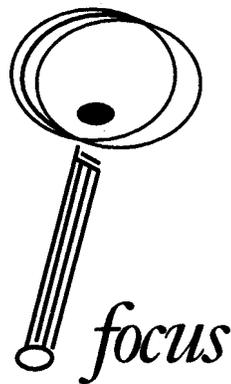


# 1

## Forensic Accounting and the Expert Witness



### Learning Objectives

By the end of this chapter, you should be able to:

- Describe the scope of forensic accounting.
- Explain damage measurement techniques used by forensic accountants.
- List the basic elements of a contract dispute or civil action.
- Describe the forensic accountant's role in a civil case.
- Describe the investigative skills utilized in a forensic accounting assignment.

Where is the money? More and more companies are asking this question. The number of fraudulent activities and dubious financial schemes has been increasing in the 1990s. Falsifying corporate data has become one of the most popular frauds of the decade, and fraudulent financial reporting has gone international.

With changing technologies, more financial records are on computer systems. Paper audit trails are disappearing. Consequently, businesses are exposed to new risks of fraudulent activity. Opportunities for new types of computer fraud schemes increase as computer applications expand. Despite efforts to strengthen control systems, computer fraud is a continuing problem facing corporate America.

When companies need to measure and recover damages caused by fraudulent activity, they often rely on a new corporate sleuth—the forensic accountant—to assist in the investigation. Forensic accountants have the skills to investigate what happened, to measure the damages, and to provide litigation support to corporate and outside counsel.

## THE SCOPE OF FORENSIC ACCOUNTING

Forensic accounting applies every branch of accounting knowledge to investigations that may lead to legal confrontations. The Random House College Dictionary (Random House, 1984) defines forensic as "pertaining to, connected with, or used in courts of law or public discussion and debate."\* Forensic accounting applies accounting, statistical, research, and economic concepts and techniques to legal problems or potential legal problems. The forensic accountant must understand the legal process because the investigation may lead to court action, requiring the corporate forensic accountant or an outside expert to give testimony as an expert witness. The outside expert could be a certified public accountant (CPA), a management consultant, a university accounting professor, or an economist.

Civil litigation commences when one party, termed the plaintiff alleges in a lawsuit some detrimental action or failure to act by another party, the defendant. The defendant is alleged to have caused the harm or loss. Most litigation is settled out of court after discovery of all information, including that supplied by the forensic accountant and other experts.

In a forensic accounting investigation, the accountant uses auditing and other investigative skills to analyze what happened, develop assumptions about what might have happened, and explain these assumptions in a written report that usually measures damages to an injured party. Sometimes this report is presented in the courtroom if the case goes to trial. Auditing skills are valuable in this process, but additional investigative techniques are required because the process goes well beyond the testing that is the basis for audit.

Many CPA firms have developed forensic accounting expertise. A party to litigation may seek assistance of the CPA on the issue of measuring damages arising from some unfortunate event. For example, an employee of a small business may have forged checks over a period of time, and the CPA is asked to measure damages to the small business. The damage estimate would be used to seek restitution from the employee if caught. Otherwise, restitution may be sought from the small business firm's auditor if there was one. Alternatively, the small business may have insured against these possible losses, and the forensic accountant's report would be used to collect from the insurance company. In this situation, the forensic accountant is working for the plaintiff. The attorney for the defendant in the case, or potential case, will also need a forensic accountant to analyze the plaintiff's expert's report. With litigation on the rise, this practice area has been growing for many CPA firms.

While forensic accounting deals predominantly with civil litigation, it also encompasses some areas of criminal law. In the case of fraud, potential criminal penalties may be a factor. FBI investigators may use the forensic accountant's findings from the civil aspects of the case to build a criminal case. Criminal cases include deeds such as arson, price fixing, and bid rigging with related payoffs. In these cases, the forensic accountant can measure the economic consequences of the crime, helping the prosecutor establish motive.

