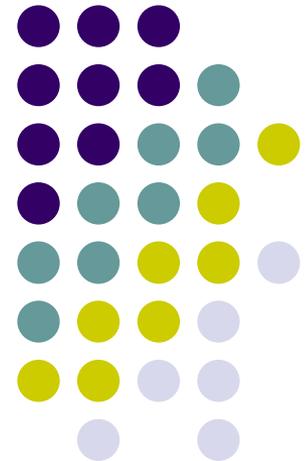


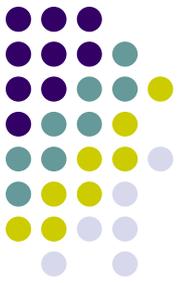
# What Attorneys Should Know About Forensic Accountants

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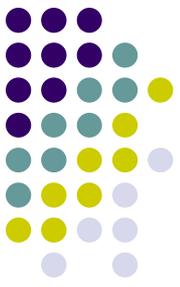
Presented by Brian A. Sullivan CPA/ABV  
177 Bovet Road Sixth Floor  
San Mateo, CA 94402  
Tel#: 650.548.1120  
Cell#: 650.703.3030  
E-mail: [brian@sullivanco.net](mailto:brian@sullivanco.net)



# What We Are Going to Talk About



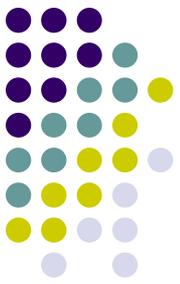
- What is Forensic Accounting/What Forensic Accountants Do
- Examples of Forensic Accounting Cases
- Skills Forensic Accountants Use to Help Litigators
- Things Attorneys Should Look For in Forensic Accounting Expert Witnesses
- References & Acknowledgements



# What is Forensic Accounting

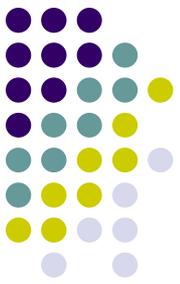
- ❑ Forensic accounting is a very specific area of accountancy which deals with disputes and litigation.
- ❑ The term “forensic” means that the findings of this type of accounting are suitable to use in a court of law.
- ❑ Forensic accountants are also called ***forensic auditors*** or ***investigative auditors*** and they are responsible for giving their expert evidence within a trial.
- ❑ Examples:
  - ❖ Could be an owner of a company who thinks that his bookkeeper might be embezzling money from him, or;
  - ❖ a government employee looking to prove that a corporation has been money laundering.
  - ❖ They might also be asked to assist in cases related to marital and family law, business valuation, bankruptcy, economic damages calculations and much more.

