1 Introduction

1.1 STAYING OUT OF TROUBLE

In this book, we do not explain the aptitudes demanded for a career in forensic accountancy. Nor do we provide a technical analysis of accounting and auditing requirements. In short, this book is not a text on how to become a forensic accountant, but instead it is about how to avoid *needing* a forensic accountant. Therefore, our purpose is practical and directly relevant to the work of accountants and auditors in public practice, the lawyers who act for them when trouble threatens and, of course, the insurers who underwrite their obligatory indemnity policies.

In compiling this text we have extracted the essential lessons that the circumstances hold for the generality of practising accountants. These lessons are distilled from hundreds of cases, in all of which accountants/auditors have found themselves in the legal or disciplinary firing line. For many years we have been personally involved in assessing the merits of claims brought against accountants for the benefit of the legal advisors of either defendants or claimants. Indeed, most of the cases that feature in this book, all of which are taken from 'real life', have been drawn from our own extensive case-book. All names used in these cases are, for obvious reasons, fictitious!

From the above it will be clear that this book is not a theoretical treatise. It is a first-hand account of the consequences, for accountants, of the myriad types of mistake that would have been eminently avoidable 'if only they had . . .' whatever! After a combined experience of some 40 years in the business of forensic accountancy the authors have several enduring messages to pass on to professional colleagues everywhere.

Although most of the litigation described in this book is UK-based, there are no territorial barriers to allegations of negligence where accountants are concerned. Financial statements are universally required to present an entity's financial results and position 'fairly' or to 'give a true and fair view'; and the methodology whereby auditors put themselves in a position to append their imprimatur is increasingly standardised and globally adopted.

This text is divided broadly by reference to subject matter. However, there are no neat boundaries to the areas in which accountants can find themselves in difficulty. For example, issues that we have included in Chapters 2 and 3 on auditors' negligence may equally arise in the disciplinary context (Chapter 6), and claims arising from fee disputes, dealing with chaotic clients and failure to maintain adequate file documentation will give rise to lessons under several headings. Similarly, allegations of negligence may arise when accountants undertake specialist share valuations and when auditors are instructed to value shares held by parties in dispute – in this book such instances will be found in Chapters 2 and 3 on auditors' negligence and Chapter 4 on accountants' negligence. The apparent overlap of subject matter should therefore be understood in this context.

1.2 THE FORENSIC ACCOUNTANT'S ROLE

Although this book is not about how to become a forensic accountant, it would not have been possible to write it if the authors had not spent so many years in the roles of forensic accountant and expert witness, principally in the area of accountants' negligence and disciplinary transgressions.

The book is aimed primarily at practising accountants, their legal representatives and insurers. Although it is bound to be of interest to forensic accountants and expert witnesses, that interest is incidental and this section of the introductory chapter merely sets the scene by describing the rigorous disciplines that the authors have been subject to in the course of their long involvement with accountants' litigation. It is this experience that informs the subject matter of the chapters that follow.

The term 'forensic' is derived from the Latin 'forum', or meeting place. The modern term has been coined to connote a relationship with the forum of the Courts or with legal matters generally. Thus, *forensic accountancy* means the use of accountancy knowledge to assist the Courts, or in seeking otherwise to resolve legal disputes.

It is obvious that the technicalities of accounting, auditing and other specialisms within the accountant's skill-set are not widely understood by non-accountants. If, therefore, in the context of a legal dispute, the conduct of an accountant is in issue, the parties, their legal advisers and, ultimately, the Court will require 'expert' evidence from one or

more independent accountants. This is why forensic accountants are frequently called upon to act as 'expert witnesses'.

Not all accountants practise auditing, although most will, on qualifying as accountants, have gained (through their training, experience and examinations) an entitlement to undertake audits, subject to obtaining 'responsible individual' status. Since the auditing discipline clearly demands a comprehensive grasp of accounting and financial reporting standards, regulation and general professional practice, the term forensic accountancy should be taken to include expertise in the key sub-discipline of auditing.

1.3 MAINTAINING IMPARTIALITY

Although expert witnesses are usually appointed by one or other of the litigating parties, it is essential that such witnesses maintain a detached and independent stance at all stages of the litigation process. Expert witnesses may choose to measure success in terms of the number of cases in which the decision of the Courts has favoured their clients. For us, however, just as critical a measure has been the number of cases in which we have prevailed upon an indignant client (and his or her lawyers) to *desist* from pursuing litigation that lacks sufficient merit to withstand the spotlight of objective courtroom scrutiny.

The conduct of civil litigation is governed by the 1999 Civil Procedure Rules (CPR). These rules were introduced to ease pressure on the Courts by weeding out cases that would be more cost-effectively dealt with by recourse to alternative methods of dispute resolution such as arbitration, expert determination or, in particular, mediation.

1.4 THE DISCIPLINES OF EXPERT WITNESS WORK

Those giving expert evidence, although invariably bound to observe the standards and codes of conduct of their own professional bodies, are equally bound to adhere to those sections of the CPR that relate specifically to the role of experts, whether party-appointed or, in an increasing number of cases, appointed by the parties jointly or even by the Court.

Experts whose evidence, whether as presented in their formal reports or given orally under cross-examination, appears to the Court to be biased in favour of those instructing them, risk the disapprobation of the Court and of having their evidence totally discredited.

In the specific field of professional negligence the Courts are bound to rely, in the context of accounting, tax or audit work, on evidence submitted by the professional peers of those whose conduct is alleged to have fallen below the requisite 'standard'. The latter is an objective test applied by the Courts, although it relies in particular cases on the subjective assessment of experts in the relevant field. Such an assessment may, in key respects, differ substantively as between one expert and another – which is obvious, since if the respective parties' experts found themselves to be in complete agreement on the issues, there would be little scope for expensive litigation!

