

1993

# Application of AICPA professional standards in the performance of litigation services; Consulting services special report, 93-1

American Institute of Certified Public Accountants. Management Consulting Services Division

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**AICPA**

**CONSULTING SERVICES  
SPECIAL REPORT 93-1**

***Application of AICPA  
Professional Standards  
in the Performance  
of Litigation Services***

*Management Consulting Services Division*

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**AMERICAN**

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## NOTICE TO READERS

This special report is designed as educational and reference material for Institute members and others who provide *consulting services* as defined in the Statement on Standards for Consulting Services (SSCS) issued by the AICPA. It does not establish standards or preferred practices.

Various members of the 1991-1992 AICPA Litigation Services Subcommittee provided information for this special report and advised the authors and staff. The subcommittee members are listed below.

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**71/100 APPLICATION OF AICPA PROFESSIONAL STANDARDS  
IN THE PERFORMANCE OF LITIGATION SERVICES**

**71/105 INTRODUCTION**

**.01** Litigation services are rendered by a CPA using accounting and consulting skills to assist a client in a matter that involves pending or potential litigation or dispute resolution proceedings with a trier of fact. These services may include fact-finding (including assistance in the discovery and analysis of data), damage calculations, document management, expert testimony, and other professional services required by the client or counsel. A listing of typical litigation services engagements and their products and services is provided in appendix 71/A.

**.02** Authoritative publications of the American Institute of Certified Public Accountants (AICPA) address litigation services only through the process of exempting these services from the attestation standards. Section 9100.48 of *Attestation Engagements Interpretations*, "Applicability of Attestation Standards to Litigation Services," excludes litigation services that "involve pending or potential formal legal or regulatory proceedings before a trier of fact in connection with the resolution of a dispute between two or more parties. . . ." In this interpretation, the term *a trier of fact* is defined in a footnote as ". . . a court, regulatory body, or government authority; their agents; a grand jury; or an arbitrator or mediator of the dispute."

**.03** Litigation services are recognized as a management consulting transaction service in the Statement on Standards for Consulting Services (SSCS) issued by the AICPA and are defined in Consulting Services Practice Aid No. 93-4, *Providing Litigation Services* (New York: AICPA, 1993) as "any professional assistance nonlawyers provide to lawyers in the litigation process." Finally, in the *Litigation Services Handbook: The Role of the Accountant as Expert Witness*, (New York: John Wiley & Sons, 1990) litigation services are defined as "the services provided by a CPA that encompass those accounting and consulting skills used to assist the attorney or client in a legal or regulatory environment." Bankruptcy, forensic accounting, reorganization, or insolvency services, as practiced by CPAs, generally are accepted as forms of litigation services. (See appendix 71/B.)

**71/110 LITIGATION SERVICES CONTRASTED  
WITH ATTESTATION SERVICES**

**.01** The role of the practitioner in a litigation services engagement is different from that in an attestation services engagement. In an attestation engagement, the CPA firm expresses a conclusion about the reliability of a written assertion of another party. In a litigation services engagement, the practitioner helps to gather and interpret facts and must support and defend the conclusions reached against challenge in cross-examination or regulatory examination and in the

work product of other experts. The attestation standards do not envision the practitioner as the asserter and were established to provide assurance to third parties. In litigation services, the practitioner is subject to the rules of the proceedings, including discovery and cross-examination. There are usually no uninformed third parties since all the litigants generally have access to the workpapers of and other documents relied upon by the CPA and can question the conclusions.

**.02** In an attestation engagement, the practitioner obtains sufficient and competent evidence to support the client's written assertion. When providing litigation services, the practitioner is an objective consultant offering opinions about facts that may be in dispute to the trier of fact and is subject to the Statement on Standards for Consulting Services (see also ¶71/115.02). The standards are no less authoritative or professional than the Statements on Standards for Attestation Engagements (SSAEs) or the Statements on Standards for Accounting and Review Services (SSARs), but are designed to consider the role of the practitioner as the asserter in litigation rather than as the attester in attestations.

**.03** Litigation engagements and attestation engagements also differ in the purpose of engaging the practitioner, in the audience for the practitioner's work product and opinion, and in the use of the practitioner's conclusions. In attestation engagements, the practitioner is the independent professional to whom third parties look for assurances about the reliability of information. The third parties can then decide what commercial or financial relationships they are willing to enter into with the client. The practitioner's association with the information provides assurance of its reliability. In litigation services, the practitioner may be retained to render an expert opinion and judgment on the economic effects of assumed facts. In addition, to arrive at the opinion or judgment, the practitioner may value businesses or marital estates, project future economic results, investigate potential fraud, or analyze performance in accordance with professional standards. The relevant data may be limited and may be much less than the full set of financial statements. Furthermore, the litigants themselves may disagree about which financial information is pertinent and therefore should be used by the trier of fact in resolving the dispute.

**.04** In litigation engagements, the audience for the practitioner's opinion and work product is limited to the court and the parties to the dispute. Each has the opportunity to evaluate and question the workpapers, documents, and methodology of the practitioner. Much of the information normally required by generally accepted accounting principles (GAAP) in financial reporting may be irrelevant to the issues to be decided in court. Requiring a practitioner to perform an audit in order to testify may not be cost effective for any of the parties to the litigation.

#### **71/115 PROFESSIONAL STANDARDS APPLICABLE TO LITIGATION SERVICES**

**.01** Litigation services are consulting services provided by CPAs and their employees as business advisors. The services are transaction services, one of six major functions within consulting services, and, therefore, adherence to the SSCS is required. Such services used to



be called *management advisory services* and were governed by the Statements on Standards for Management Advisory Services (SSMASs). These statements were superseded by the SSCS, effective January 1, 1992. The CPA engaged in litigation services must also comply with the general standards of the accounting profession contained in the AICPA Code of Professional Conduct. The appropriate standards that apply are discussed further in this report.