# 5 situations where counsel can benefit from hiring forensic accountants

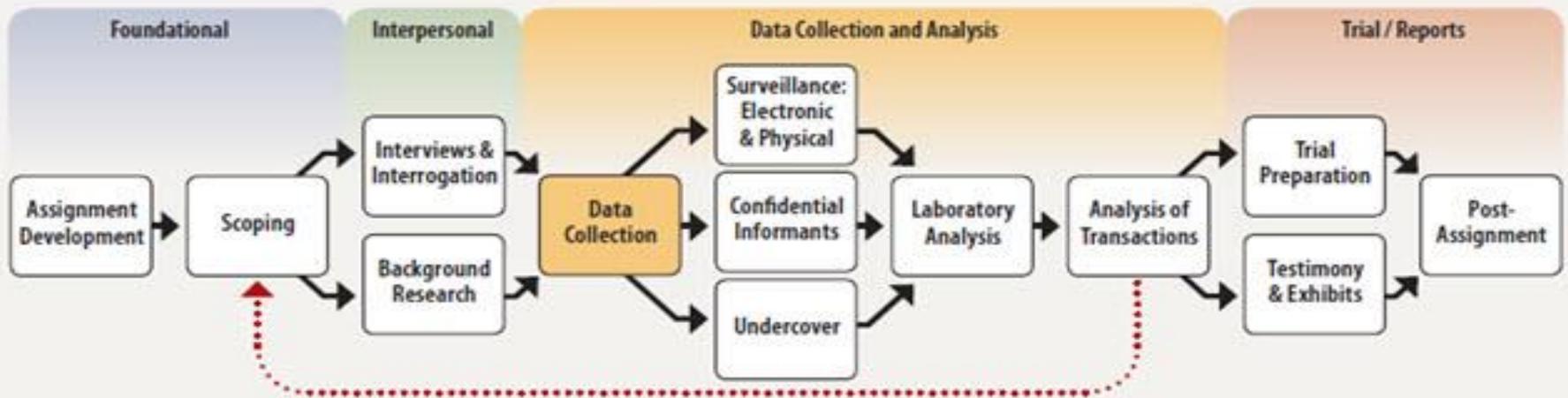


- ❑ **Foundational:** provide assistance in the case development and discovery stages and assist in defining the financial framework of the case. Assess the quality of the documents in determining what might be relevant
- ❑ **Interpersonal:** conduct interviews to aid in the planning and execution of case data collection, and perform background research on the people and entities relevant to the matter.
- ❑ **Data Collection & Analysis:** accumulate the data, and marshal the necessary tasks to either support or refute the legal theories presented. If requested, assist in any hearings, conferences and settlement negotiations
- ❑ **Expert report & trial:** aggregate all of the forensic accountant's conclusions during the assignment, followed by the submission of an expert report and possibly testify at deposition or trial. If requested by the attorney, the forensic accountant can critique the opposing expert's report
- ❑ **Testifying v Non-Testifying Expert:** Disclosure rules apply and depending on the circumstances could be invaluable benefit to counsel preparing for trial

# Forensic Accounting Investigation Methodology



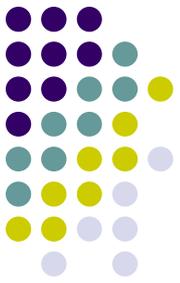
## Forensic Accounting Investigation Methodology® (FAIM®) Process Map



The Forensic Accounting Investigation Methodology® (FAIM®) Process Map is a comprehensive "Body of Knowledge" that contains 300+ specific forensic accounting/financial forensics tools, techniques, methods, and methodologies. FAIM's Process Map is continually updated as current and new forensic tools and techniques are formalized.

FAIM's foundation is an Internet app, i.e., a user-interactive Process Map containing context-sensitive embedded hyperlinks to numerous tools that are instantly accessible to the user. The Process Map approach is used to illustrate the application of forensic accounting tools, techniques, methods, and methodologies to all aspects of valuation, auditing, litigation and fraud professional

services, and consulting engagements. FAIM's contents cover virtually all practice areas likely to be encountered by CPAs, non-CPAs, analysts, etc. Individuals accessing the FAIM® Process Map are armed immediately with usable and practical tools and techniques.



# What Forensic Accountants Do



## Fraud Investigation

“Developing evidence that someone has by deceit, trickery, or evil intent deprived another of property or rights.”



## Litigation Support

Like solving a financial puzzle.  
Hired by Judges, Attorneys, or Individuals.



## Business Valuation

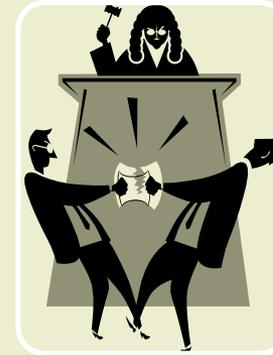
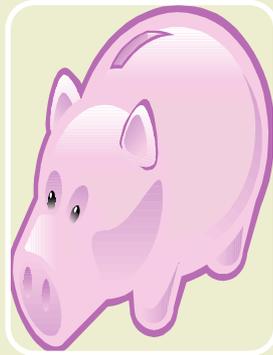
Essential Skill for many types of Forensic work.



## Marital Dissolution

Divorce.  
Could work for “In-Spouse”, “Out-Spouse”, or as Neutral Expert.

# What Forensic Accountants Do (Cont.)



## Damage Studies

Measure and Testify on Damages

## Bankruptcy

Fraud  
Financial Reorganization  
Liquidation

## Shareholder Disputes

Company Dissolution  
- Buy-Sell Agreements  
- Valuation of Company or Shareholder Interest  
Mismanagement

## Partnership/ LLC Dissolution

Valuation of Partnership and/or Membership Interest  
Embezzlement

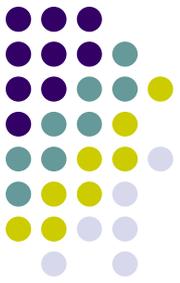
## Financial Audits

Think there might be fraud? Need help with a goodwill impairment test? Forensic to the Rescue!