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## DAMAGE MEASUREMENT

Corporations and individuals may seek damages if they believe they suffered a loss due to another's wrongful act. Forensic accounting is used to measure the damages. In litigation, the plaintiff must prove three things to be awarded damages: (1) that the defendant violated a legal right of the plaintiff, (2) that the violation harmed the plaintiff, and (3) that the harm caused the plaintiff to suffer damages.

Some types of wrongful acts result in damages that are relatively easy to measure. For example, supplier overbilling frauds can be measured by determining the difference between the correct amount and the billed amount. Supplier shipment shortages can be measured and correct billing amounts determined based on what was actually received. Similarly, an employee's fraudulent expense report for a trip not taken presents very little challenge to measure damages.

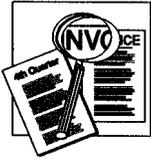
Damage measurement for other types of wrongful acts is not so easy. If a supplier ships inferior goods to a manufacturer, resulting in the production of an inferior final product for customers, what are the damages? If a contractor does not perform required maintenance on equipment and it subsequently breaks down causing production problems, what are the damages? If a customer returns goods that were used or damaged, what are the damages?

In more difficult cases, measuring compensatory damages for actual losses requires a clear understanding of the causation of the damages and the consequences of those damages. Legally, damages may be defined as compensation to an injured party for all detriment caused by the unlawful act of the defendant. The general rule for measuring compensatory damages is to measure out-of-pocket costs plus reasonably foreseeable "but-for" losses. The term but-for arises from the notion that "but-for" the defendant's actions, plaintiff's damages A, B, C, and so on would not have occurred. But-for losses are made up of the following elements:

1. Increased costs
2. Lost profits
3. Decrease in value of the investment

Increased costs include interest expense necessary on borrowed funds, general administrative expenses that result from the defendant's wrongful act, and additional costs incurred to repair damage resulting from the nonperformance of the defendant. Lost profits include past profits and prospective profits. In the case of the supplier providing inferior raw materials, the lost profits would include past profits due to customers returning inferior goods that resulted from the inferior supplies. Prospective profits also would be measured because the firm lost some customers and customer goodwill due to the inferior products that resulted. A decrease in the value of the investment would include loss in earnings capacity, loss of business goodwill, and loss in the value of the business due to a decrease in prospective earnings.

Lost customers result in a decline in the value of the investment in the business.



**Forensic Accounting in Practice** In an unfair competition case, a Massachusetts court awarded the plaintiff \$40.6 million. The case involved the measurement of damages, including \$14.1 million in lost profits which were doubled under the Massachusetts Unfair Trade Practices Law. Also included were \$10.7 million in interest that accrued during the period from when the damage was suffered in the early 1980s until 1992 when the award was granted. The injured party also was awarded \$1.6 million in attorney fees. In this case, the damaged party was in a high-technology business and a competitor used unfair tactics to recruit key employees away from the company (Wall Street Journal, December 18, 1992).

## CIVIL LITIGATION

Civil litigation involves a myriad of different types of cases. In all civil cases, the plaintiff attempts to establish that the defendant violated contractual or legal rights causing a loss to be suffered.

When a contract is involved, the focus is on interpreting the contract. Many contracts are written in language that can be interpreted in more than one way. An expert, often an attorney, may be hired to interpret the contract. The contract may include accounting terms that must be interpreted by the forensic accountant. For example, the contract may provide that the plaintiff get a certain percentage of the profits of a business, without stating clearly how those profits are to be measured. The dispute would focus on what measurement method is the fairest for measuring profits or what measurement method the parties had in mind when the contract was signed. In forming an opinion, the forensic accountant would consider the facts of the case and industry practices in measuring profits.

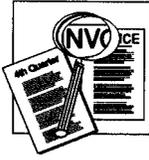
Contract disputes might also revolve around allowable reimbursable expenses. It may be that a defendant was reimbursed for expenses that were not reasonable or necessary for the business. For example, an employee may have included as operating expenses excessive entertainment costs or personal expenses. The defendant also may have hired a relative who either billed excessive amounts for services performed or did no work at all.