### General Standards

**.02** The general standards contained in rule 201 of the AICPA Code of Professional Conduct apply to litigation services as well as to all other services rendered by CPAs to their clients. The general standards cover professional competence, due professional care, planning and supervision, and sufficient relevant data.

**.03 Professional Competence.** Practitioners undertake only those litigation services that they reasonably can expect to complete with professional competence. Litigation services involve such diverse areas as business valuation, economic damages, bankruptcy, family law, fraud, breach of contract, antitrust, and intellectual property. Consequently, practitioners may be unprepared to meet client needs adequately in every area and in every phase of litigation engagements. To comply with this standard in providing some litigation services, practitioners may need the assistance of other individuals with the required education and experience while retaining professional responsibility for the opinions that fall within their areas of expertise.

**.04** Professional competence includes being able to identify client needs and to apply an analytical approach and being knowledgeable about the technical areas involved in the litigation engagement. CPAs also need to gain an understanding of the litigation process and to discuss with the client their qualifications and those required under court rules and procedures.

**.05 Due Professional Care.** A practitioner exercises due professional care in the performance of an engagement. Due care requires diligence and critical analysis of all work performed. It also requires that all work be completed in accordance with the provisions of the applicable professional standards of the AICPA including the Code of Professional Conduct. A practitioner engaged to attest to the results of the services rendered must perform in accordance with the SSAEs.

**.06** In a litigation engagement, practitioners are often the only accounting professionals capable of quantifying the impact of the events that led to the dispute. Their work product is therefore important in the litigation process. Each party to the proceedings will retain professionals to quantify and analyze the economic impact of events. Practitioners need to be able to evaluate and challenge the assumptions and calculations of other professionals as well as defend their own assumptions and calculations under rigorous cross-examination.

**.07 Planning and Supervision.** A practitioner adequately plans and supervises the performance of professional services. Planning is essential in a litigation engagement both to control costs and to focus the practitioner's work product on the engagement requirements. Planning consists of developing engagement objectives and translating them into the activities necessary for the CPA to form an opinion within the constraints of cost, time, and available

information. Planning guides the conduct, supervision, control, and completion of the engagement.

**.08** The facts and circumstances of each litigation engagement are unique. Planning is essential to ensure the quality of the performance of professional services in each engagement. Planning includes obtaining information from counsel or the client. Plans continually change in a litigation engagement and usually are not written because the litigation process is dynamic.

**.09** As with any professional services, the supervision of assistants helps to ensure quality performance. The extent of the supervision will vary according to the number of assistants, their experience, and the complexity of the engagement. The practitioner, as the potential expert witness or consultant, is responsible for the results of the engagement.

**.10 Sufficient Relevant Data.** A practitioner attempts to obtain relevant data that is sufficient to provide a reasonable basis for conclusions or recommendations for any professional service performed. In litigation, data are obtained by discovery through depositions, interrogatories, and production motions. In addition, the data-gathering process may include a review of relevant documents, research and analysis, and interviews. The nature and extent of the data will vary with each engagement and may include the practitioner's computations and analysis and other information supporting conclusions.

### Consulting Standards

**.11** In addition to the general standards, specific consulting standards apply to the consulting process and are established by the SSCS under rule 202 of the AICPA Code of Professional Conduct. These standards concern serving the client's interest, entering into an understanding with the client, and communicating with the client.

**.12** The general standards are concerned with the quality of the performance of any professional service. The consulting standards apply specifically to the consulting process to guide practitioners in their relationships with consulting clients.

**.13 Defining the Client.** Each of the consulting standards refers to the client. The practitioner needs to have an understanding of who the client is to comply with the consulting standards. Under the AICPA Code of Professional Conduct (AICPA, *Professional Standards*, vol. 2, ET sec. 92.01), the client is defined as—

. . . any person or entity, other than the member's employer, that engages a member or a member's firm to perform professional services or a person or entity with respect to which professional services are performed. The term 'employer' for these purposes does not include those entities engaged in the practice of public accounting.

**.14** In litigation services, the client can be the law firm or the litigant as the client of the law firm, or an agency, regulatory body, or court that employs the CPA. In cases in which the

practitioner is a consultant and the work product may be confidential or even considered to be an attorney's work product, the law firm may wish to be designated as the client. In cases in which the practitioner expects to testify or have the work product open to discovery and challenge, the litigant usually would be considered the client. For all practical purposes, particularly to consider conflict of interest issues, the litigant should be deemed to be a client irrespective of the form of engagement.<sup>1</sup> Thus, from the CPA's point of view, both the attorney and the litigant may be deemed clients in the engagement.

**.15** From the attorney's perspective, the question of who the client is may vary according to the particular circumstances of each engagement. Therefore, the CPA should carefully determine who the client is and address the engagement letter to the client identified by the attorney.

**.16 Client Interest.** In compliance with the consulting standards, the CPA serves the interest of the client by seeking to accomplish the objectives established by the understanding with the client while maintaining integrity and objectivity. Rule 102 of the AICPA's Code of Professional Conduct states:

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

**.17** Under this standard, the practitioner in litigation engagements is required to maintain professional integrity and objectivity and to meet technical and ethical standards in performing services. The practitioner serves the client's interest best when objectivity and integrity are paramount concerns.

**.18** An engagement should be undertaken with a clear understanding of the purposes of the services and the expected areas of testimony. The practitioner begins a litigation services engagement by considering its objectives and the expected benefits. During the course of the engagement, the practitioner needs to inform the client of any reservations about achieving these objectives within the constraints of cost and time.

**.19 Understanding With the Client.** The practitioner establishes a written or an oral understanding with the client, who may for this purpose be the attorney representing the litigant, about the responsibilities of the parties and the nature, objectives, and limitations of the services to be performed. If the understanding is oral, the practitioner considers documenting the agreement in the workpapers. If circumstances require a significant change during the engagement, the understanding, whether written or oral, should be modified accordingly.