# Forensic Accounting vs. Auditing

	<b>Forensic Accounting</b>	<b>Financial Statement Audit</b>
Scope of Work	Examination of financial data related to one or more specific allegations	Examination of overall financial statements and associated disclosures
Purpose	Determine if alleged acts occurred and/or assess alleged damages	Express an overall opinion of financial statement compliance with GAAG
Techniques Employed	Random Sampling; confirmation; tracing; investigative interviews; detailed review of records	Audit Sampling; testing; confirmation; reconciliation; materiality assessment



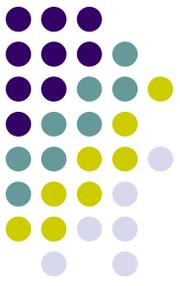
# How to critique financial statements

- ❑ How well do the financial statements represent the business.
  
- ❑ Three categories of analysis commonly used
  - ❑ Indirect Methods
  - ❑ Direct Methods
  - ❑ Comprehensive Methods



# Documents/Information Reviewed

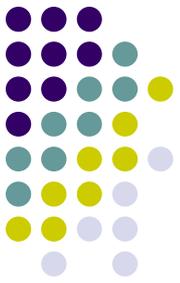
- ❖ Accounting Ledgers & Chart of Accounts
- ❖ Periodic Financial Statements (Internal & External)
- ❖ Tax Returns
- ❖ Sales Journals, Ledgers and Reports
- ❖ Underlying Accounting Records (e.g. invoices, checks, purchase orders)
- ❖ Bank Statements
- ❖ Capital Budgeting Requests/Approvals
- ❖ Budgets, Forecasts and Business Plans
- ❖ Prospectuses
- ❖ Sales Opportunity Management System
- ❖ Requests for Proposals/Quotations
- ❖ Analyst/Media Reports
- ❖ SEC Filings
- ❖ Bankruptcy Filings & Reports
- ❖ Valuations for Acquisitions
- ❖ Valuations for Goodwill Impairment



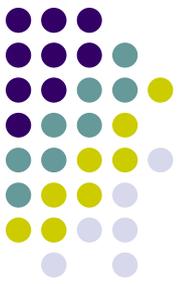
# Indirect Methods

- Compare key accounts on a year-to-year basis
- Advantage of indirect methods allow for more intensive investigation to be time-effective use of resources
- Disadvantage of indirect methods may lack specificity to support conclusions and may necessitate the need for further inquiry

# Financial Status Audit Techniques (FSAT)



- ❑ FSAT – Financial Status Audit Techniques (aka “Indirect Methods”)
  
- ❑ Indirect Methods are appropriate when the litigant books & records are missing, incomplete or irregularities are identified
  
- ❑ 5 Indirect Methods
  - Source & Application of Funds Method
  - Bank Deposit & Cash Expenditures Method
  - Markup Method
  - Unit & Volume Method
  - Net Worth Method



# Direct Methods

- ❑ **Horizontal Analysis** – compare key account categories over time
- ❑ **Vertical Analysis** – compare relative size of accounts over time
- ❑ **Trending Analysis** – compare rate of growth
- ❑ **Common-Sizing** – convert f/s to % of rev or total assets.
- ❑ **Ratio Analysis** – measures liquidity profitability turnover leverage, etc
- ❑ **Visual Testing** – visually examine relationships within the financial statements
- ❑ **Drill Down** – applying software tools to drill down from highest to lowest transaction levels
- ❑ **Statistical Analysis** – Mathematical tools used to sample data technique
- ❑ **Benford's Law** – Mathematical technique used to indicate the truthfulness of the numbers



# Famous Forensic Accounting Cases

- Al Capone Income Tax Evasion
- Sir Paul McCartney & Heather Mills Divorce
- Robert Maxwell's Embezzlement
- OJ Simpson's Millions
- Bernie Madoff Ponzi Scheme

# Al Capone - Income Tax Evasion



Al Capone was one of the most legendary gangsters of the 1920s and 1930s and he was able to avoid being caught by many of the best FBI agents & detectives of the day. However, the famous gangster was finally brought down by an accountant.