In contract disputes or civil actions involving suppliers, contractors, employees, customers, competitors, and others affecting the organization, the organization as plaintiff must first establish that there was a violation of its rights, such as a breach of contract or a contract infringement. Subsequently, the plaintiff must establish three basic elements: proximate cause, reasonable certainty, and foreseeability.

### Proximate Cause

As the plaintiff, the organization seeks a damage award to compensate it for the economic loss that it suffered on account of the defendant's action. To recover damages, the plaintiff must show that it was the defendant in the case who proximately caused the damage. Proximate cause is the most direct cause

involved; it need not be the only cause of the damage. A cause-and-effect linkage between the defendant's action and the damages suffered by the plaintiff must be shown.



**Forensic Accounting in Practice** A contractor (the defendant) provided substandard maintenance on equipment. Because of breakdowns during a three-month period, customers experienced delays in receiving orders. The question before the court was whether the contractor's poor maintenance was the proximate cause of the loss of the customers who experienced delays. The forensic accountant's expert witness report attempted to show that there was proximate cause. Customer ordering patterns during the two-year period before the delay period were contrasted with the two-year period afterward. The forensic accountant also measured the extent of the damages caused by the contractor's failure. Some of the plaintiff's marginal customers were lost due to poor service, and some of its loyal customers reduced their orders. The defendant's expert attempted to show that the customers went elsewhere for the products for other reasons, such as competitors offering lower prices for higher-quality goods. The defendant also attempted to show that if the plaintiff organization had been properly managed, there would have been no delays.

### Reasonable Certainty

The rule of reasonable certainty permits recovery of damages only if they are reasonably certain to have resulted from the injury received. The forensic accountant does not have to measure damages exactly to the penny. The plaintiff must demonstrate a rational basis for the damage computation. The damages are calculated on the basis of certain assumptions. Statistical methods often are used in this regard.

### Foreseeability

The final element the plaintiff must establish is the foreseeability of the damages the plaintiff supplied. For example, lost profits must have been foreseeable at the time the wrongful act was committed. In the case of a breach of contract, the lost profits must have been foreseeable as a natural result of the breach at the time the contract was made. The plaintiff's attorney will try to impress on the court that a reasonable person could have foreseen damages for nonperformance of the contract, or any other wrongful act. The forensic accountant for the plaintiff will testify that the lost profits or damages were foreseeable and that the measurement of the damages is reasonable. The defendant's attorney will hire a forensic accountant with a different opinion.

## THE ROLE OF THE FORENSIC ACCOUNTANT

The type of case and the parties involved will determine the forensic accountant's role. A forensic accountant is most likely to be used when damages are difficult to determine or prove.

Larger corporations are able to do some forensic accounting in-house. Management accountants or internal auditors may be assigned the role of a corporate forensic accountant to measure damages in certain cases. They may work in cooperation with the corporate legal department to assess whether a case is large enough to pursue.

In reality, most cases never reach trial; they are settled out of court. Experts can be valuable in building a case that is strong enough that the other side sees that going to trial would be a waste of money and very risky. If a case does go to trial, additional experts may be retained immediately before the trial date to provide testimony. A forensic accountant can provide services as an expert witness during various stages of the litigation process.

### Pretrial Support

A forensic accountant may be engaged as an expert very early in the case development process. The attorney may choose to engage an expert at an early stage because the expert can advise the attorney on what information to seek during discovery. The attorney is able to develop a good working relationship with the expert, assuring that a qualified expert will be available when needed. The attorney may simply want to bounce ideas off the expert. If the point arises in the case to compute damages, then the forensic accountant will become more involved.

At the pretrial stage, the forensic accountant may be asked by the attorney to write a report on any findings, to establish causation between the defendant's actions and the plaintiff's losses, to gather facts to support the case, to translate accounting jargon into understandable English, to organize the data supporting the case, or to assist in the formulation of a strategy.

