 topical area of “Fees and Other Remuneration;” the number 10 denotes the “Contingent Fees” subtopic area (note that some topics do not have any subtopics, only interpretations); the number 030 section number refers to the area in which “Services Performed by a Member’s Spouse For a Contingent Fee” is addressed; and the number 02 is the paragraph number that refers to the location of specific information about this subtopic area.

² All ET sections can be found in AICPA *Professional Standards*.

³ Note that prior to the adoption of the new format shown, the “Integrity and Objectivity Rule” could be found in Rule 102. The new format was adopted by the Professional Ethics Executive Committee on January 28, 2014, and became effective on December 15, 2014. The new format was adopted to make the AICPA Code of Professional Conduct more user-friendly.

References to content in the preface begin with the single digit “0.” For example, “Overview of the Code of Professional Conduct” is in ET section 0.100. The principles in the preface are applicable to all members, whether in public practice or in business, and address responsibilities, the public interest, integrity, objectivity and independence, due care, and the scope and nature of services. These principles are statements of ideal conduct but are not enforceable. The rules of the code, which represent the minimum standard of conduct and are enforceable, are contained in parts 1, 2, and 3.

Forensic accounting is usually practiced as a part of public accounting; therefore, part 1, which pertains to members in public practice, applies. However, members in business, such as those who work in firms and companies that do not conform to the rules contained in the “Form of Organization and Name Rule” (ET sec. 1.800.001), may also perform forensic accounting services. For example, a member of the AICPA who works as an employee of a retail business may be asked to collect evidence of a suspected skimming scheme. The content of the topics most applicable to forensic accountants are, for the most part, the same regardless of whether the members practice as public accountants or as members in business. There are two differences: (1) The first number of the citation is to part 1 if the member practices as a public accountant, or part 2 if the member is in business, and (2) the rules and interpretations codified within each part can differ depending on whether the interpretation would be of concern to a member in public practice or a member in business (note that if a rule and interpretation apply to both, the rule and interpretation are repeated in each part). For example, “Independence” and associated interpretations appear in part 1 but not in part 2 because independence is a concern to members in public practice but not to members in business. The following references are, as a matter of convention, relative to part 1, but the sections discussed are applicable to the offering of forensic accounting services, regardless of whether the member is in public practice or is a member in business (except for any discussion of independence).

If a member cannot find an interpretation in the code that pertains to his or her situation, he or she can apply the “Conceptual Framework for Members in Public Practice” (ET sec. 1.000.010) (discussed under “Threats to Member’s Compliance with Code of Professional Conduct”).

Use of the Words “Should Consider,” “Consider,” “Evaluate,” and “Determine”

Throughout the code, particular phrases are used to convey differing levels of responsibility of the forensic accountant. When the code states that a procedure or action is one that the member “should consider,” consideration of the procedure or action is presumptively required; however, carrying out the procedure or action is not necessarily required and depends on the forensic accountant’s professional judgment. For example, if the code states that the “member should consider the ‘Conflicts of Interest’ interpretation under the Integrity and Objectivity Rule,” the member is to consider whether the interpretation applies to the member’s situation but is not required to comply with the interpretation.

The word “consider” is used in the code when the member is required to think about various matters, whereas the word “evaluate” is used when the member is to assess and weigh the importance of a matter. “Determine” is used when a member is to arrive at a conclusion and make a decision.



Case in Point

According to “Ethical Conflicts” (ET sec. 1.000.020.04)

[b]efore pursuing a course of action, the member should consider consulting with appropriate persons within the firm or the organization that employs the member.

The directive “should consider” in paragraph .04 does not mean that the member must or even should consult with appropriate persons within the firm or organization that employs the member. Instead, it means that the member is to carefully think about whether consulting with these persons is necessary.

Threats to Member's Compliance With Code of Professional Conduct

The "Conceptual Framework for Members in Public Practice" (ET sec. 1.000.010) states that various relationships or circumstances that create threats to the member's compliance with the rules may not be covered by all rules and interpretations. In that case, the member should evaluate whether the relationship or circumstance would cause a reasonable and informed third party who is aware of relevant information to believe that there is a threat to the member's compliance with the rules and that this threat is not at an acceptable level.

When making this evaluation, the member should identify threats to compliance with the rules and evaluate the significance of these threats. Threats should be identified both individually and in the aggregate because of the potentially cumulative effect threats can have on a member's compliance with the rules. There are three main steps in applying the conceptual framework approach: identify threats, evaluate the significance of a threat, and identify and apply safeguards (safeguards are actions or other measures that may eliminate or reduce a threat to an acceptable level).