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<sup>1</sup> For further discussion of conflicts, see the AICPA Consulting Services Special Report 93-2, *Conflicts of Interest in Litigation Services Engagements* (New York: AICPA, 1993).

**.20 Communication With the Client.** In compliance with rule 102 of the AICPA's Code of Professional Conduct and interpretations thereof, the practitioner informs the client of any conflicts of interest. A conflict of interest may occur if a significant relationship could be viewed as impairing the practitioner's objectivity in the performance of a professional service. The practitioner should carefully evaluate each engagement request with sensitivity to the possibility of such conflicts.

**.21** A conflict of interest might arise in the performance of litigation services when the CPA has a relationship with one of the partners to the dispute, the court, attorneys, or witnesses and thus may not be an impartial expert. The responsibility of the practitioner is to decline litigation engagements that involve a conflict of interest. Otherwise, the practitioner might disclose confidential client information in the litigation process through discovery or testimony. Before accepting an engagement, the practitioner might, to the extent possible given confidentiality requirements, disclose to the client and counsel any situations involving conflicts of interest so that each party may independently consider the impact of such facts.

**.22** When the conflict is uncertain, the practitioner discloses the possible conflict of interest and allows the prospective client or counsel to consider the potential impact on the litigation.<sup>2</sup> Nothing in the professional standards requires a practitioner to accept any engagement, so the practitioner can, without stating specific reasons, refuse an engagement for any reason. On the other hand, a practitioner who wishes to accept an engagement, but is concerned about possible conflicts, should evaluate those possibilities before acceptance.

**.23** In addition to assessing possible conflicts of interest, practitioners consider whether it is otherwise in their best interest to accept the engagement. The goals and objectives of their practice might conflict with the performance of services in the proposed engagement. Although there may be no conflict with the attorneys or parties to the litigation, the issues in dispute may be areas that the practitioners are uncomfortable about pursuing or that may conflict with their philosophy, practice, or business interest.

**.24** Under the SSCS, before accepting or during the engagement, the practitioner should communicate to the client any serious reservations concerning the scope or benefits of the engagement. During the performance of the engagement, communications should include significant engagement findings and events. These communications enable the client to evaluate the costs and benefits of the engagement.

#### **71/120 RELATIONSHIP OF ATTESTATION AND OTHER PROFESSIONAL STANDARDS TO LITIGATION SERVICES**

**.01** Litigation services are professional services rendered by a practitioner or employee of the CPA firm in accordance with the AICPA's SSCS. Litigation services differ in several ways

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<sup>2</sup> *Ibid.*

from services provided in attestation engagements. In attestation engagements, the practitioner assesses the fairness of the written assertions of others, which may be in the form of financial statements, parts of such statements, or information not of a financial nature. In litigation engagements, the practitioner typically renders an expert opinion or provides other consulting services based upon expert judgment, experience, education, training, and analysis in compliance with applicable professional standards. The foundation of and audience for this opinion are different from those addressed by the attestation standards. Disclosure of the basis for the CPA's conclusion normally is greater in litigation services than in attestation services. In attestation engagements, the opinion expressed is that of the CPA firm. In litigation engagements, the individual practitioner is the expert expressing an opinion. The litigation services practitioner is not exempt from professional standards but must comply with standards different from those that apply to attestation services. An understanding of the standards is essential in order to evaluate the performance of the CPA expert. A decision tree to help practitioners determine which professional standards to comply with in an engagement is provided in exhibit 71C-1 in appendix 71/C.

**.02** Litigation services are normally exempt from compliance with attestation standards and certain other professional standards including the AICPA's Statements on Auditing Standards (SASs) and SSARs. In a July 1990 interpretation of the attestation standards, the AICPA's Auditing Standards Board indicated the circumstances under which the standards do not apply to litigation services. Similarly, in May 1991, the AICPA's Accounting and Review Services Committee issued an interpretation stating the conditions under which SSARs do not apply to litigation services engagements.

**.03** Attestation standards do not apply to litigation engagements when the CPA does not issue a report expressing an opinion about the assertion of another party.<sup>3</sup> (As part of a litigation services engagement, the CPA often is asked to critique the written report of the opposing party's expert. This consulting service in and of itself does not constitute an attestation service.) The CPA is subject to neither the SSAEs nor SSARs when serving as a trier of fact or an expert witness, when developing a work product that is subject to analysis and challenge by other parties to the dispute, or when performing work that is protected by the attorney's work product privilege and is not intended to be used for any other purposes.<sup>4</sup>

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<sup>3</sup> Attestation standards, according to the Interpretation of Statement on Standards for Attestation Engagements, "Attestation Standards: Attestation Engagements Interpretations of Section 100" (AICPA, *Professional Standards*, vol. 2, AT sec. 9100-50), may apply if the practitioner "expresses a written conclusion about the reliability of a written assertion that is the responsibility of another party and that conclusion and assertion are for the use of others who, under the rules of the proceedings, do not have the opportunity to analyze and challenge such work."

<sup>4</sup> See the Interpretation of Statement on Standards for Attestation Engagements, "Attestation Standards: Attestation Engagements Interpretations of Section 100" (AICPA, *Codification of Statements on Standards for Attestation Engagements*, AT sec. 9100.48) and the Interpretation of Statement on Standards for Attestation Engagements, "Attestation Standards: Attestation Engagements Interpretations of Section 100" (AICPA, *Professional Standards*, vol. 2, AT sec. 9100.76).

.04 When the SSAEs or the SSARs do not apply to litigation engagements, the work should be performed in compliance with the SSCS as well as the general standards and Code of Professional Conduct.