### Writing a Report

The forensic accountant's work as an expert typically results in a written report. The attorney and expert will agree on the basic scope of the report. The expert performs an investigation of the information based on this scope and provides a report on the findings. If the expert is engaged by the plaintiff's attorney, the report typically will provide a computation of the damages. The report will indicate the procedures followed in gathering the information and making the computation of damages. If the expert forensic accountant is retained by the defendant's attorney, the task will be to rebut the plaintiff's expert report on damages. Frequently, the defendant's expert will prepare a report on damages for the court that shows a much lower computation of the loss.

### Establishing Causation

The attorney for the plaintiff sometimes will engage a forensic accountant to assist in establishing that the plaintiff's losses were caused by the defendant's actions. This is relatively common when accounting concepts, techniques, and records are important in establishing the cause of the plaintiff's damage. A good example of such a situation involves unfair pricing tactics. A foreign company may be accused by a domestic company of dumping products on the market to drive out competition. Dumping involves selling products below

their cost. Determining the cost of the products in question is critical to establishing the causation and amount of damages. An expert with impressive credentials in cost accounting theory and practice will be valuable in making a strong case for the plaintiff. Prior cases that have been tried in court may be used as a basis for evaluating the costs of the products in question. The task of the defendant's expert will be to analyze the plaintiff's expert report showing the basis of the damage computation.

#### Gathering Facts

Proving or disproving issues at trial involves submitting and identifying documents as evidence. In the discovery phase of the case, the forensic accountant can review many business records for their relevance to the issues. While the attorney develops the strategies and identifies the issues, the forensic accountant can help identify the kinds of business documents that normally exist in a particular type of business and identify which ones the attorney should request.

A practical problem in the adversarial situation is that the defendant may not be responsive to requests for documents because the exact titles of the documents are not used in the request. The forensic accountant can help the attorney assess whether the other side is holding back.

#### Translating Jargon

Another pretrial opportunity for the forensic accountant is assisting attorneys in preparing for depositions of any financial experts employed by the defendant or plaintiff, who may use technical terms and jargon in responding to questions. A forensic accountant can help the attorney understand the responses and formulate additional questions directed at getting to the heart of the issue.

#### Organizing Data

Managing the database of documents and facts pertinent to the case is another opportunity for the forensic accountant. The positions established by the attorney at trial must be based on facts. The facts are derived from the business records of the parties involved and from external sources. External sources include government, industry, and market databases. In large cases, the amount of facts and documents can become overwhelming if they are not coded and stored in a database for retrieval. A forensic accountant with knowledge of information systems and database management computer programs can be a valuable aid to the attorney in collecting, organizing, and summarizing the large volume of facts and related documents.

#### Formulating Strategy

When the forensic accountant becomes involved in the case at an early stage, insights can be gained that will provide the opportunity to assist attorneys in formulating case strategy. Many forensic accountants are trained in professional skepticism in the auditing phases of their careers. This training can help them look at the facts gathered and identify possible scenarios and positions that the lawyer can use to develop case strategy. The accountant can aid the attorney in anticipating strategies that will be used by the other side.

## Trial Support

As the trial date draws nearer, the forensic accounting activities become more intense. Typically, the attorneys are still hoping for a settlement, but their mentality is "we are going to trial." The expert witness will prepare testimony and rehearse for the courtroom appearance. Preparing exhibits such as posters or transparencies is an important part of this process. The expert wants to present testimony in an understandable fashion for the jury.

The experts on both sides can aid attorneys during the trial process. The attorney for the plaintiff is trying to develop a strong theory of causation and a theory of damages. The attorney for the defendant is trying to discredit those theories. The forensic accountant's expertise in business matters can be very helpful to the attorney in analyzing the situation as it develops in court.

