



## SECTION I

# *Introduction*



# CHAPTER 1

# *The Forensic Accounting Profession*

## LEARNING OBJECTIVES

- Explain the nature of **forensic accounting** services
- Explain the different categories of forensic accounting services
- Elaborate on the different types of knowledge areas and skills required for forensic accounting
- Explain the different professional opportunities available to forensic accountants
- Discuss three major organizations and credentials important to forensic accountants

## INTRODUCTION

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### 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 including 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 accounts interpret evidence and communicate expert opinions for 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 CPAs<sup>1</sup> is subject to Consulting Services (CS) section 100, *Consulting Services: Definitions and Standards* (AICPA, *Professional Standards*). 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 chapter 11, “Digital Forensics.”

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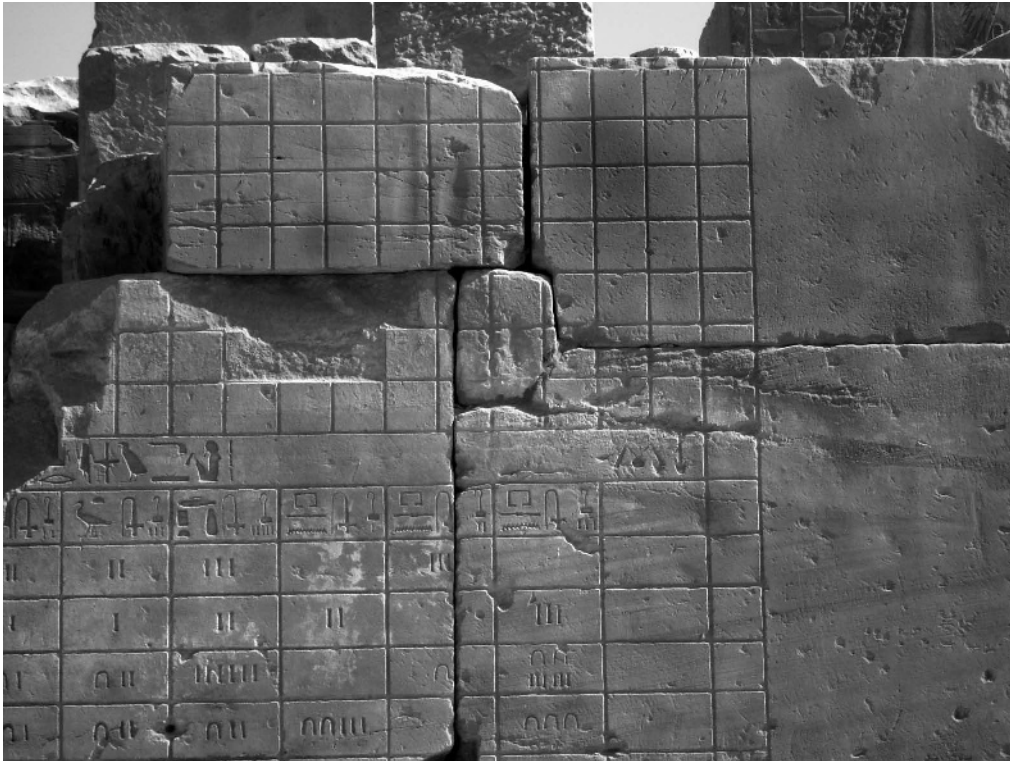
<sup>1</sup> For brevity, throughout the text we say that AICPA standards apply to CPAs. Strictly speaking, AICPA standards apply to CPAs who are members of AICPA or those who are licensed by state governments that require their licensees to comply with AICPA standards. Generally speaking, state regulators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

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](http://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 died, on January 25, 1947, from cardiac arrest.

### Al Capone



Source: FBI

## FORENSIC ACCOUNTING KNOWLEDGE AND SKILLS

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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.<sup>2</sup> 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 (CAATs) 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.

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<sup>2</sup> 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/](http://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.<sup>3</sup> 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.

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<sup>3</sup> See [www.pwc.com/id/en/forensic-services/](http://www.pwc.com/id/en/forensic-services/).



## 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 Accountants<sup>4</sup>

##### 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.

<sup>4</sup> Source: "FBI Forensic Accountants: Following the Money." March 9, 2012. [www.fbi.gov/news/stories/2012/march/forensic-accountants\\_030912/forensic-accountants\\_030912](http://www.fbi.gov/news/stories/2012/march/forensic-accountants_030912/forensic-accountants_030912).

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**

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There are many professional organizations and certifications applicable to forensic accountants. The particular organizations that are most beneficial to individual forensic accountants depend on their 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.

### **AICPA (WWW.AICPA.ORG)**

The **American Institute of Certified Public Accountants (AICPA)** 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 AICPA 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 AICPA also offers the Accredited in Business Valuation (ABV) credential. This credential is open to CPAs who are members of the AICPA 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 AICPA 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

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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

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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, 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 areas.

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, CFE, 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

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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. Which approach is recommended when extracting data from an accounting information system?
  - a. Use of client personnel to obtain the needed data.
  - b. Comparing the output of an accounting information system to the expectations of the forensic accountant.
  - c. Use of sampling.
  - d. Use of computer-assisted audit tools and techniques (CAATTs).
4. Internal fraud schemes typically involve weaknesses in \_\_\_\_\_.
  - a. Accounting.
  - b. Internal controls.
  - c. Leadership.
  - d. Assessment.
5. 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.
6. 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.
7. 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.
8. 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.

9. Whereas traditional accounting has many subspecialties such as cost accounting, forensic accounting has relatively few sub-specialties.
  - a. True.
  - b. False.
10. 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

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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

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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.

## INTERNET RESEARCH ASSIGNMENTS

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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.