- *Identify threats.* When a member encounters a relationship or circumstance not specifically addressed by a rule or an interpretation, he or she should determine whether the relationship or circumstance creates one or more threats. The existence of a threat does not mean that the member has violated any rules, only that the member should evaluate the significance of the threat. These threats are subsequently discussed and include adverse interest threat, advocacy threat, familiarity threat, management participation threat, self-interest threat, self-review threat, and undue interest threat.
- *Evaluate the significance of a threat.* After a member has identified threats, he or she is to evaluate the significance of each threat by determining whether the threat is at an acceptable level. An acceptable level exists when a reasonable and informed third party who is aware of the relevant information is likely to conclude that the threat would not adversely affect the member's compliance with the rules. Both qualitative and quantitative factors are to be considered when evaluating each threat's significance; these factors include the effect that existing safeguards have had in reducing the threat to an acceptable level. If, after evaluating the threat, the member concludes that a reasonable and informed third party who is aware of the relevant information would be likely to conclude that the threat does not adversely affect his or her compliance with the rules, the threat is at an acceptable level and no further evaluation of the threat is necessary.
- *Identify and apply safeguards.* If, after evaluating the significance of an identified threat, the member concludes that the threat is not at an acceptable level, he or she should apply safeguards to eliminate the threat or reduce it to an acceptable level. Professional judgment should be applied when determining the nature of the safeguards to be applied because differing circumstances can cause the effectiveness of safeguards to vary. Under certain circumstances, one safeguard may eliminate or reduce multiple threats whereas in other circumstances, multiple safeguards should be applied to eliminate or reduce one threat to an acceptable level. In some cases, an identified threat may be so significant that either (1) no safeguards will eliminate the threat or reduce it to an acceptable level, or (2) the member is unable to implement effective safeguards. In these circumstances, providing the specific professional services would compromise the member's compliance with the rules and he or she should decide whether to decline or discontinue providing the professional services. The code specifies that under certain circumstances no safeguards can reduce a threat to an acceptable level. In these circumstances, a member may not use the conceptual framework to overcome a prohibition or requirement contained in the code. For example, the code specifically refers to the "Integrity and Objectivity Rule" (ET sec. 1.100.001) that specifies that a member may not subordinate his or her professional judgment to others. Thus, a circumstance that would cause the member to subordinate his or her judgment to others is a threat that cannot be reduced to an acceptable level by any safeguards.

The threats that a forensic accountant can encounter include the adverse interest threat, advocacy threat, familiarity threat, management participation threat, self-interest threat, self-review threat, and undue interest threat.

The adverse interest threat is the threat that a member will not be objective because his or her interests are opposed to the client's interests. Examples of this type of threat include the situation in which the client has indicated that it desires to engage in litigation against the member.

The advocacy threat is the threat that the member will promote the client's position to such an extent that his or her objectivity or attest independence is compromised. These types of threats can occur when a member provides forensic accounting services to a client in litigation or a dispute with third parties.

A familiarity threat is the threat that a member will become too sympathetic to the client's interests or too accepting of the client's work or product as a result of a long or close relationship with a client. For example, a familiarity threat exists when a close friend of the member is employed by the client.

The management participation threat is the threat that a member will assume the role of management for the client or otherwise assume management responsibilities. This type of threat can occur if the member performs consulting services for the client and implements any improvements suggested to the client.

A self-interest threat is the threat that a member could benefit, financially or otherwise, from an interest in, or relationship with, a client or anyone associated with the client. An example of this type of threat is the possibility of losing a client that generates a large amount of revenue on which the member heavily relies.

The self-review threat is a threat that a member will not properly evaluate the results of a previous judgment made or service performed or supervised by the member (or an individual in the member's firm). This threat can also exist when a member relies on an inappropriately evaluated judgment or service when forming a judgment in another engagement. An example of this threat is the reliance, by a member, on the **work product** of the member's firm.

The undue influence threat is the threat that a member will subordinate his or her judgment to that of an individual (such as a client or any third party) as a result of the individual's reputation or expertise, aggressive or dominant personality, or attempts to coerce or exercise excessive influence over the member. Examples of the undue influence threats include the situation in which the client (or any individual associated with the client) threatens to dismiss the member's firm from the engagement if the member does not reach a certain judgment or conclusion.

Members are to closely monitor engagements and carefully assess proposed engagements to determine whether any of these threats exist. If one or more of these threats exist and is judged not to be at an acceptable level, the member is to apply appropriate safeguards, if possible, to reduce or eliminate the threat. If the threat cannot be eliminated or reduced to an acceptable level, the member should decline acceptance of the engagement or, if already involved in the engagement, dissociate him or herself from the engagement and consider whether to consult with an attorney.

Responses to Ethical Conflicts

"Ethical Conflicts" (ET sec. 1.000.020) states that

An ethical conflict arises when a member encounters one or both of the following:

- a. Obstacles to following an appropriate course of action due to internal or external pressures
- b. Conflicts in applying relevant professional standards or legal standards.

An example of an ethical conflict exists when a member suspects that fraud may have occurred, but the act of reporting the suspected fraud would violate the member's responsibility to maintain client confidentiality.

If an ethical conflict is encountered, the member is to consider relevant facts and circumstances and the rules, laws, or regulations that apply; the ethical issues involved; and established internal procedures that are to be followed to resolve the conflict. The member should then choose a course of action and take steps to comply with the rules and applicable laws.

The member should also be prepared to justify any departures from the code that the member believes were appropriate in applying the relevant rules and law. If the member is not able to resolve the ethical conflict by complying with the applicable rules and law, he or she may have to bear the consequences of violations.

Before choosing a course of action, the member should consider consulting with appropriate persons within the member's firm or organization. If he or she decides not to consult with appropriate persons within the firm or organization and, after following a course of action, the conflict remains, the member should consider requesting the advice of other individuals in resolving the ethical conflict or obtaining advice from an appropriate professional body (such as the AICPA) or legal counsel.

When members encounter ethical conflicts, they should consider documenting the substance of the issue that gave rise to the conflict, the parties with whom the issue was discussed, the details of discussions held, and any decisions made by the member.

If the ethical conflict remains unresolved, the member may have violated one or more rules, particularly if he or she continues to be associated with the issue that created the conflict. If this is the case, the member should consider whether to continue his or her relationship with the engagement team, the assignment in which the conflict arose, the client, the firm, or the employer organization.

Topics in the AICPA Code of Professional Conduct Most Applicable to Forensic Accountants

The topics that affect forensic accountants include integrity and objectivity, general standards, compliance with standards, acts discreditable, contingent fees, and confidential information. Each of these topics is subsequently discussed.