.05 Attestation standards may be applicable to litigation services engagements under certain circumstances. For instance, the practitioner may choose to perform litigation services in accordance with attestation standards. To decide what standards to follow, the practitioner has to evaluate carefully the steps that will be taken to complete the engagement. The AICPA's SSAEs usually do not apply to litigation services engagements. They do apply, however, when the practitioner, as a part of a litigation services engagement, is engaged specifically to perform a service governed by those standards or to express in writing a conclusion about the assertion of a third party that other parties cannot analyze or challenge.<sup>5</sup>

.06 A difficult circumstance could exist when, during the course of a litigation services engagement, the CPA firm is required to perform an audit or review of financial records to support a litigation opinion or is retained to perform professional services that come under the Statement on Standards for Accountants' Services on Prospective Financial Information, *Financial Forecasts and Projections*. The engagement clearly involves attestation services that are governed by the SSAEs. Accordingly, if the litigation services engagement requires the practitioner to perform an audit, the engagement will have to be in compliance with generally accepted auditing standards (GAAS). A practitioner who does not perform such an engagement in accordance with the attestation standards, but who nevertheless labels the work product as audited or uses the report language of prospective financial services, could be in violation of the professional standards. A requirement of independence exists for providing attestation services, but not for providing litigation services.

.07 Normally, SSARs do not apply to litigation services. However, these standards are applicable whenever the practitioner performs or is engaged to perform a compilation or a review as part of an overall litigation services engagement. Therefore, unless services must be performed in accordance with SSARs or unaudited financial statements are prepared, SSARs will not apply and the consulting standards will govern the conduct of the engagement.

.08 Identification of the applicable standards may be difficult in some circumstances. At the outset of the engagement, it may not be clear whether the practitioner's work product is subject to the attestation standards. If engaged, the practitioner should therefore attempt to foresee the outcome of the engagement and decide whether the attestation standards or the consulting standards apply.

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<sup>5</sup> The evaluation of statements contained in a written assertion of another party when providing a consulting service does not in and of itself constitute the performance of an attest service. See the Statement on Standards for Attestation Engagements, *Attestation Standards* (AICPA, *Professional Standards*, vol. 1, AT sec. 100.74) for further explanation.

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### Reporting Standards

**.09** No specific reporting standards apply to consulting engagements including litigation services engagements. However, the SSCS requires that the results of a consulting engagement be communicated to the client without specifying the nature of the communication. Whether the practitioner needs to provide a conclusion and written report at the end of the engagement depends upon the agreement between the client and the practitioner.

**.10** If a written report is provided, it must be worded carefully to avoid representing that the work was performed in conformance with the attestation standards when it was not. Accordingly, a term such as *examination* should be avoided because it implies the use of the attestation standards.

**.11** Certain litigation proceedings involve no direct oral testimony. In such cases, the practitioner may be asked to issue testimony in writing. There are no reporting standards that apply to testimony in a litigation services engagement. Furthermore, given the diversity of litigation engagements, a standard reporting format is impractical and unrealistic. However, the practitioner who issues a report must convey the purpose of the report in a clear and logical manner, which accurately reflects the work performed and the conclusions reached and does not imply conclusions that were not reached or standards that were not implemented.

### 71/125 CONCLUSION

**.01** Litigation services encompass a wide range of professional services that a practitioner may provide to clients. A list of engagement situations and the products, services, and functions associated with litigation services is provided in appendix 71/A. The practitioner and the client should understand the professional standards that apply in a litigation services engagement. The general standards of the profession and the Code of Professional Conduct apply to all services rendered by a practitioner. Usually, litigation services are covered by the SSCS. However, the practitioner may accept and perform litigation engagements that require compliance with the SSAEs or the SSARs.

## APPENDIX 71/A

**TYPICAL LITIGATION SERVICES ENGAGEMENTS  
AND THEIR PRODUCTS AND SERVICES**

Although the following list of products and services is extensive, it is not all-inclusive.

- A. A CPA may be engaged to provide litigation services as—
- An expert witness before a trier of fact.
  - A consulting expert to an attorney (protected by the attorney's work product privilege) with no other intended purpose.
  - A trier of fact.
  - An arm of the court (as distinct from being appointed by the court as accountant for the parties).
- B. The possible products or services include—
- Computation of economic damages:
    - Lost profits
    - Lost value
    - Extra costs
    - Lost cash flow
    - Mitigation
    - Restitution
  - Professional standards analyses.
  - Valuation of:
    - Businesses
    - Pensions
    - Intangibles
  - Fraud identification.
  - Pre- and post-bankruptcy restructuring and liquidation consulting.
  - Products relating to solvency in bankruptcy situations.
  - Tax analyses:
    - Tax basis
    - Cost allocation
    - Treatment of specific transactions
  - Maintenance and asset divisions relating to divorce.
  - Contract cost and claims analyses.



- Historical results analyses.
- Projections.
- Antitrust analyses:
  - Price fixing
  - Market share
  - Market definition
  - Predatory conduct
  - Dumping
  - Price discrimination
- Attest services, if specifically engaged to perform them in connection with litigation services.

C. Any of the following functions may be performed:

- Issue identification
- Locating other experts
- Fact-finding:
  - Asset searches
  - Market studies
  - System reviews
  - Interviewing of witnesses
  - Due diligence
  - Research
- Analysis:
  - Investigative accounting
  - Computer modeling
  - Statistical
  - Actuarial
- Discovery assistance
- Document management
- Settlement assistance
- Expert testimony
- Trial and deposition assistance
- Post-trial support (bookkeeping services, funds administration)

- Negotiations
- Arbitration
- Mediation
- Training

## APPENDIX 71/B

**BANKRUPTCY AND REORGANIZATION SERVICES****Bankruptcy and Reorganization Services Defined**

CPAs frequently provide accounting and financial advisory services, as well as unique bankruptcy services, such as acting as trustee-examiners and providing claims processing, to financially troubled companies that are considering or are in the process of reorganizing. The reorganization may be a formal proceeding in a bankruptcy court (for example, a Chapter 11 case) or an out-of-court restructuring. Such services may also be provided to creditors and other parties-in-interest of the restructuring company. Common characteristics of troubled companies that seek to restructure include underperformance, poor cash flow, overleveraging, weak management, extensive litigation involvement (for example, product liability cases and labor disputes), loss of market share, and so forth.