The plaintiff presents the case against the defendant first. The defendant's expert will listen to the plaintiff's expert in preparation for rebuttal. When the defendant's expert is presenting the rebuttal, the plaintiff's expert will listen and help develop questions for cross-examination.

## Expert Witnesses

What is an expert witness? The judge at trial will decide whether a purported expert qualifies as an expert witness. If the witness is qualified, he or she is allowed to give expert testimony. To determine whether a witness is qualified, the judge must be convinced that the individual knows or understands the matters about which testimony is to be rendered and that the expert possesses special knowledge, experience, training, or skills that pertain to the case and testimony. The expert witness's qualifications will be presented by the attorney proposing him or her as an expert, and the opposing attorney will have an opportunity to challenge the expert's qualifications. The opposing attorney's goal is to diminish the jury's confidence in the expert's opinion. Occasionally, the opposing attorney is successful in persuading the judge to restrict the expert's testimony or to disallow the expert.

Expert witnesses testify in the form of an opinion that has been formed based on the facts assumed by the expert and on the facts that have been presented by others. Formulation of this opinion distinguishes the expert witness from an ordinary, nonexpert witness. Generally, an ordinary witness may testify only to facts. Opinions, inferences, and conclusions are left to the judge and jury. The ordinary witness is viewed to be a layperson; the court sometimes will allow an opinion if it is perceived that the matter falls within the experience of most people.

The expert witness's opinion must be based on facts in evidence and cannot be based on the opinions or conclusions of others. His or her opinion may be based, however, on facts testified to by others. The information used as the basis of the expert's opinion must be of the type that reasonably is relied on by experts in forming opinions on the subject being covered by the testimony. Therefore, a forensic accountant testifying as an expert may use accounting records, audited financial statements, and other business documents as a basis for his or her opinion, provided they have been introduced as evidence. The expert must be careful not to base an opinion on improper information.

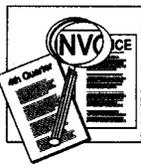
Some expert witnesses are retained just before the trial date. Because they do not have intimate knowledge of the facts, they will be provided with assumed facts to help them render an opinion. For example, the expert may be provided assumed facts about a firm's sales and expenses before and after a certain event. The expert would be asked to provide an opinion on whether the value of the firm had decreased after this event, assuming that the facts were true. The expert also could provide an opinion on the amount of the decline in value. The assumed facts would be established prior to the expert's opinion by testimony and other experts. The opposing attorney can challenge these facts.

An expert witness must be well prepared and provide a well-reasoned opinion based on the facts gathered. Experienced judges have seen many experts testify. Generally, judges take a very dim view of experts who are poorly prepared or seem to be presenting biased or unrealistic testimony. For example, one judge referred to the old problem of expert witnesses who are "often the mere paid advocates or partisans of those who employ and pay them, as much so as the attorneys who conduct the suit. There is hardly anything not palpably absurd on its face that cannot now be proved by some so-called experts" (*Keegan v. Minneapolis and St. Louis R.R.*, 1899).

### Settlement Support

The vast majority of civil cases are settled before trial. Executives generally want to avoid the uncertainties of trial and prefer private settlement procedures. Therefore, opportunities abound for the forensic accountant to provide assistance to attorneys in the settlement negotiation process. Some settlement negotiations occur after a lower court has awarded a judgment, and both sides recognize that a higher court may not uphold the judgment. All cases differ in one or more respects, and no one is able to predict accurately what an upper court will do.

The forensic accountant's role in settlement procedures can be to develop alternative settlements and place a value on them. For example, the damages claimed for lost profits include projections. The expert can determine a range of possible values that the court might possibly accept. The expert can help the attorney identify the most likely value and the probabilities associated with other values. Statistical techniques can be used to place a valuation on these alternatives. These calculations can be used as the basis for presenting a settlement offer to the other side.