1.5 CONDUCT THAT IS 'REASONABLY COMPETENT'

The requisite standard referred to in the previous section is, of course, the standard of work that would have been undertaken by a *reasonably competent* accountant, auditor or tax adviser, as the case may be. If, for example, a company's audited balance sheet includes assets that are shown subsequently to have been materially overstated, the Court will wish to hear expert evidence on whether a *reasonably* competent (not the *most* competent auditor in the land) would, in the ordinary course of the audit, have performed tests that had a reasonable expectation of detecting that overstatement.

The expert accountant or auditor engaged to provide an opinion on a fellow professional's work brings to bear not only technical expertise on the specific issues, but also a wealth of experience gained in comparable cases, and is thus able to inject a crucial measure of objectivity into often fraught proceedings. Claimants are understandably indignant at having lost money, while their auditors may be instinctively over-defensive, even deeply offended, at the very idea of being sued. Yet the most cost-effectively sensible resolution, which will often have the backing of the auditor's insurers, is usually for the claimant to seek compensation for the consequences of perceived wrongs through the process of a negotiated settlement. The impartial input of an independent expert can be the catalyst for achieving this aim.

1.6 THE DISCIPLINARY ARENA

The majority of practising accountants, like members of most respected professions, are required to comply with codes of conduct developed

and periodically updated by their professional bodies to keep pace with changing circumstances. The Code of Ethics published by the ICAEW in 2006 is one example. These codes are laid down either as guidance on best practice or as mandatory rules with which all members must comply. These strictures are supported by disciplinary sanctions that are applied in instances of proven non-compliance.

The emphasis in the non-mandatory guidance is on the need for members to conduct themselves in such a manner that their professional integrity is seen to be maintained and not impugned, and will relate to such matters as keeping the client informed of the scale of charges being incurred, responding to correspondence within a reasonable timescale or putting in place an appropriate complaints procedure.

More serious issues are addressed in the codes of mandatory conduct and concern, for example, matters such as the following: competence with which the accountant's work has been performed; the need to avoid conflicts of interest when, say, acting for both parties to a transaction; preserving independence when acting in an auditing capacity and ensuring that such independence is *perceived* to be in place; undertaking work in a 'reserved area' in which the accountant demonstrably lacks proven competence; and, more generally, not performing any action that might bring the accountant, the firm, the professional body or the profession of accountancy into disrepute as a consequence.

For the disciplinary machinery to be set in motion, a formal complaint needs to be registered with the professional body, and there are designated procedures for assessing the weight and the seriousness with which complaints should be taken. Since adverse findings in a disciplinary forum may prove to be a preamble to litigation, accountants and their insurers clearly need to view any such complaints with the utmost seriousness. Complaints considered by the professional body to be frivolous, mischievous or otherwise unworthy of further consideration will be given short shrift. Others, which clearly demonstrate that there is a case to be answered, will be dealt with in accordance with a disciplinary process that is thorough but often hugely time-consuming for the accountant and his or her firm. Complaints that concern matters with a prominent public profile, either because of the sums of money involved or because of sensitivities due to the high profile of the parties/entities involved, or because of widespread interests such as in a public offering of shares, will normally be dealt with in the more public arena of the Joint Disciplinary Scheme or the Accountants and Actuaries Discipline Board.

Although the conduct of disciplinary procedures is less formal than in a Court of law, there are obvious parallels in the way evidence is heard, and the tribunal hearing a particular case may well include a lawyer and a lay member. This is clearly another area in which the services of suitably experienced expert witnesses will be critical.

1.7 LITIGATION IN THE CURRENT CLIMATE

The current economic crisis, which began in 2008, is global in its sweep, and yet there is no consensus on the apportionment of culpability to each of its contributing elements. Several such elements have been publicly cited, including: inept governance; 'light-touch' regulation; negligent audits; procyclical financial reporting standards that exacerbate distortion; outdated computer modelling by rating agencies; and the bonus culture that has blinded banks to the precariousness of their own crumbling balance sheets.

What is certain, however, is that this lethal cocktail of self-serving deception has led to the loss of vast amounts of money, in respect of which restitution will continue to be sought via civil Courts in many countries, but most notably in the UK and USA.

Shareholders in financial institutions whose holdings have effectively been destroyed by 'rescue' rights issues, shot-gun 'mergers' with other investment houses or banks or, more simply, by the discovery that an apparently healthy, *audited*, balance sheet is in reality crippled with worthless assets, may well feel encouraged to test the conduct of the management and the auditors in the objective forum of the Courts.

Even if the factors contributing to the 2008/9 credit crisis are set aside, it is an historic fact that an inverse relationship exists between the severity of any economic downturn and a rise in disputes requiring recourse to law. When times are tough overdrafts are called in, staff are laid off, suppliers are more demanding, and businesses that in their own commercial terms are unquestionably viable are suddenly faced with having to call in the receivers.

Whenever money is lost, compensation is sought; and professional advisers, notably accountants and auditors, are consistently perceived as having deep insurance-backed pockets. The question of *merit* is often relegated to the status of an afterthought.

Many claimants, desperate for recovery of at least some of their losses, will adopt a scatter-gun strategy in a legal framework that still incorporates joint and several liability, in anticipation that professional

defendants (and their insurers) will prefer to settle a claim rather than face the risks, trauma and expense of a full trial.

We live in such times.

To assist readers in forming a coherent grasp of the multi-faceted subject matter, at the conclusion of each chapter we restate the key lessons to be gleaned from the pitfalls described in that chapter's cases.