The delivery of reorganization services to such companies may include—

- Preparing or reviewing valuations of the debtor's business.
- Analyzing the profitability of the debtor's business.
- Preparing or reviewing the monthly operating reports required by the bankruptcy court.
- Reviewing disbursements and other transactions for possible preference payments and fraudulent conveyances.
- Preparing or reviewing the financial projections of the debtor.
- Performing financial advisory services associated with mergers, divestitures, capital adequacy, debt capacity, and so forth.
- Consulting on strategic alternatives and developing business plans.
- Providing assistance in developing or reviewing plans of reorganization or disclosure statements.<sup>6</sup>

Reorganization services are dynamic. Often the scope of the engagement is revised as the restructuring progresses and as negotiation strategies develop. Companies frequently begin a reorganization outside of bankruptcy, but when they cannot reach agreement with all the necessary parties, the reorganization is completed as a bankruptcy proceeding.

Out-of-court restructurings are generally undertaken with the aid of bankruptcy counsel and financial advisers. Each negotiating party, such as a borrower or a lender, enters the discussions with full knowledge of its rights should a bankruptcy filing result from the failure to reach a consensus on the restructuring.

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<sup>6</sup> The words *review* and *reviewing* are not intended to have the same meaning as they do in the AICPA's SSARSs.

## **Bankruptcy and Restructuring Services as Litigation Services**

Bankruptcy services provided by CPAs generally are accepted as a form of litigation services. This acceptance is due to the many fundamental and practical similarities between bankruptcy services and the consulting services associated with other forms of litigation. Bankruptcy law, as promulgated by the Bankruptcy Code and case law, is applied by bankruptcy judges and lawyers to resolve disputes between a debtor and its creditors (for example, distribution of the debtor's assets). Bankruptcy cases frequently include actions related to claims for preferential payments and fraudulent conveyances; negligence of officers, directors, or professionals engaged by the debtors; or other allegations common to commercial litigation. The bankruptcy court has the power and authority to value legal claims and resolve such common litigation as product liability, patent infringement, and breach of contract. The decisions of bankruptcy judges can be appealed as can the decisions of other courts.

From a practical standpoint, negotiation among the parties in bankruptcy cases is as important as it is in civil and criminal litigation (for example, settlement of commercial litigation and plea bargains in criminal trials). When the parties are unable to resolve the disputes themselves, the trier of fact determines the outcome.

There are similarities between the judicial process applied to bankruptcy and that used for other litigation (for example, discovery, expert testimony, and rules of evidence). It is reasonable to conclude, therefore, that bankruptcy services are a form of litigation services consistent with the type of services contemplated by the AICPA in developing the interpretation, "Applicability of Attestation Standards to Litigation Services" (AICPA, *Professional Standards*, vol. 1, AT sec. 9100.47-55).

Out-of-court restructuring holds the potential for litigation. Therefore, the settlement process is generally conducted with the same scrutiny, due diligence, and intense challenge as that of a formal court-administered process. Furthermore, bankruptcy services provided by CPAs are typically not three-party attest services (the three parties in attest services are the assertor, the attester, and the third party). Instead, affected parties have the opportunity to question, challenge, and provide input to the bankruptcy findings and process.

## **When Other Professional Standards Apply to Bankruptcy and Reorganization Services**

CPAs regularly provide both consulting and attest services in connection with bankruptcy or restructuring. The CPA must evaluate the nature of the services carefully to determine if any are exempt from the Statements on Standards for Attestation Engagements (SSAEs) and the Statements on Standards for Accounting and Review Services (SSARs). For the litigation services' exemption to apply, the service must be performed in connection with the litigation and the parties to the proceeding must have an opportunity to analyze and challenge the work of the CPA. Furthermore, the CPA must—

- Assess the services to be performed.
- Understand the intended use of the CPA's work product.

- Identify the parties that may rely on the work product.
- Decide whether the attestation standards apply.

It is quite possible that in a particular reorganization engagement, certain services will not be subject to attestation standards, but others will. If the attestation standards do not apply, the CPA should consider disclosing on the face of the documents, or in a separate report, the extent of service rendered and the responsibility assumed by the CPA, if any. Such disclosures may help the reader to understand the extent of the CPA's role and the intended use of the work product.

Both the SSAEs and SSARs are applicable to litigation services and bankruptcy engagements when the practitioner—

- a. Expresses a written conclusion about the reliability of a written assertion by another party, and the conclusion and assertion are for the use of others who, under the rules of the proceedings, cannot analyze and challenge the work.
- b. In connection with litigation services, is specifically engaged to perform a service in accordance with the SSAEs or SSARs.

Further, an essential part of many bankruptcies and restructurings is the development of prospective financial information (PFI). PFI often is used to negotiate with creditors or committees of creditors representing a group or class of creditors. PFI also may be included in disclosure statements to inform creditors and other parties of the financial condition of the company according to certain restructuring and operating instructions.

Parties-in-interest generally can challenge PFI and its assumptions during negotiations or during bankruptcy court hearings on the plan's feasibility and adequacy of disclosure. In situations in which the users of the PFI cannot challenge the CPA's work, the attestation standards may apply. Such situations may arise, for example, when exchange offers are made to creditors or shareholders with whom the company has not negotiated or who are not members of a creditor group represented by a committee.