**Forensic Accounting in Practice** Out-of-court settlements can involve substantial sums of money. After sixteen years of litigation, four states settled with major oil companies for conspiring to fix gasoline prices from 1955 through 1972. A lower court had dismissed the case seven years earlier. The case was appealed and settled for \$150 million one month before going to trial. In the settlement, the defendants denied guilt (*Seattle Times*, January 16, 1993). No doubt, forensic accountants played an ongoing role in the many determinations of value.

## THE CORPORATE ROLE OF THE FORENSIC ACCOUNTANT

Corporate accountants with forensic accounting expertise can help make a case economically viable. They can team up with the outside expert and provide assistance in the many roles described earlier. The corporate forensic accountant has the advantage of understanding the firm's accounting and management information systems.

Making a preliminary damage assessment is an important role for the corporate forensic accountant. The potential damage claim will be identified by management and the facts will be presented to the corporate forensic accountant, often by corporate in-house legal counsel. The corporate forensic accountant can investigate the potential case using forensic accounting techniques. A preliminary damage estimate will result in a written report. This report may include an opinion about the merits of the case, providing a basis for a decision on whether to pursue the matter with outside legal counsel.

Corporate forensic accountants can provide valuable assistance in matters that are highly unlikely to become lawsuits. Their expertise can be used to investigate wrongdoing by employees, and their findings can be used to decide whether an employee should be dismissed for not following company procedures. For example, a company may have purchasing procedures to assure that raw materials are acquired at the lowest possible cost. An investigation might reveal that a purchasing agent could have obtained raw materials at substantially lower cost. This information will be used to determine what the company's response will be.

## THE NONCORPORATE ROLE OF THE FORENSIC ACCOUNTANT

Forensic accountants can provide valuable services to individuals and small businesses. Circumstances such as divorce, bankruptcy, and death may necessitate a financial investigation.

Valuations are often needed in divorce cases. A privately owned business is sometimes a marital asset involved in the property settlement. Usually, only one spouse is active in running the business and will want to continue to operate the business after the divorce. The business must be valued so that it can be included in the total value of the property to be divided. The spouse who manages the business will want it valued as low as possible and the other spouse will want it valued as high as possible. For example, assume that the total marital assets to be divided equally amount to \$800,000 plus the business. If the business is valued at \$800,000 one spouse will get the business and the other spouse will get everything else. If the business is valued at \$900,000, the spouse getting the business will have to pay the other spouse \$50,000, which is half of the difference between the business valuation and the value of the other assets.

Valuations are needed in other circumstances. In estate planning and estate taxation, a business valuation is necessary. IRS rules and related court cases must be considered. Someone planning to acquire a business does not

want to offer more than it is worth. A forensic accountant can apply valuation techniques to value the business.

Valuation procedures can be very complicated, and various methods can be used to arrive at a valuation. Valuation requires forensic accounting investigative skills because the business owner may be motivated to take actions that distort the business valuation. For example, in the divorce situation, the spouse who manages the business may try to make the business look less valuable by incurring unnecessary expenses or charging personal expenses as business expenses. Someone planning to sell a business, by contrast, may be motivated to make profits appear as large as possible. Thus, the owner may not record some expenses in the books, or he may record revenues prematurely. In these situations, the forensic accountant will examine business records. Adjustments will be made to the profit figures provided by management. A valuation will be calculated, using the adjusted profit.

Another type of valuation situation arises in wrongful death cases. If someone dies because of the wrongful act of another person or a corporation, a lawsuit may be initiated to recover damages. The economic loss must be measured. For example, suppose that a professional manager is killed by a drunk driver and that the deceased was forty years old, married, and earned \$80,000 per year. The surviving spouse would seek compensation for the deceased's lost future earnings. The forensic accountant would gather information about the deceased's past earnings and future prospects. Lost earnings would be projected and valued. The projection and valuation would be based on techniques that have been accepted by the courts in previous cases.

## SKILLS REQUIRED OF THE FORENSIC ACCOUNTANT

Because forensic accounting cases span a wide range of business problems and disputes, a varied range of skills are required of the forensic accountant, including investigative skills and interviewing skills.