In 1931, a forensic accountant brought down Al Capone in 1931 by uncovering his tax evasion. The IRS tracked all of the earnings that Capone brought in from his illegal activities and then put together a compelling evidence that showed he did not report for income tax purposes.



# Sir Paul McCartney & Heather Mills – Family Law

When this famous couple divorced, there was a dispute over how much money the former Beatle was actually worth. He claimed to be worth approximately £400 million, however according to Heather Mills she thought he was worth a lot more – around £800 million. She hired a team of forensic accountants to investigate his assets, so that she could prove that she was correct.

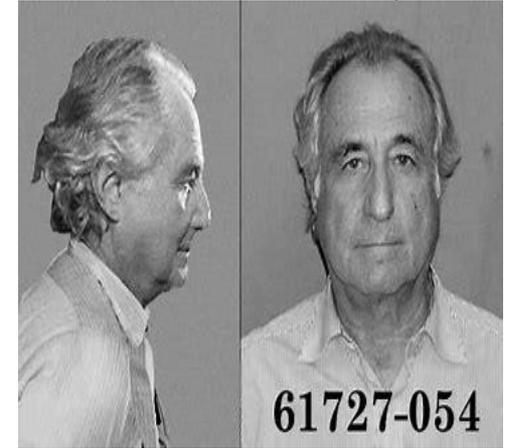
However, the judge accepted that McCartney's assets were £450 million rather than £800 million and Heather Mills was eventually awarded a lump sum of £16.5 million.





# Bernie Madoff – Ponzi Scheme

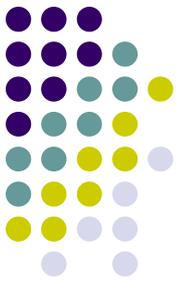
Forensic accountants have been hired by actress Zsa Zsa Gabor, who wants them to track as much as \$10 million that her lawyer says she lost to Madoff, the Wall Street Journal Reported.



# Robert Maxwell

## \$1 Billion Embezzlement

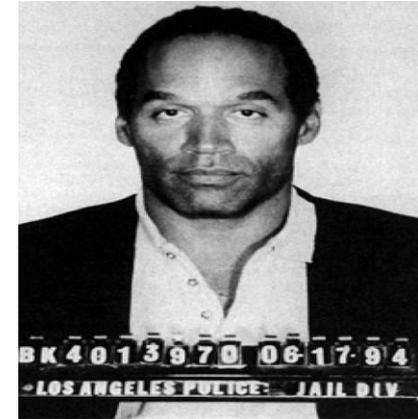
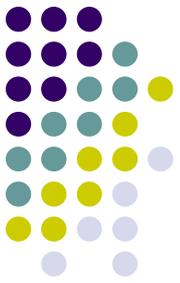
Robert Maxwell, European publisher, had been embezzling funds from shareholders, clients and more for years when he died in 1991. As soon as he passed away, his entire company started to crumble as it was mostly built on deceit and lies and the games he had played with funding and loans. A team of forensic accountants spent 14 years figuring out the entire mess and discovered that Maxwell had embezzled approximately \$1 billion.

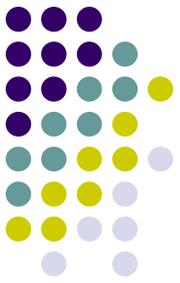


# OJ Simpson's Millions

After O.J. Simpson received a verdict of not guilty, the families of his victims attempted to file a civil suit in order to get financial compensation. O.J. claimed that he was broke and had no money to give to the civil suit. However, forensic accountants investigated his finances and found that he was hiding away millions. The families of the victims were able to receive a \$33 million settlement.

These are just a few examples of cases in which forensic accounting played a very important role. Forensic accountants are experts in investigating deep into every situation, looking where others didn't think to look and meticulously tracking expenses, taxes and other important details. Most people would overlook these little details, but the forensic accountant knows that it's their job to spot them. When these small details can affect the outcome of a course case and ultimately, the lives of others, they can be very important!

