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Fraud investigations in litigation and dispute resolution services : a nonauthoritative guide; Consulting services practice aid, 97-1

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**CONSULTING SERVICES
PRACTICE AID 97-1**

AICPA

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

Technical Consulting

Fraud Investigations in Litigation and Dispute Resolution Services

A Nonauthoritative Guide

Management Consulting Services Team

NOTICE TO READERS

This practice aid 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. Other approaches, methodologies, procedures, and presentations may be appropriate because of the widely varying nature of management consulting services as well as specific or unique facts about the client and engagement.

Various members of the 1995–1996 AICPA Litigation and Dispute Resolution Services Subcommittee provided information for this practice aid and advised the authors and staff. The subcommittee members are listed below.

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*Ronald L. Durkin
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PREFACE

This practice aid is one of a series intended to assist practitioners in applying their knowledge of organizational functions and technical disciplines in the course of providing consulting services. Although these practice aids often deal with aspects of consulting services knowledge in the context of a consulting engagement, they are also intended to be useful to practitioners who provide advice on the same subjects in the form of a consultation. Consulting services engagements and consultations are defined in the Statement on Standards for Consulting Services (SSCS), *Consulting Services: Definitions and Standards*, issued by the AICPA.

This series of technical consulting practice aids should be particularly helpful to practitioners who use the expertise of others while remaining responsible for the work performed. It may also prove useful to members in industry and government in providing advice and assistance to management.

Technical consulting practice aids do not purport to include everything a practitioner needs to know or do to undertake a specific type of service. Furthermore, engagement circumstances differ and therefore the practitioner's professional judgment may cause him or her to conclude that an approach described in a particular practice aid is inappropriate.

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75/100

FRAUD INVESTIGATIONS IN LITIGATION AND DISPUTE RESOLUTION SERVICES

75/105 INTRODUCTION

.01 Litigation and dispute resolution services are provided by a CPA using accounting and consulting skills to assist a client in a matter that involves a pending or potential formal legal or regulatory proceeding before a “trier of fact” (for example, a judge, jury, arbitrator, mediator, or special master) in connection with the resolution of a dispute between two or more parties.¹ Litigation services, a type of consulting service, are provided by a CPA acting only as a consultant, usually to an attorney, or as an expert witness. The services provided may include fact-finding (such as assistance in the discovery and analysis of data), damage calculations, document management, preparation of demonstrative evidence, expert testimony, and other professional services. Fraud investigation is one of the many services considered litigation services.² Litigation services are classified as transaction services in the Statement on Standards for Consulting Services (SSCS) No. 1,³ and are subject to the SSCS, as well as the professional standards embodied in the AICPA Code of Professional Conduct.

75/110 SCOPE OF THIS PRACTICE AID

.01 Cases involving management fraud, money laundering, tax fraud, bankruptcy fraud, securities fraud, and other types of fraud continue to be prevalent and are increasing in frequency. Fraud issues surface in many engagement circumstances that involve the skills of the CPA, including attest, tax, and general consulting services. However, this practice aid discusses the CPA’s responsibilities, opportunities, and assignments in fraud-related matters only in the context of litigation services and provides nonauthoritative guidance for the CPA providing such services. This practice aid does not set standards for the performance of such engagements or other litigation services.

.02 A key difference between litigation services engagements and other consulting services engagements is that litigation services involve an actual or potential dispute resolution proceeding.

¹ AT Section 9100.48. The practice discipline includes actual or potential disputes that may or may not proceed to formal litigation. For brevity’s sake, this practice aid uses the term *litigation services* when, unless otherwise indicated, it means *litigation and dispute resolution services*. This practice aid may benefit CPAs, as well as non-CPAs employed by member firms. Similarly, therefore, the provider of these services is referred to as the CPA, although other professionals also provide such services.

² Litigation services are discussed in detail in Consulting Services Practice Aid 93-4, *Providing Litigation Services* (New York: AICPA, 1993)

³ CS Section 100. SSCS No. 1 was effective January 1, 1992.