The attestation standards (in Statement on Standards for Accountants' Services on Prospective Financial Information, *Financial Forecasts and Projections* (AICPA, *Professional Standards*, vol. 1, AT section 200.02) generally provide that an examination, compilation, or agreed-upon procedures engagement should be performed whenever an accountant submits PFI to clients or others. However, AT section 200.03 does provide an exemption from the attestation standards when an engagement involves prospective financial statements used solely in connection with litigation support services. This exemption is provided because, among other things, the accountant's work in such proceedings is ordinarily subject to detailed analysis and challenge by each party to the dispute.

When attestation standards do not apply, CPAs may wish to state the extent of their association with any work product and the responsibility they have assumed. It may be appropriate for CPAs to explain both their association and their responsibility, if any, through a transmittal letter or a statement affixed to documents distributed to third parties. The following wording is suggested:

The accompanying schedules (projected financial information; debt capacity analysis; liquidation analysis) were assembled for your analysis of the proposed restructuring and recapitalization of ABC Company. The aforementioned schedules were not examined or reviewed by independent

**71/100-18**

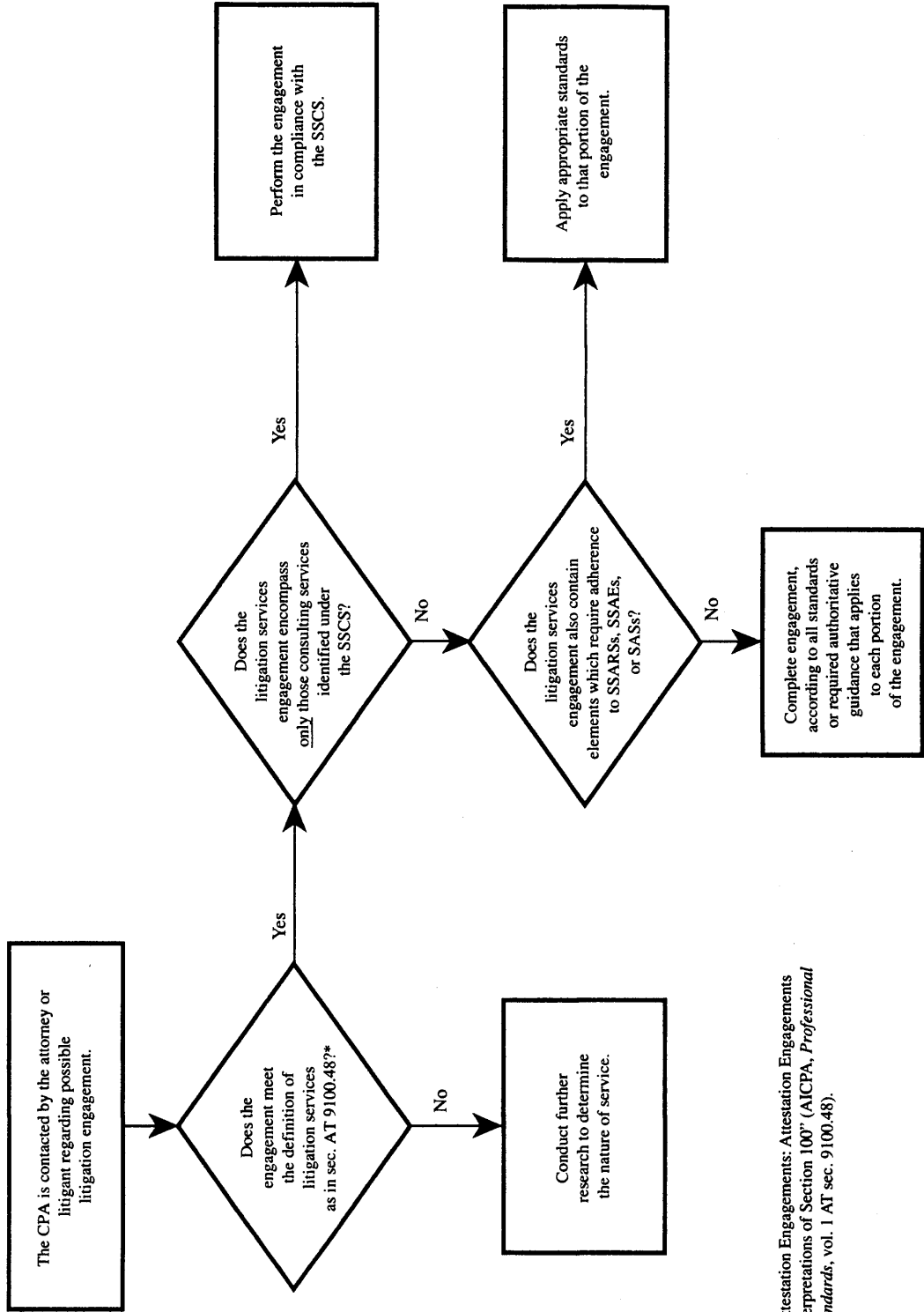
accountants in accordance with standards promulgated by the AICPA. This information is limited to the sole use of the parties involved (management; creditors' committee; bank syndicate) and is not to be provided to other parties.

## APPENDIX 71/C

**DECISION TREE FOR DETERMINING THE APPROPRIATE PROFESSIONAL STANDARDS  
TO APPLY TO LITIGATION SERVICES, WITH ILLUSTRATIVE CASE STUDIES**

Practitioners can use the decision tree provided in exhibit 71C-1 to determine which professional standards apply in a litigation services engagement. The case studies in exhibits 71C-2 to 71C-6 illustrate the application of the decision tree to particular engagements.

### Decision Tree to Determine the Application of Professional Standards



\* "Attestation Engagements Interpretations of Section 100" (AICPA, *Professional Standards*, vol. 1 AT sec. 9100.48).