Integrity, Objectivity, and Conflicts of Interest

The “Integrity and Objectivity Rule” (ET sec. 1.100.001) states

[i]n the performance of any professional service, a member shall maintain objectivity and integrity, shall be free of conflicts of interest, and shall not knowingly misrepresent facts or subordinate his or her judgment to others.

Being objective is a state of mind. Objectivity requires that the member be impartial, intellectually honest, disinterested, and free from conflicts of interest. Maintaining integrity means to conduct oneself in accordance with an ethical code and not be affected by corrupting influences and motives.

Members are not to subordinate their judgment to others. Whereas attorneys are advocates of their clients, forensic accountants who serve as expert witnesses are advocates of their opinions and, as such, are to assist the court in understanding concepts that are either complex or unfamiliar, or both.

According to the “Conflicts of Interest” interpretation (ET sec. 1.110.010)

A member or his or her firm may be faced with a conflict of interest when performing a professional service. In determining whether a professional service, relationship or matter would result in a conflict of interest, a member should use professional judgment, taking into account whether a reasonable and informed third party who is aware of the relevant information would conclude that a conflict of interest exists.

This section provides many examples of situations in which a conflict of interest could exist, including the situation in which a plaintiff or plaintiff’s attorney requests that a member perform litigation services in connection with a lawsuit filed against a client of the member’s firm and the situation in which the member has provided tax or personal financial planning services to a married couple who is now divorcing and who wish the member to continue providing services to both parties.

Members should evaluate the significance of threats to objectivity to determine if they are at an acceptable level. If the member determines that the threats are so significant that no safeguards could eliminate or reduce the threat to an acceptable level (that is, the member’s objectivity is impaired), the member should either (1) not perform the service or (2) terminate the relationships that cause the conflict.

A member may perform the service if the threats are not significant or can be reduced to an acceptable level by applying safeguards. Threats to objectivity would be at an acceptable level and thus objectivity would not be impaired if both of the following safeguards exist before performing the service:

- a. The member provides notification to the client or other appropriate parties of the relevant facts and circumstances.
- b. The member obtains consent from the client or other appropriate parties to perform the service. If these parties refuse to give their consent, the member should either (1) not perform the service or (2) terminate the relationships that cause the conflict.⁴

⁴ This section points out that some engagements (for example, audits, reviews, and other attest services) require independence and that disclosure and consent cannot eliminate impairments of independence discussed in the “Independence Rule” (ET sec. 1.200.01) and its interpretations.

The member should consider the guidance provided by the “Confidential Client Information Rule” (ET sec. 1.700.001) when providing notification to and obtaining consent from clients and other appropriate parties.⁵

General Standards

The “General Standards Rule” (ET sec. 1.300.001) states

[a] member shall comply with the following standards and with any interpretations thereof by bodies designated by Council.

- a. Professional Competence. Undertake only those professional services that the member or the member’s firm can reasonably expect to be completed with professional competence.
- b. Due Professional Care. Exercise **due professional care** in the performance of professional services.
- c. Planning and Supervision. Adequately plan and supervise the performance of professional services.
- d. Sufficient Relevant Data. Obtain sufficient relevant data to afford a reasonable basis for conclusions or recommendations in relation to any professional services performed.

Competence means that the member (and the member’s staff) has the appropriate qualifications to perform the professional services for which he or she has been engaged to perform and, when required, can appropriately supervise and evaluate the quality of work performed. The member is required to have knowledge of the profession’s standards, the techniques used, and the subject matter. Members are also to exercise sound judgment in applying this knowledge.

Although professional competence is a standard with which the member is expected to comply, the courts have instituted safeguards to determine whether practitioners are competent to testify. These safeguards arose principally from two court cases: *Daubert v. Merrill Dow Pharmaceuticals, Inc.*, 509 U.S. 579 (1993), and *Kumho Tire Company, Ltd. v. Patrick Carmichael*, 526 U.S. 137 (1999). Members are to determine whether they have the requisite knowledge and skills to provide relevant and reliable testimony in accordance with these court cases; if they do not, the court will likely bar them from testifying. The impact of these cases on forensic accountants engaged as expert witnesses is discussed in chapter 4, “Evidence,” and chapter 6, “Litigation Services.”

The requirement to exercise due professional care in the performance of professional services means that members are to be diligent when performing professional services and to engage in critical analysis of their work. Due professional care also requires conformity to applicable professional standards of the AICPA and the code.

Planning the engagement is essential to conducting an efficient and effective engagement. Planning involves formulating the objectives of the engagement and selecting the nature, timing, and extent of the procedures required to obtain and analyze evidence. It also provides the structure for the conduct, supervision, and completion of the engagement in a timely manner. Supervision of staff is important to ensure that the quality of the engagement meets professional standards. The extent of supervision necessary will depend on the number of assistants, their education, and training.

The member may need to engage other individuals who have the necessary training and experience to assist the member in completing the engagement in a competent manner. Any member who employs a specialist to perform consulting services for the member’s clients should be capable of defining the tasks, supervising, and evaluating the work (including the work product) of the specialist. Whether work is performed by assistants or specialists, the member is responsible for the quality of the work.

The member should obtain sufficient relevant data to provide a reasonable basis for conclusions or recommendations. Gathering this data is often accomplished by using procedures such as document reviews and background investigations, interviews of knowledgeable persons, use of confidential sources, analysis of physical and electronic evidence, physical and electronic surveillance, and ratio analysis. Some information is obtained through document production motions, depositions, and interrogatories by means of the legal process of discovery.