Many CPA services that address or consider the possible occurrence or prevention of fraud, are not necessarily classified as litigation services. These services include the following:

- Assessing the risk of fraud and illegal acts.
- Evaluating the adequacy of internal control systems.
- Substantive testing of transactions during an attest or a general consulting engagement.
- Designing and implementing internal control procedures.
- Proactive fraud auditing when fraud is not suspected.
- Preparing company codes of business ethics and conduct.
- Consulting about employee bonding.
- Developing corporate compliance programs.⁴

.03 The services listed above are not addressed in this practice aid. In practice, a CPA may perform many or all of the above-mentioned activities when providing either litigation or nonlitigation services that involve concerns about fraud. This fact does not change the distinction between the two categories of assignments, nor does it warrant broadening the scope of this practice aid.

.04 A CPA who is providing nonlitigation services may encounter signs of actual or potential fraud that might be considered during the nonlitigation services engagement or that might be addressed specifically in a separate engagement. If an attest team detects errors and irregularities that suggest fraud, the attest engagement team must comply with the applicable professional standards.⁵ However, the attest team should report their concerns to management, or other company representatives, who might initiate a fraud investigation using appropriate counsel as well as CPAs. Counsel, with the CPA's assistance, would conduct the fraud investigation and communicate the findings to management. Then, management could provide the findings to the attest team, who would evaluate the findings and proceed as appropriate. This practice aid discusses many fraud investigation assignments and approaches, but does not represent that all such services should be included in each CPA's scope of practice.

⁴ Under the Federal Sentencing Guidelines, a company compliance program could help mitigate the amount of fines and the determination of whether probation should be imposed as part of an organization's sentence. The program must be in place prior to the time a violation occurred to reduce the company's fine.

⁵ The auditor's responsibilities to detect and report on fraud as a part of an audit in accordance with GAAS or as a result of the performance of other accounting services is defined in various portions of the AICPA professional standards, including, but not limited to, the AICPA Professional Standards in AU 316, *Consideration of Fraud in a Financial Statement Audit* (SAS No. 82), AU 316A, *The Auditor's Responsibility to Detect and Report Errors and Irregularities* (SAS No. 53), and AU 317, *Illegal Acts by Clients* (SAS No. 54). There are no similar standards applicable to consulting engagements.

75/115 NONAUTHORITATIVE GUIDANCE AND PROFESSIONAL STANDARDS

.01 SSCS No. 1 applies to fraud investigations as litigation services and subjects such engagements to Rule 201 of the AICPA Code of Professional Conduct, which comprises the standards of professional competence, due professional care, planning and supervision, and sufficient relevant data, and the SSCS No. 1, which establishes the standards of client interest, understanding with client, and communication with client. Such engagements also are subject to the AICPA Code of Professional Conduct.⁶

.02 In addition to this practice aid, other AICPA practice aids and special reports provide nonauthoritative guidance about fraud investigations in litigation services to the CPA. These publications discuss the nature of litigation services more fully, including applicable professional standards, conflicts of interest, the differences between attest and consulting services, communication considerations for consulting engagements, and engagement letters.

Nonauthoritative Literature

.03 The nonauthoritative publications include:

- Consulting Services Special Report 93-1, *Application of AICPA Professional Standards in the Performance of Litigation Services* (New York: AICPA, 1993).
- Consulting Services Special Report 93-2, *Conflicts of Interest in Litigation Services Engagements* (New York: AICPA, 1993).
- Consulting Services Special Report 93-3, *Comparing Attest and Consulting Services: A Guide for the Practitioner* (New York: AICPA, 1993).
- Consulting Services Practice Aid 93-4, *Providing Litigation Services* (New York: AICPA, 1993).
- Management Advisory Services Practice Administration Aid No. 3, *Written Communication of Results in MAS Engagements* (New York: AICPA, 1987).
- Consulting Services Practice Aid 95-2, *Communicating Understandings in Litigation Services: Engagement Letters* (New York: AICPA, 1995).
- AICPA Consulting Services Practice Aid 96-3, *Communicating in Litigation Services: Reports* (New York: AICPA, 1996).

⁶ In addition to Rule 201— General standards, the CPA fraud investigation is subject to such Code requirements as Rule 102— Integrity and objectivity, including ET 102.06 — Applicability of Rule 102 to members performing educational services and ET 102.07 — Professional services involving client advocacy.