### Investigative Skills

Accounting and auditing skills provide the forensic accountant with core investigative competencies. These core skills are supplemented with experience in financial matters such as capital budgeting, corporate financial planning, and working capital management. Computer skills are also critical components of the forensic accountant's investigative arsenal.

### Computer Skills

Advanced computer skills are essential. The required skills often go beyond the need to use word-processing and spreadsheet software. Some forensic assignments require the use of financial modeling software. Estimating lost profits is accomplished by making assumptions about what would have been. Based on these assumptions, pro forma financial statements are prepared. In complex cases, the power and efficiency of a financial modeling language are required

to prepare the pro forma statements in an efficient and accurate manner. Financial modeling languages are specifically designed for this purpose and have many built-in features to aid the user in developing pro forma financial statements. Powerful database software is required for large cases with many documents.

Sophisticated statistical techniques are sometimes applied to analyze the data gathered in an investigation. These methods are more advanced than the basic statistical techniques taught in required undergraduate business courses. With the help of advanced statistical software, users can employ techniques that usually are taught only in masters- and doctoral-level courses.

### Interviewing Skills

Knowledge of effective interviewing techniques is essential for most types of forensic investigations. The forensic accountant cannot just rely on paper trails, computer databases, and documents to provide evidence. In most cases, the accountant must acquire information from people possessing critical information.

Through interviews the forensic accountant can obtain information that identifies key issues of a case. Leads can be developed to other sources of evidence. Information about the personal backgrounds of those involved can be obtained in interviews. Interpersonal relationships can be uncovered. Possible motives can be explored. Interviews can be used to obtain the cooperation of victims and witnesses. In forensic cases evidence is often gathered piece by piece. Interviewing is often an important step in putting the pieces together.

### Planning

Careful planning is a key to a successful interview. A second chance to interview someone is often impractical. A field visit to a distant place is expensive, and a second visit is not practical in most cases. In a field visit, the forensic accountant may have only one opportunity for an entrance interview and an exit interview. Therefore, planning should encompass what information is needed and the interview techniques designed to obtain it. Some fundamental techniques are described here.

The forensic accountant should do everything possible to promote cooperation of the interviewee. People are busy and generally are not anxious to talk. While conducting the interview at the forensic accountant's office might save time, it usually is the least effective approach. The interview should be planned for the convenience of the interviewee. The time and place should be agreeable to both parties. The place should be conducive to confidential conversations. Interruptions from telephone calls and other people can undermine the interview. A place should be selected where these distractions are minimized.

An advantage of conducting the interview at the interviewee's location is that relevant documents are likely to be located there. Arrangements should be made to make copies of any documents before the accountant leaves to avoid delaying the investigation. The accountant does not want to hear later on the excuse of "I believe that the copies are in the mail." Yet another advantage of using the interviewee's location is that the accountant may be directed to a coworker at the same location for additional information.

Interviews should be planned so that there is enough time to accomplish the accountant's objectives. In some cases, however, arriving unannounced is effective if the accountant wants to catch someone off-guard. This tactic eliminates the opportunity for the interviewee to have second thoughts about talking. It also can block intervention by others.

Time should not be spent on unimportant matters. Before the interview, facts should be gathered from other sources so that interview time is minimized. An interview outline should cover only the facts that are needed. The outline should cover relevant who, what, where, when, how, and why questions. Short questions should be used to confirm facts from other sources.

The interviewee should be treated with respect. Talking down to someone is counterproductive, as is conveying an authoritarian attitude or using jargon.

### Victims

Victims need special treatment. They have suffered a loss that should not be belittled. Nothing should be said that might be interpreted incorrectly as providing hope for recovery of the loss or part of it. Many victims want sympathy. Interviews are often most productive when the accountant is sympathetic. Active listening techniques, which basically involve rephrasing what the other person has said, should be used. They convey sympathy and can be used to move on to the next issue. The victim never should be made to feel that the loss had anything to do with being dumb, untrained, or not using common sense.