⁵ Such notification and consent as a safeguard could violate the “Confidential Client Information Rule” (ET sec. 1.700.001) in some instances. For example, a CPA firm has a husband and wife as tax clients, and one spouse’s lawyer contacts the accountant to analyze the couple’s net worth in connection with a possible divorce action that is unknown to the second spouse. Giving notification to the second spouse and seeking consent to perform this work may violate the rule on confidential information.

At times, forensic accountants rely heavily on documents as a source of relevant data. If the engagement has progressed to the point that a case is being prepared for trial, the documents that are most beneficial are those that have been authenticated by the litigants or are otherwise admissible by the court under the applicable rules of evidence, which can vary by jurisdiction.

Apart from obtaining the relevant documentation, the forensic accountant generally should document the work performed (including the source of documents relied upon) and the conclusions reached. The type, quantity, and content of the documentation are affected by several factors, including professional judgment and the nature of the engagement, and thus are to be tailored to the engagement itself. Also important are the documentation of the assumptions made by the practitioner, the source of information that provided the basis for the assumptions, and the reasoning used to arrive at the assumptions.

Documentation is not only the basis for the conclusions or recommendations made; it also supports the assertion that the member complied with professional standards when performing the engagement. Documentation that was essential in determining the conclusions or recommendations made should be retained for a sufficient period.

Compliance With Standards

According to the “Compliance With Standards Rule” (ET sec. 1.310.001)

[a] member who performs auditing, review, compilation, management consulting, tax, or other professional services shall comply with standards promulgated by bodies designated by Council.

The Forensic and Valuation Services Executive Committee is one of the principal bodies that promulgate standards for forensic accountants. It has the authority to issue professional standards that guide the practice of offering forensic and valuation services. There are, of course, standards issued by other AICPA bodies that affect the practice of forensic accounting, such as the following:

- Statements on Auditing Standards (SASs, codified as AU-C sections⁶)
- Statements on Standards for Attestation Engagements (SSAEs, codified as AT-C sections⁷) issued by the Auditing Standards Board
- Statements on Standards for Accounting and Review Services (SSARSs, codified as AR-C sections⁸) issued by the Accounting and Review Services Committee
- Statement on Standards for Consulting Services (SSCS, codified as a CS section) issued by the Consulting Services Executive Committee
- Statement on Standards for Valuation Services (SSVS, codified as a VS section) issued by the AICPA Consulting Services Executive Committee.

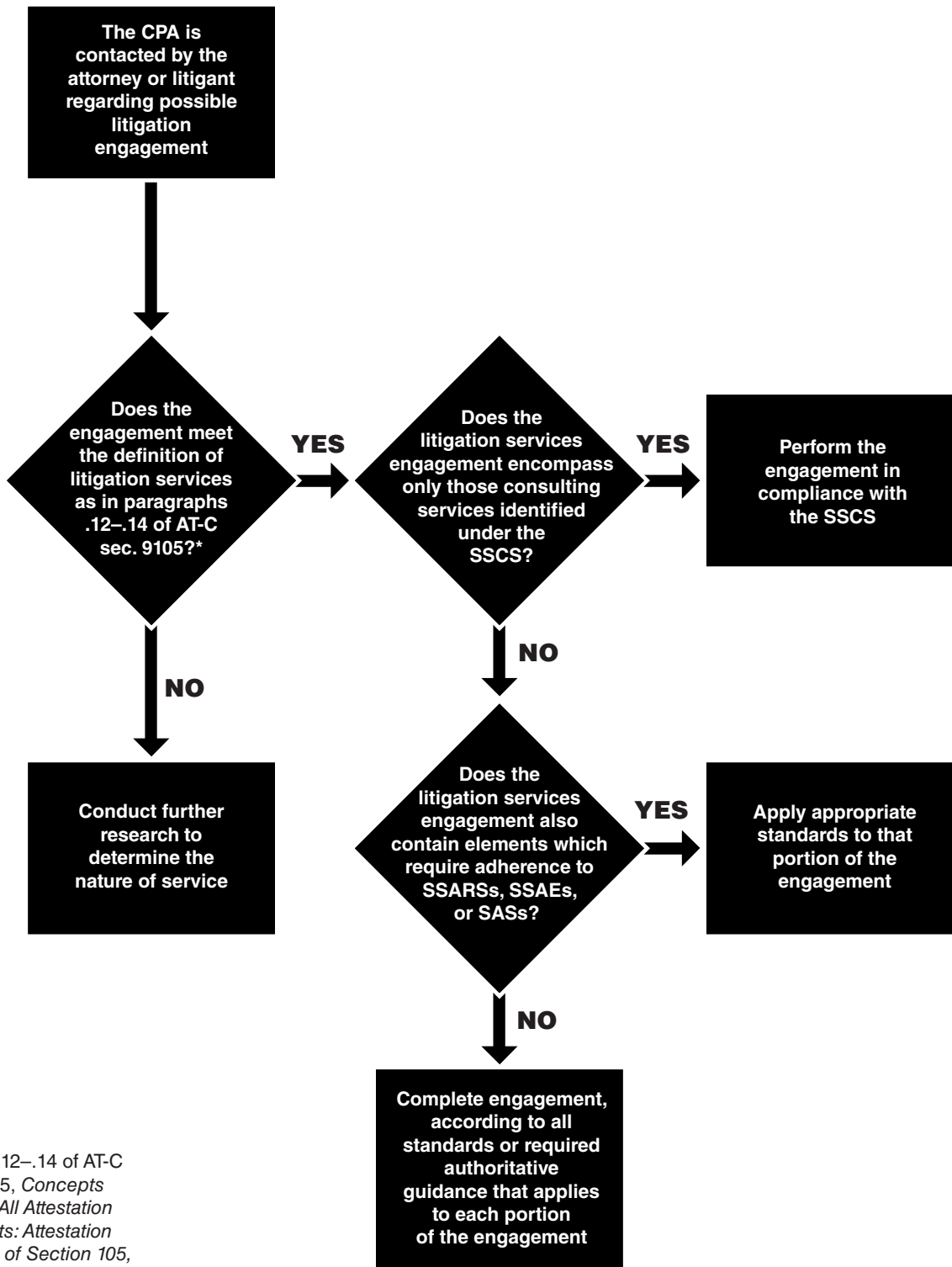
For example, the Code of Professional Conduct and relevant interpretations should be consulted if a member is determining whether the member’s independence would be impaired if he or she were to perform forensic and valuation services for an attestation client of his or her firm. See figure 2.2, “Decision Tree to Determine the Application of Professional Standards,” for a tool designed to assist members in determining which standards apply to litigation services engagements.