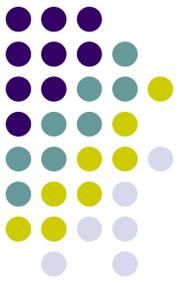




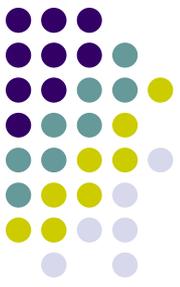
# Federal Rules of Evidence – What Every Expert Witness Needs to Know

- The Federal Rules of Evidence cover both criminal and civil US Court proceedings
- designed and are amended to ensure fairness in judicial administration,
- reduce or eliminate unjustifiable delay and expense, and
- promote the growth and development of the law of evidence so that truth may be ascertained and proceedings justly resolved.

# Application of Federal Rules of Evidence to Forensic Experts



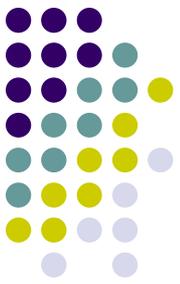
- Opinions must be disclosed in an oral or written report.
  - ❑ The basis for all opinions must be identified.
  - ❑ The report must include a list of information that was considered in forming the opinions and exhibits used as supporting documentation for the opinions.
  - ❑ Qualifications including articles written for publication and history of expert witness testimony must be listed (prior 4 years)



## Which Accounting Specialist Suits the Needs of the Case?

Will vary by the focus of the case; standard accountant; CPA; fraud examiner; an auditor; and an accounting IT specialist; professor/academic and others.

- Speak as to what the standard job duties and responsibilities of an accounting position are;
- Provide an understanding of Generally Accepted Accounting Principles (GAAP) or other definitions in the field;
- Give documented past case evidence of accounting fraud;
- Explain how an inside or outside auditor may initially discover potential fraud; or;
- Give examples and explanations of how accounting software and other IT tools may be used to commit fraud.

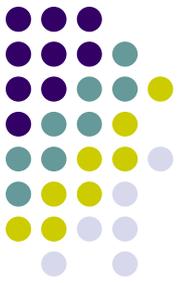


# How Can Legal Team Use Their Experts

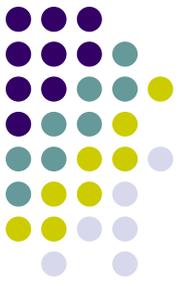
## Non-Testifying vs. Testifying Witnesses

- ❑ The differences are critical in how the expert is utilized and how the court does or does not provide protection.
- ❑ A non-testifying expert's opinions are considered work product, typically protected by attorney/client privilege
- ❑ The preparation of a fraud case may rely in great part on this expert

# Effective Use of Non-Testifying Experts (attorney client privilege protected)



- ❑ The preparation of a fraud case the non-testifying witness may assist counsel:
  - ✓ Provide counsel with an evaluation of the case
  - ✓ Assist in planning strategy.
  - ✓ Search, obtain, examine and evaluate evidence.
  - ✓ Interview witnesses and potential witnesses.
  - ✓ Explain developments in the case as the original theory may become altered by discovered evidence.
  - ✓ Assist in pre-trial motions, pleadings and responses.
  - ✓ Attend trials and assist counsel in unexpected changes during trial, thereby being able to assist in cross examination of the opposing parties witnesses and alert counsel to inconsistent testimony.
  - ✓ Take notes and conduct investigations during the trial.



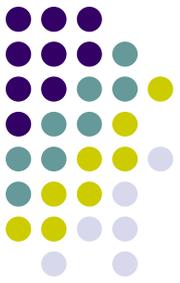
# Effective Use of Testifying Experts (not protected by attorney client privilege)

- ❑ Testifying expert is not protected by attorney/client privilege and the expert's identity and most if not all documents used to prepare the testimony may become discoverable.
- ❑ Opposing counsel would be aware of proposed testifying witnesses and would likely counter with their own witnesses with opposing expert opinions.
- ❑ These “testifying” experts must satisfy the requirements of Federal Rule of Evidence 702
- ❑ A qualified expert may testify and give his/her expert opinion if:
  - the testimony is based upon sufficient facts or data;
  - the testimony is the product of reliable principles and methods; and
  - the witness has applied the principles and methods reliably to the facts of the case

# Marriage of Honer (2015)

## 236 Cal App 4<sup>th</sup> 687

### What the Court Said About Expert Reports



✓ A credible expert seeks to minimize or prioritize differences with the opposing expert, if given the opportunity. This saves court time and helps attorneys focus their respective case presentations.