### Closure

Interviews should be finished with a statement of appreciation for cooperating. The interviewee should be given one last opportunity to provide information or an opinion with an open-ended question such as "Is there anything else you can think of?" The accountant should encourage the interviewee to contact him or her if some potentially relevant information is recalled at a later time.

## SUMMARY

Forensic accountants utilize investigative skills to answer the questions "Where is the money?" "What caused the damages?" and "What were the damages?" Their expertise is effective in investigating corporate fraud by management, suppliers, contractors, employees, and customers. Their investigations typically result in reports that identify causes and measure damages. Attorneys use forensic accountants in many types of civil cases ranging from contract disputes to massive antitrust cases.

Corporate forensic accountants perform investigations of fraud and other wrongful acts that may or may not result in lawsuits. They can assess potential damage claims so that corporate legal departments can decide whether to pursue the litigation process. At some stage in civil litigation, attorneys will engage expert witnesses. Forensic accountants as expert witnesses can provide valuable services at various stages of the litigation process.



## Review Questions

1. In a forensic accounting investigation, the accountant does which of the following? 1. (d)
  - (a) Uses auditing and other investigative skills
  - (b) Prepares a written report that usually measures damages to an injured party
  - (c) Analyzes what actually happened and develops assumptions about what would have happened
  - (d) All of the above
  
2. The general rule for measuring damages is to measure plus reasonably foreseeable \_\_\_\_\_ losses \_\_\_\_\_. 2. (b)
  - (a) opportunity costs; certain
  - (b) out-of-pocket costs; but-for
  - (c) committed costs; proximate
  - (d) but-for costs; certain
  
3. To be awarded damages for lost profits in contract disputes or civil actions, the three basic elements that must be proven include all of the following except: 3. (c)
  - (a) proximate cause.
  - (b) that damages were incurred with reasonable certainty.
  - (c) that fraud was committed by the defendant.
  - (d) that lost profits were foreseeable at the time the wrongful act was committed.

4. In civil actions, the plaintiff must demonstrate a rational basis for the damage computation, meeting the criteria of: 4. (b)
- (a) proximate cause.
  - (b) reasonable certainty.
  - (c) foreseeability.
  - (d) measurability.
5. The forensic accountant's work as an expert usually results in a written report that typically includes all of the following except. 5. (a)
- (a) a plan for winning the case.
  - (b) a computation of the damages.
  - (c) the procedures followed in gathering information.
  - (d) the procedures followed in computing the damages.
6. When a case involves a large volume of facts and documents, the forensic accountant can help the attorney collect, organize, and summarize the facts by developing a: 6. (c)
- (a) written report.
  - (b) case strategy.
  - (c) relational database.
  - (d) document analysis system.
7. Expert witnesses testify in the form of a(n) \_\_\_\_\_ that has been formed from \_\_\_\_\_ perceived by the expert and \_\_\_\_\_ that have been presented by others. 7. (d)
- (a) opinion; opinions; reports
  - (b) report; opinions; opinions
  - (c) opinion; the report; the facts
  - (d) opinion; the facts; the facts
8. The forensic accountant's role in settlement procedures is to: 8. (a)
- (a) develop alternative settlements and place a value on them.
  - (b) prepare an opinion report.
  - (c) negotiate settlements.
  - (d) discover financial records.
9. The forensic accountant's core investigative skills are: 9. (a)
- (a) accounting and auditing skills.
  - (b) advanced computer skills.
  - (c) sophisticated statistical skills.
  - (d) interviewing skills.
10. The advantage of going to the interviewee's location is that: 10. (d)
- (a) relevant documents are likely to be located there.
  - (b) copies of documents can be made before the accountant leaves.
  - (c) the accountant may be directed to a coworker at the same location for additional information.
  - (d) all of the above apply.