⁶ The “C” in AU-C, AT-C, and AR-C refers to clarified standards. When the AICPA redrafted (clarified) its auditing, attestation, and accounting and review standards, it chose to distinguish the clarified standards from extant standards by adding the symbol “C” to “AU,” “AT,” and “AR” (prior to clarification, auditing standards were codified as “AU”; attestation standards were codified as “AT”; and accounting and review standards were codified as “AR”).

⁷ *Ibid.*

⁸ *Ibid.*

Figure 2.2
Decision Tree to Determine the Application of Professional Standards



*Paragraphs .12-.14 of AT-C section 9105, *Concepts Common to All Attestation Engagements: Attestation Interpretations of Section 105*, in AICPA Professional Standards.

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Case in Point

In some cases, determination of the proper standard to use is dependent on a careful reading of the standards themselves. For example, assume that a forensic accountant (who is also a CPA) has been engaged by counsel representing the client to determine whether the client's computation of Allowance for Doubtful Accounts is, in all material respects, correct given assumptions provided by management.

Is this an agreed-upon procedures engagement? If so, AT-C section 215, *Agreed-Up Procedures Engagements*, applies. If, however, the determination is a part of a consulting engagement, CS section 100, *Consulting Services: Definitions and Standards*, applies. The type of service is determined by the agreement (usually contained in an engagement letter) between the CPA and client. Thus, if the parties agree that the CPA's work will be a consulting engagement, then the CPA's services are consulting services. Conversely, if the parties agree the CPA's work will be an agreed-upon procedures engagement, then the CPA's services are agreed-upon procedures. Engagement letters are very important and should clearly state the purpose of the engagement.

The following list illustrates several differences between a consulting engagement and an attestation engagement:

- A consulting engagement is usually conducted for the primary benefit of the client and need not result in a written report, whereas an agreed-upon procedures engagement is usually conducted for the benefit of persons or entities who did not create the subject matter being examined (for example, the balance of the Allowance for Doubtful Accounts), and a written report is required.
- A consulting engagement results in a presentation or statement that is usually those of the forensic accountant, whereas an agreed-upon procedures engagement results in a report containing findings that are the result of procedures agreed to by those to whom the report is addressed.
- Independence is not required for consulting engagements, whereas it is required for attestation engagements, such as an agreed-upon procedures engagement.

According to AICPA Bylaw (BL) section 220,⁹ *Requirements for Admission to Membership*, a person engaged in the practice of public accounting as an owner or as an employee who has been licensed as a CPA for more than two years may become a member of the AICPA if the person is practicing in a firm that is enrolled in an AICPA-approved practice-monitoring program (that is, **peer review**) if the services performed by such a firm are governed by SASs; SSARSs; SSAEs; *Government Auditing Standards* (the Yellow Book), issued by the U.S. General Accounting Office (GAO); and engagements under PCAOB standards. For example, persons who are practicing forensic accounting and who perform reviews subject to SSARS and who wish to be AICPA members must have their relevant practices peer reviewed. One objective of peer review is to determine whether the firm being peer-reviewed is in compliance with applicable standards.

Acts Discreditable

According to the "Acts Discreditable Rule" (ET sec. 1.400.001)

A member shall not commit an act discreditable to the profession.

Application of this simple rule depends partly on adherence to the various interpretations of this rule that exist. Selected interpretations that pertain to members who practice forensic accounting are discussed as follows:

- **Disclosure.** Disclosure of confidential information obtained from a prospective client or non-client without consent is considered an act discreditable under this rule.

⁹ All BL sections can be found in AICPA *Professional Standards*.

In addition, disclosure, without proper authority or specific consent, of confidential information pertaining to the member's current or previous employer or confidential information obtained about organizations for which the member works (or worked) as a volunteer is an act discreditable unless there is a legal or professional responsibility to use or disclose this information. For purposes of this rule, confidential employer information is any proprietary information pertaining to the employer or any entity for which the member works (or worked) in a volunteer capacity obtained as a result of these relationships and which is not available to the public.

- *False promotion, misleading, or deceptive behavior.* Also considered an act discreditable is falsely promoting a member's abilities to provide professional services; engaging in misleading or deceptive behavior; or making false, misleading, or deceptive claims about the member's experience or qualifications. Efforts are false, misleading, or deceptive if they contain any claim or representation that is likely to cause a reasonable person to be misled or deceived.
- *Compliance with rules and regulations of authoritative regulatory bodies.* Members must comply with the rules and regulations of authoritative regulatory bodies (for example, state boards of accountancy) when subject to these rules and regulations. To not comply is an act discreditable.
- *Retention of records.* Members are to, at the client's request, return records that the client provided and which are in the member's custody or under his or her control. A member need not comply with a second request for the return of client records if the member complied with the client's initial request unless the client lost the records due to a natural disaster. The member may make copies of any client-prepared records he or she returned but must return the records within a reasonable period of time, if practicable (for example, no later than 45 days after the request has been made). Even if the state in which the member practices allows the member to place a lien on records under his or her control, the member must comply with the interpretations of the "Acts Discreditable Rule" (ET sec. 1.400.001).