Authoritative Literature

.04 Readers should also be aware that the following authoritative literature applies to litigation services as well as any other service provided by CPAs in public practice:

- AICPA Code of Professional Conduct (particularly Rule 201)
- Statement on Standards for Consulting Services No. 1, "Consulting Services: Definitions and Standards"

75/120 DEFINITIONS

.01 An understanding of selected terms is important to the CPA rendering litigation services relative to fraud issues. The term *fraud* is defined in *Black's Law Dictionary* (Sixth Edition, 1990) as:

An intentional perversion of truth for the purpose of inducing another in reliance upon it to part with some valuable thing belonging to him or to surrender a legal right. A false representation of a matter of fact, whether by words or by conduct, by false or misleading allegations, or by concealment of that which should have been disclosed, which deceives and is intended to deceive another so that he shall act upon it to his legal injury. . . . A generic term, embracing all multifarious means which human ingenuity can devise, and which are resorted to by one individual to get advantage over another by false suggestions or by suppression of truth, and includes all surprise, trick, cunning, dissembling, and any unfair way by which another is cheated.

Fraud can also be defined as either a misrepresentation of a material fact relied upon by someone to their detriment, or concealed, improper conversion of another's assets to one's own benefit. While theft simply involves the taking or appropriating of assets without consent, fraud includes the intentional use of deception to the same end. The ultimate conclusion of law regarding any fraudulent act is a matter for the trier of fact since fraud involves state-of-mind issues for both the perpetrator and the victim (for example, intent and reliance) which cannot be directly evaluated by the CPA. In summary, the essential elements of fraud are:

- a. Intentional material false statements or willful omission of a material fact, either orally or in writing.
- b. Knowledge by the perpetrator that the statements or omissions are false and misleading.
- c. Intent for the misrepresentation to be acted upon.
- d. Reliance by the victim on the statements made.
- e. Damage to the victim who relied upon the false statements.

.02 Fraud involving a business entity often falls into one of the following categories:

- *Management fraud*, which involves intentional misrepresentation of financial statements or theft or improper use of resources by senior management.
- *Employee fraud*, which involves theft or improper use of resources by employees below the entity's senior management level.
- *External fraud*, which involves theft or improper use of resources by people who are neither management nor employees of the firm.

.03 The above categorization of fraud is useful, but not absolute. Middle management employees may intentionally misrepresent financial statement transactions, for example, to improve their apparent performance, or outside individuals may collude with company management or employees. In addition, many other types of fraud exist in which the victim is not a business, such as securities fraud perpetrated on individual investors or fraud perpetrated in the procurement of government contracts.

.04 No specific standard terminology is used to name the CPA's litigation services assignment when fraud is suspected or alleged. Many terms are used interchangeably, including *forensic or fraud audit, examination, investigation or accounting*, but the term *forensic* is also generally used in conjunction with descriptions of other litigation consulting services. For engagements involving suspected or alleged fraud, these terms are used to describe a process that usually involves the following activities:

- Using knowledge about the principles for recording transactions, accumulating data relating to assets, liabilities, revenues, and expenses, and interpreting the financial books, records, and statements of any entity, or individual, in an inspection, probe, inquiry, scrutiny, search, study, or survey for the purpose of discovering or developing information about actual or potential fraud.
- Applying knowledge and expertise about fraud to the assessment of records validity.
- Conducting interviews and reviewing documents.
- Assisting in determining the fraud methodology, the fraud parameters, the fraud participants, and the amount of damages.

.05 Many of the other terms also frequently used during fraud investigations are included in the glossary of this practice aid.

75/125 TYPES OF ENGAGEMENTS

.01 The CPA may be engaged by a client (an attorney, the attorney's client, or another party) to provide litigation consulting services involving a fraud investigation. The CPA may be engaged as a

consultant, an expert witness, or both.⁷ Sometimes, the CPA may begin the assignment as a consultant only, then later be designated as an expert witness. This transition may occur, for example, when the CPA is engaged to investigate potential fraud, then is asked to present his or her findings to a trier of fact. The CPA may be retained by an individual, a business, a public entity, or various groups potentially affected by a fraud, such as creditors, shareholders, investors, partners, or business managers. The business client may include management, the board of directors, the audit committee or others. Early identification of the client is particularly important because the CPA may suspect management fraud later. For a formal dispute, the CPA may be retained by either the plaintiff or the defendant in either civil or criminal litigation.