### Case Study I: Forensic Accounting

Mark Helm, CPA, has been requested by ABC Company to ascertain the extent of fraud allegedly perpetrated by one of the company's employees. The results of the investigation will be used to negotiate a settlement with PENN Bonding Company. Helm has been asked to perform the procedures that he considers necessary, and it is expected that he will issue a formal report.

The following questions and answers illustrate the process of determining which professional standards must be complied with in the engagement:

A. *Question:* What form of service is being requested?

*Answer:* The answer to question A can be determined by applying the decision tree in exhibit 71C-1, as follows:

<u>Step</u>	<u>Criteria</u>	<u>Decision</u>
1.	Does the engagement meet the definition of litigation services?	Yes. Forensic accounting is a litigation service.
2.	Does the litigation services engagement encompass only those consulting services identified under the SSCS?	Yes. The practitioner is to perform a consulting service.
3.	Does the litigation services engagement also contain elements that require adherence to the SSARSs, SSAEs, or SASs?	No. See below.

Exemption from the SSARSs, SSAEs, and SASs requires a *no* answer to question *a* or a *yes* answer to any questions from *b* through *e*.

- |    |   |     |
|----|---|-----|
| a. | Will the practitioner issue a written communication that expresses a conclusion about the reliability of a written assertion that is the responsibility of another party? | No. |
| b. | Will the service comprise being an expert witness?  | No. |
| c. | Will the service comprise being a trier of fact or acting on behalf of one?   | No. |

- d. Is the practitioner's work, under the rules of the proceedings, subject to detailed analysis and challenge by each party to the dispute? Yes.\*
  - e. Is the practitioner engaged by an attorney that will be protected by the attorney's work product privilege, and is such work not intended to be used for other purposes? No.
- 4. Determine the nature of the elements not covered by the SSCS, SSARs, SSAEs, or SASs, and adhere to appropriate standards or refer to available guidance.
  - 5. Complete the engagement.

B. *Question:* Would the answer be different if no formal report was requested and the results were to be supported only by Helm's working papers?

*Answer:* No. The answer would be the same. The written report is not a criterion for distinguishing engagements.

C. *Question:* If Helm constructs the engagement as an agreed-upon procedures engagement, is he governed by "Special Reports—Applying Agreed-Upon Procedures to Specified Elements, Accounts, Items of a Financial Statement," (AICPA, *Statement on Auditing Standards No. 35*, Section 622), on agreed-upon procedures or by the attestation standards?

*Answer:* Neither. The answer would be the same. Agreed-upon procedures can be used in a consulting engagement and the practitioner can look to SAS 35 for guidance but should not indicate, imply, or construe the engagement as falling under the attestation standards or the auditing standards (including SAS 35).

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\* It is reasonable to presume that the adverse party will evaluate and challenge the company's position.

### Case Study II: Potential Legal Proceedings

Barbara Matson, CPA, has been requested by XYZ Company, which is a defendant in a legal suit, to evaluate a damages study presented by the plaintiff Contractors, Inc. Matson has been requested to provide a report of her findings and an opinion regarding the reasonableness of the study. The following questions and answers illustrate the process of determining the professional standards with which Matson must comply in performing the engagement.

A. *Question:* What form of service is being requested?

*Answer:* The answer to question A can be determined by applying the decision tree in exhibit 71C-1, as follows:

<u>Step</u>	<u>Criteria</u>	<u>Decision</u>
1.	Does the engagement meet the definition of litigation services?	Yes. The case involves a client with potential formal legal or regulatory proceedings before a trier of fact.
2.	Does the litigation services engagement encompass only the consulting services identified under the SSCS?	No. As stated in Statement on Standards for Attestation Engagements, <i>Attestation Standards</i> , (AICPA, <i>Professional Standards</i> . vol. 1, AT sec. 100.75). "The evaluation of statements contained in a written assertion of another party when performing a management advisory service does not in and of itself constitute the performance of an attest service."
3.	Does the litigation services engagement also contain elements that require adherence to the SSARs, SSAEs, or SASs?	No. See below.

Exemption from the SSARs, SSAEs, and SASs requires a *no* answer to question *a* or a *yes* answer to any questions from *b* through *e*.

- |    |  |   |
|----|--|---|
| a. | Will the practitioner issue a written communication that expresses a conclusion about the reliability of a written assertion of another party? | No. See the response to question 2 above. |
| b. | Will the service comprise being an expert witness?   | No.                                       |

- c. Will the service comprise being a trier of fact or acting on behalf of one? No.
- d. Is the practitioner's work, under the rules of the proceedings, subject to detailed analysis and challenge by each party to the dispute? No.
- e. Is the practitioner engaged by an attorney to do work that will be protected by the attorney's work product privilege, and is such work not intended to be used for other purposes? No.

- 4. Determine the nature of the elements not covered by the SSCS, SSARs, SSAEs, or SASs and adhere to appropriate standards or refer to available guidance.
- 5. Complete the engagement.

B. *Question:* Under what circumstances would this become an attestation engagement?

*Answer:* If Matson was engaged to report to both parties as to the reliability of the damage study.

### Case Study III: Expert Witness

John Lake, CPA, has been requested by the law firm of Smith & Miller to be an expert witness and provide a report critiquing a damage study prepared for the law firm by Ray Dante, another expert witness. The following questions and answers illustrate the process of determining which professional standards Lake must comply with in performing the engagement.

A. *Question:* What form of service is being requested?

*Answer:* The answer to question A can be determined by applying the decision tree in exhibit 71C-1, as follows:

<u>Step</u>	<u>Criteria</u>	<u>Decision</u>
1.	Does the engagement meet the definition of litigation services?	Yes. The practitioner is engaged to be an expert witness.
2.	Does the litigation services engagement encompass only those consulting services identified under the SSCS?	Yes. This practitioner is to perform a consulting service.
3.	Does the litigation services engagement also contain elements that require adherence to the SSARSs, SSAEs, or SASs?	No. See below.