Although the member's work papers are the member's property, if the client requests these records related to work the member has completed and for which the work product has been issued to the client, the member should comply with the client's request. If, however, the member has not been paid for the work product to which the member-prepared materials pertain, these records may be withheld. Members may also not comply with a client's request for member-prepared materials if the work product is incomplete, the noncompliance is for the purpose of complying with professional standards, or if actual or threatened litigation exists related to the engagement or member's work.

When providing copies of client-prepared or member-prepared materials or the member's work product, the member may charge the client a reasonable fee and require that the client pay the fee prior to providing the materials or work product to the client. The member may provide the requested records in any format usable by the client, but is not required to convert records to electronic format if they are not in electronic format. If the client requests records in a specific format and the records are available in the requested format, the member should honor the client's request. The member is not required to provide the client with formulas, unless the formulas support the client's underlying accounting or other records or the member was engaged to provide the formulas as part of a completed work product.

Contingent Fees

The "Contingent Fee Rule" (ET sec. 1.510.001) states

[a] member in public practice shall not

a. Perform for a contingent fee any professional services for, or receive such a fee from a client for whom the member or the member's firm performs,

i. an audit or review of a financial statement; or

ii. a compilation of a financial statement when the member expects, or reasonably might expect, that a third party will use the financial statement and the member's compilation report does not disclose a lack of independence; or

iii. an examination of prospective financial information; or

b. Prepare an original or amended tax return or claim for a tax refund for a contingent fee for any client.

The prohibition stated in this section applies during the period in which the member performs a service and the periods covered by any financial statements referred to in the preceding paragraphs. Note that if the member does not perform any of the services previously listed, he or she is allowed to perform a service for a contingent fee.

A contingent fee is defined as a fee for the performance of any service under an agreement that stipulates that no fee will be charged unless a specified finding or result is attained or that the amount of the fee is dependent on the finding or result of the service. For purposes of the “Contingent Fee Rule,” fees are not considered contingent if fixed by courts or other public authorities; in tax matters, fees are not contingent if based on the results of judicial proceedings or if based on the findings of governmental agencies if the member can demonstrate that, at the time of the fee arrangement, he or she reasonably expected that a government agency would substantively consider the subject matter.

Nothing in the prohibition against the acceptance of a contingent fee would preclude a member from charging a fee (either fixed or hourly) that is dependent on the complexity of services performed. Therefore, a higher hourly fee may be charged for services that are more complex than are other services.



Case in Point

A member has been engaged by company X (a nonpublic company) to perform forensic accounting services in connection with a proposed acquisition of company Y. Specifically, the member has been asked to determine whether any indications of fraud (that is, red flags) appear to be associated with company Y (also a nonpublic company). The member charges a fee that is contingent upon whether the acquisition occurs. If the member then performs a compilation for company X, and reasonably expects that the compiled financial statements will be used by third parties, he or she must disclose in the compilation report that he or she is not independent with respect to company X.

Confidential Information

The “Confidential Client Information Rule” (ET sec. 1.700.001.01) states

[a] member in public practice shall not disclose any confidential client information without the specific consent of the client.

This confidentiality rule cannot be used to relieve a member of certain obligations. These include the member’s obligation to

- a. adhere to the Compliance With Standards Rule (1.310.001) or the Accounting Principles Rule (1.320.001);
- b. comply with a validly issued and enforceable subpoena or summons and to comply with applicable laws and government regulations;
- c. submit to a review of his or her professional practice under AICPA or state CPA society or Board of Accountancy authorization; and
- d. initiate a complaint with, or respond to any inquiry made by, the professional ethics division or trial board of the AICPA or an authorized investigative or disciplinary body of a state CPA society or Board of Accountancy.

In addition, information to which the member is privy as a result of being involved with a review or disciplinary matter of another member is not to be used for personal advantage (exchanging information in connection with investigative or disciplinary proceedings is not considered using information for personal advantage).

The “Confidential Client Information Rule” is a very important rule in the practice of forensic accounting. The forensic accountant is not to divulge any confidential information—including prior experiences that may be helpful to the court—that would disclose confidential client information of parties that are not involved in the case presently before the court. The forensic accountant should be wary; if he or she bases his or her opinion on prior experiences gained from work performed for individuals or organizations that are not involved in the present case, the court may require that the source of the basis for opinion be disclosed. If the forensic accountant refuses to divulge the source, the testimony of the forensic accountant may be excluded from evidence. If the forensic accountant obtains the consent of the individuals or organizations for which the work was performed, the source may be disclosed and the testimony accepted into evidence.



Case in Point

In some cases, the fact that the forensic accountant performed services for a party may be confidential. For example, assume that four years ago one spouse considered divorcing the other and hired a forensic accountant to perform investigative services such as background checks and financial analyses of the couple's net worth. Further assume that the spouse who was considering divorce decided to abandon the idea of divorce and had the forensic accountant sign an agreement stating that she would not divulge the fact that she had performed work related to the anticipated divorce.