✓ A credible expert seeks to steer attorneys and clients away from spending time and efforts on financially immaterial or less relevant issues. Being once removed from the client (relative to the attorney) the expert may be able to assist in lowering the conflict and financial expectations surrounding emotionally charged issues.

✓ A credible expert acknowledges unfavorable facts, concedes obvious points, and does not dispute every fact.

✓ A credible expert defends his/her opinions and does not advocate the client's positions.

✓ A credible expert is unbiased, trustworthy, competent, and likable.

✓ A credible expert is a trusted advisor to the client's team whom may objectively provide input as to certain aspects of their client's case strengths and weaknesses.

✓ Two credible experts' findings should be within a range of reasonableness respective to each other in most cases with same set of facts. Legal positions may widen differences.

✓ A credible expert seeks to maximize the use of "in the hallway" time while waiting for the court. This may mean assisting with settlement or refining court presentation with the attorney.

✓ In family law, credible experts should seek to minimize conflicts. Our clients are not large corporations; many times they are vulnerable families in turmoil. Doing our part to lessen the burden on our court system is a worthwhile goal

# The Effective Use of Daubert Challenges

## Flourine on Call Ltd v Flourogas Ltd (US Ct of Appeals 5<sup>th</sup> Cir)

### No. 03-50419

### Decided 0810.2004



- This case determined that lost profits arising from a breach of contract and lost market value of a contract are different.
- The original case the jury awarded the plaintiff \$120 million in damages. It went to appeal and that verdict was *overturned in its entirety*.
- Plaintiff expert only computed damages using lost profits arising under the contract, but failed to make any calculations that distinguish a lost asset damage model from a straight forward lost profits one. At appeal, the court found plaintiffs projection lacked requisite reasonable certainty.
- It is noteworthy that on cross examination of the expert the plaintiff acknowledged that he only looked at damages from a lost profits point of view. I suspect some in attendance will argue that they do their work based on counsel's direction only.
- What is best practice when faced with this situation?
- Requires careful consideration of trial court judge history & demeanor
- Is the trier of fact more likely to allow expert to correct deficiency in expert report or throw expert opinion out altogether?



# Reference Materials & Thank You's

"Financial Forensics Body of Knowledge", John Wiley & Sons & Inc., Darrell D Dorrell & Gregory A Gadawski, Hoboken New Jersey, Copyright 2012

"A Quantative Appraoch to Commercial Damages – Applying Statistics to the Measurement of Lost Profit", John Wiley & Sons & Inc , Copyright 2012 Mark G Filler & James A DiGabriele,

"Lost Profits Damages: Principles, Methods & Applications" Valuation Products & Services, LLC Copyright 2017, Everett P Harry III & Jeffrey H Kinrich

"What Lawyers Should Look for in a Forensic Accounting Expert Witness (part 1 - 3)

<http://www.bbcpa.com/what-a-lawyer-should-look-for-in-a-forensic-accounting-expert-witness-part-1-of-3/>

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What Makes Your Family Law Expert Credible by JB Rizzo & Lynda R Setzke- Schauer Fall 2015 ACFLS Family Law Specialist;  
[file:///C:/Users/BSullivanCPA/AppData/Local/Microsoft/Windows/INetCache/Content.Outlook/B696ZXAK/ACFLS%202015%20-3%20Fall%20Final%20-%20What%20Makes%20and%20Expert%20Credible%20\(002\).pdf](file:///C:/Users/BSullivanCPA/AppData/Local/Microsoft/Windows/INetCache/Content.Outlook/B696ZXAK/ACFLS%202015%20-3%20Fall%20Final%20-%20What%20Makes%20and%20Expert%20Credible%20(002).pdf)

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