Exemption from the SSARSs, SSAEs, and SASs requires a *no* answer for question *a* or a *yes* answer to any question from *b* through *e*.

a.	Will the practitioner issue a written communication that expresses a conclusion about the reliability of a written assertion of another party.	No. As stated in Statement on Standards for Attestation Engagements, <i>Attestation Standards</i> , (AICPA, <i>Professional Standards</i> , vol. 1, AT sec. 100.75). "The evaluation of statements contained in a written assertion of another party when performing a management advisory service does not in and of itself constitute the performance of an attest service."
b.	Will the service comprise being an expert witness?	Yes.
c.	Will the service comprise being a trier of fact or acting on behalf of one?	No.

d. Is the practitioner's work, under the rules of the proceedings, subject to detailed analysis and challenge by each party to the dispute? No.

e. Is the practitioner engaged by an attorney to do work that will be protected by the attorney's work product privilege, and is such work not intended to be used for other purposes? Yes.

4. Determine the nature of the elements *not* covered by the SSCS, SSARSs, SSAEs, or SASs, and adhere to appropriate standards or refer to available guidance.

5. Complete the engagement.

B. *Question:* Would the answer to question A be different if John's conclusions were to be expressed in testimony to the court in a form that adheres to the SSAEs or SSARSs.

*Answer:* Yes, if Smith & Miller had requested Lake to issue a report in accordance with the SSAEs or SSARSs or if Lake had decided to do so.

### Case Study IV: Claim Evaluation

Judith Sauter, CPA, has been requested by Pawling Insurance Company to evaluate a claim by an insured for a business interruption that is in litigation. Sauter is requested to perform the procedures she considers necessary to evaluate the claim, supporting her conclusions in her working papers. The following questions and answers illustrate the process of determining which professional standards Sauter must comply with in performing the engagements.

A. *Question:* What form of service is being requested?

*Answer:* The answer to question A can be determined by applying the decision tree in exhibit 71C-1, as follows:

<u>Step</u>	<u>Criteria</u>	<u>Decision</u>
1.	Does the engagement meet the definition of litigation services?	Yes. The practitioner is engaged to do work related to a claim in litigation.
2.	Does the litigation services engagement encompass only those consulting services identified under the SSCS?	Yes. The engagement is a consulting service as contemplated by the SSCS.
3.	Does the litigation services engagement also contain elements that require adherence to the SSARs, SSAEs, or SASs?	No. See below.

Exemption from the SSARs, SSAEs, and SASs requires a *no* answer to question *a* or a *yes* answer to any question from *b* through *e*.

a.	Will the practitioner issue a written communication that expresses a conclusion about the reliability of a written assertion of another party?	No. The workpapers are not a written report on a third party assertion but are the practitioner's own assertions.
b.	Will the service comprise being an expert witness?	No.
c.	Will the service comprise being a trier of fact or acting on behalf of one?	No.

d. Is the practitioner's work under the rules of the proceedings, subject to detailed analysis and challenge by each party to the dispute? No.

e. Is the practitioner engaged by an attorney to do work that will be protected by the attorney's work product privilege, and is such work not intended to be used for other purposes? No.

4. Determine the nature of the element not covered by the SSCS, SSARs, SSAEs, or SASs and adhere to appropriate standards or refer to available guidance.

5. Complete the engagement.

B. *Question:* Would the answer to question A be different if a formal report was requested?

*Answer:* No. As stated in Statement on Standards for Attestation Engagements, *Attestation Standards*, (AICPA, *Professional Standards*. vol. 1, AT sec. 100.75) "The evaluation of statements contained in a written assertion of another party when performing a management advisory service does not in and of itself constitute the performance of an attest service."



### Case Study V: Business Valuation and Audit

Paul Davis, CPA, has been requested by Bob Trep, managing partner of Able Law Services, a law firm in a partnership dissolution and whose partners are in litigation with one another, to perform a business valuation and to audit the practice's financial statements as of the date of the dissolution in accordance with the SSAEs. The following questions and answers illustrate the process of determining which professional standards Davis must comply with in performing the engagement.

A. *Question:* What form of service is being requested?

*Answer:* The answer to question A can be determined by applying the decision tree in exhibit C-1, as follows:

<u>Step</u>	<u>Criteria</u>	<u>Decision</u>
1.	Does the engagement meet the definition of litigation services?	Yes. The practitioner is performing a business valuation and the client situation involves pending formal legal or regulatory proceedings before a trier of fact.
2.	Does the litigation services engagement encompass only those consulting services identified under the SSCS?	No. This practitioner is to perform an attestation service.
3.	Does the litigation services engagement also contain elements that require adherence to the SSARSs, SSAE, or SSASs?	Yes. See below

Exemption from the SSARSs, SSAEs, and SASs require a *no* answer for question *a* or a *yes* answer to any question from *b* through *e*.

a.	Will the practitioner issue a written communication that expresses a conclusion about the reliability of a written assertion of another party.	Yes.
b.	Will the service comprise being an expert witness?	No.
c.	Will the service comprise being a trier of fact or acting on behalf of one?	No.

d. Is the practitioner's work under the rules of the proceedings, subject to detailed analysis and challenge by each party to the dispute? No.

e. Is the practitioner engaged by an attorney to do work that will be protected by the attorney's work product privilege, and is such work not intended to be used for other purposes? No.

4. Determine the nature of the elements not covered by the SSCS, SSARs, SSAEs, or SASs and adhere to appropriate standards or refer to available guidance.

5. Complete the engagement.

B. *Question:* Would adherence to the SSAEs be required if Paul was not specifically engaged to perform the service in accordance with the SSAEs?

*Answer:* No, if Paul's written communication, which expresses a conclusion about the reliability of the financial statements, is, under the proceedings, subject to detailed analysis and challenge by each party to the dispute.

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