In this case, the relationship between the spouse who considered the divorce and the forensic accountant is considered confidential information. If the forensic accountant is later approached by the other spouse to perform financial analyses for the couple due to a renewed interest in divorce, the forensic accountant may decide not to accept the engagement because of the possibility that her prior work relationship might be subject to disclosure. If, however, the spouse for whom the forensic accountant performed the earlier work consents to allow the forensic accountant to reveal the former work relationship, the forensic accountant could accept the engagement without violating the "Confidential Client Information Rule" (ET sec. 1.700.001.01).

The confidentiality rule extends to confidential information obtained from nonclients. According to the "Use of Confidential Information From Nonclient Sources" interpretation (ET sec. 1.400.240)

"[i]f a *member* discloses confidential information obtained from a prospective *client* or nonclient without consent, the *member* would be in violation of the 'Acts Discreditable Rule' [1.400.001]."

Other Sections That May Be Applicable

Although the sections of the code previously discussed are those most directly related to the practice of forensic accounting, other sections such as those discussed in the following section, may also affect the practice of forensic accounting.

Independence

The "Independence Rule" and the "Conceptual Framework for Independence" (ET sec. 1.210.010) may be applicable if the member is considering whether to perform litigation services, such as forensic accounting, for an attest client.

The "Independence Rule" (ET sec. 1.200.001) states

[a] member in public practice shall be independent in the performance of professional services as required by standards promulgated by bodies designated by Council.

If the client is a company that is required to register and file reports under the securities acts, the Sarbanes-Oxley Act of 2002 may preclude the member from offering litigation services to that client.

Related to the issue of independence, the "Forensic Accounting," interpretation (ET sec. 1.295.140) defines (for purposes of this independence interpretation) forensic accounting and states that forensic accounting services are made up of investigative services and litigation services (which are further categorized as **expert witness services** and **fact witness services**). This interpretation also defines investigative services, litigation services, and **litigation consulting services**, and discusses the threats to the independence of a **covered member** and whether they are at an acceptable level when performing these services. See box 2.5, "Forensic Accounting Services and Threats to Independence," for a summary of these threats and safeguards that can be applied to reduce the effect of these threats.

The interpretation also states that when a law firm engages a member on behalf of the member's attest client and the law firm is also an attest client of the member, the member should consider the applicability of the "Cooperative Arrangements With Attest Clients" interpretation (ET sec. 1.265.010). The "Cooperative Arrangements With Attest Clients" interpretation defines cooperative arrangements with attest clients as a business activity in which a member (or his or her firm) and an attest client jointly participate. If a cooperative arrangement does exist, independence may be impaired by operation of the self-interest, familiarity, and undue influence threats. These threats to compliance with the "Independence Rule" (ET sec. 1.200.001) would not be at an acceptable level and could not be reduced to an

acceptable level by safeguards if, during the period of the professional engagement, the cooperative arrangement is material to the CPA firm or the attest client. As a result, independence would be impaired.

Examples of cooperative arrangements include the existence of prime and subcontractor arrangements to provide services or products to a third party, joint ventures to develop or market products or services, and agreements to combine one or more of the CPA firm's services or products with one or more of the attest client's services or products and market the package by referring to both the CPA firm and the attest client.

However, a cooperative arrangement does not exist when all of the following safeguards are met:

- a. The firm's and attest client's participation are governed by separate agreements, arrangements, or understandings that create no rights or obligations between the firm and attest client.
- b. Neither the firm nor the attest client assumes responsibility for the other's activities or results.
- c. Neither party has the authority to act as the representative or agent of the other party.

Advertising

If a member chooses to advertise his or her services as a forensic accountant, the member is required to comply with the "Advertising and Other Forms of Solicitation Rule" (ET sec. 1.600.01).

The "Advertising and Other Forms of Solicitation Rule" states that

[a] member in public practice shall not seek to obtain clients by advertising or other forms of solicitation in a manner that is false, misleading, or deceptive. Solicitation by the use of coercion, over-reaching, or harassing conduct is prohibited.

The "False, Misleading, or Deceptive Acts in Advertising or Solicitations" interpretation (ET sec. 1.600.010) states that promotional efforts would be considered false, misleading, and deceptive if they

- a. create false or unjustified expectations of favorable results.
- b. imply the ability to influence any court, tribunal, regulatory agency, or similar body or official.
- c. contain a representation that the member will perform specific professional services in current or future periods for a stated fee, estimated fee, or fee range when it was likely at the time of the representation that such fees would be substantially increased and the member failed to advise the prospective client of that likelihood.
- d. contain any other representations that would be likely to cause a reasonable person to misunderstand or be deceived.

Box 2.5

Forensic Accounting Services and Threats to Independence

Type of Forensic Accounting Non-Attest Service	Threats to Covered Member's Compliance With Independence Rule and Safeguards, If Any, That Can Be Applied to Reduce Their Effects
Investigative services	<p>Self-review and management participation threats may exist.</p> <p>If the member applies the following safeguards (found in the "General Requirements for Performing Nonattest Services" interpretation [ET sec. 1.295.040]), the threats are at an acceptable level and independence is not impaired:</p> <ol style="list-style-type: none"> a. The attest client and its management agree to <ol style="list-style-type: none"> i. assume all management responsibilities. ii. appoint an individual, preferably within senior management, who possesses suitable skill, knowledge, or experience to oversee the service. iii. evaluate the adequacy and results of the services performed. iv. accept responsibility for the results of the services. b. The member does not assume management responsibilities and the attest client and its management will <ol style="list-style-type: none"> i. meet the conditions specified in item (a). ii. make an informed judgment on the results of the member's non-attest services. iii. accept responsibility for making significant judgments and decisions that are the responsibility of management.

(continued)

Box 2.5**Forensic Accounting Services and Threats to Independence (continued)**

Type of Forensic Accounting Non-Attest Service	Threats to Covered Member's Compliance With Independence Rule and Safeguards, If Any, That Can Be Applied to Reduce Their Effects
Investigative services (continued)	<p>(If the attest client is unable or unwilling to assume the responsibilities enumerated in items (a) and (b), the member's performance of non-attest services would impair independence.)</p> <p>c. Before performing non-attest services, the member establishes and documents (in writing) his or her understanding with the attest client, including</p> <ul style="list-style-type: none"> i. objectives of the engagement, ii. services to be performed, iii. attest client's acceptance of its responsibilities, iv. member's responsibilities, and v. any limitations of the engagement. <p>(The preceding safeguards do not apply to certain activities performed by the member, such as providing advice and responding to the attest client's questions as part of the client-member relationship. Also, the member is not to not assume management responsibilities in these circumstances.)</p>
Litigation services	<p><i>Expert witness services:</i> The advocacy threat exists.</p> <p>The advocacy threat would not be at an acceptable level and could not be reduced to an acceptable level by the use of safeguards. As a result, if a member is engaged (conditionally or unconditionally) to provide expert witness services or expert testimony for an attest client, independence would be impaired unless the member provides expert witness services for a large group of plaintiffs or defendants that includes one or more attest clients of the firm and if, from the beginning of the engagement to testify,</p> <ul style="list-style-type: none"> 1. the member's attest clients represent less than 20 percent of the members of the group, voting interests of the group, and the claim; 2. no attest client within the group is named as the lead plaintiff or defendant of the group; and 3. no attest client has the sole decision-making power to select or approve the selection of the expert witness.
Litigation service	<p><i>Fact witness services:</i> No threats to compliance would exist because acting as a fact witness is not considered a non-attest service. Therefore, serving as a fact witness would not impair the member's independence.</p> <p>(To determine whether the service is an expert witness or fact witness service, members can consult Rules 701–703 of Article VII, Opinions and Expert Testimony, of the Federal Rules of Evidence and all other applicable laws, regulations, and rules.)</p>
Litigation consulting services	<p>The advocacy and management participation threats may exist.</p> <p>If the member applies the safeguards discussed under "Investigative Services," these threats would be at an acceptable level and independence would not be impaired (instead of designating an appropriate individual such as a person from senior management to oversee the engagement, the attest client may designate its attorney to oversee the litigation consulting services).</p>

Box 2.5**Forensic Accounting Services and Threats to Independence**

Type of Forensic Accounting Non-Attest Service	Threats to Covered Member's Compliance With Independence Rule and Safeguards, If Any, That Can Be Applied to Reduce Their Effects
Other litigation services	<p>The advocacy threat exists if a member serves as a trier of fact, a special master, a court-appointed expert, or an arbitrator (including serving on an arbitration panel) in a matter that involves an attest client. This threat is not at an acceptable level and thus would impair the independence of a member with respect to an attest client.</p> <p>However, if the member applies the safeguards discussed under "Investigative Services," these threats would be at an acceptable level and independence would not be impaired when a member serves as a mediator or any similar role in a matter that involves an attest client as long as the member does not make any decisions on behalf of the parties and is acting only as a facilitator by assisting the parties in reaching their own agreement. The member should also consider the requirements of the "Conflicts of Interest for Members in Public Practice" interpretation (ET sec. 1.110.010) of the "Integrity and Objectivity Rule" (ET sec. 1.100.001).</p>

Therefore, a forensic accountant should not promote himself or herself in a manner that fosters a misunderstanding in the minds of reasonable persons. Note that false, misleading, and deceptive efforts of promotion are considered discreditable acts under the "Acts Discreditable Rule."

Disciplinary Procedures

Potential disciplinary matters are investigated by the PEEC of the AICPA Ethics Division. Deliberations by the PEEC will result in one of three possible conclusions:

1. No prima facie evidence of a violation of the code
2. Prima facie evidence of a violation of the code
3. The member has failed to cooperate with the committee in its investigation of the member

If no prima facie evidence of a violation of the code is found, the matter is closed. If a violation is found, the PEEC determines whether it will offer a settlement to the member (which is published), issue a confidential letter of corrective action (for example, a specified number of continuing professional education [CPE] hours in a specific area) that is required of the member, or to present the case before the Joint Trial Board (board). If the member rejects the offer of settlement, the PEEC may refer the matter to the board for a hearing.

The board hears and determines disciplinary action for violations of the bylaws and ethics codes of the AICPA and some state CPA societies (see "State CPA Societies"). It comprises at least 36 members; at least 3 members of the 36 are from each of the 12 regions of the United States. Disciplinary hearings are conducted by a panel of at least 5 members of the board.

Members who have allegedly violated the AICPA bylaws or code and whose case has been referred to the board may, but are not required to, appear before the board with counsel and may produce witnesses. There is an established procedure of notification so that the member is apprised of scheduled hearings.

Decisions the panel can make include acts to

1. expel the member from membership in the AICPA (and his or her state society);¹⁰
2. suspend the member from membership in the AICPA (and his or her state society)¹¹ for a period of up to two years;
3. admonish the member; or
4. take additional action, such as requiring the member to complete specific CPE courses, submit a work product for review, or supply a pre-issuance review of engagements.

¹⁰ This is true if the state society is a member of the Joint Ethics Enforcement Program (JEEP) discussed under "State CPA Societies"; if the state CPA society is not a member of JEEP, it makes its own determination of whether its members are to be expelled, suspended, admonished, or required to engage in corrective action.

¹¹ *Ibid.*