.02 The CPA who provides litigation services associated with fraud issues may be retained to perform a variety of assignments. The more common types of fraud investigation engagements include investigating suspected fraud (the presence of fraud is possible, but not certain), investigating assertions of fraud (an individual makes specific allegations), and developing fraud-loss estimates.

Investigating Suspected Fraud

.03 The client may observe events or receive other information that suggests fraud is occurring or has occurred. For example, an employer may notice that an employee's standard of living exceeds his or her actual earnings and other known financial resources, a business manager may believe that assets of the business are dissipating without reasonable explanation, or investors may feel they are not receiving adequate explanations for the loss of their funds. In such situations, the CPA could be retained to help explore the possible presence of fraud. The engagement is considered to be a litigation consulting service because the CPA's findings may be important in any resulting dispute resolution proceeding between the harmed party and those committing the fraud. The CPA could begin the engagement stemming from fraud suspicions in the role of consultant only, but this role could change to that of expert witness, if the investigation leads to a formal dispute resolution proceeding.

.04 To investigate and identify suspected fraud, the CPA uses the tools of traditional accounting data examination, as well as other investigative techniques which may be beyond the realm of experience and training for many CPAs. The CPA identifies high risk areas and then performs certain analyses to detect the signs or indicia of fraud. He or she may use computers and computer-assisted analyses, such as statistical sampling, in addition to more traditional accounting investigation approaches, such as verifying supporting documentation for recorded transactions. In investigating fraud, the CPA looks for certain *red flags* or signs of possible fraudulent activity. Red flags may consist of bank checks written in large amounts payable to cash, bank checks written frequently in small amounts to the same payee or for a similar ostensible purpose where the cumulative value is significant, fund transfers to offshore banks, transactions not consistent with the entity's business purpose, and frequent or unusual related-party transactions. There are also environmental and

⁷ See Consulting Services Practice Aid 93-4, *Providing Litigation Services* (New York: AICPA, 1993) for a detailed discussion of the roles of the expert witness and consultant.

behavioral fraud indicators, such as the opportunity or pressure to commit certain acts of fraud. App. A presents a summary of selected indicia of fraud.

.05 Fraud may be undetected for extended periods because the wrongdoing is intentionally concealed by the perpetrator. Individuals may collude to disguise their actions. Collusion is difficult to detect and may continue indefinitely. The CPA should realize that a fraud could still exist even in the absence of the fraud indicia. The CPA generally should not assume or conclude that an entity is free of fraud, even if the fraud investigation does not identify any indications or apparent occurrences of fraud.

Investigating Assertions of Fraud

.06 The CPA may be engaged to conduct an investigation after a fraud is specifically asserted. A whistleblower may allege that a specific fraud has occurred, informing company management about the specific nature of a wrongful activity, the people involved, and the method of the fraud scheme. For example, management of a defense contractor may receive an anonymous tip through a fraud hotline that a project manager has altered certain time cards to mischarge direct labor from a fixed price contract to a cost reimbursable contract. The specifics of an asserted fraud may also be formally alleged through a litigation-related document, such as a criminal indictment or “true bill” handed down by a federal grand jury and prepared by the U.S. Attorney’s office or through a legal pleading in a civil or criminal lawsuit.

.07 When specific allegations of fraud are asserted, the CPA’s work normally is more focused than when the client simply suspects that fraud may have occurred. Fraud investigation and detection techniques vary from assignment to assignment and depend upon the nature of the alleged fraud scheme. An investigation of fraudulent transactions involving top management may require different and more extensive analyses than an investigation of improprieties related to an employee’s expense report.

.08 Before beginning either of the above types of engagements, the CPA typically requests that suspicions or allegations of fraud be outlined and submitted in writing. The written statements can come from the client, not necessarily the asserter of the suspected or alleged fraud (for example, an anonymous hotline caller). Written statements of suspected or alleged fraud are considered the predication or basis for the CPA’s fraud investigation and help protect the CPA from malicious prosecution lawsuits. An engagement letter describing the suspected or alleged fraud and the CPA’s general assignment may be considered sufficient predication to begin a fraud investigation. To ensure there is no misunderstanding about the potential fraud and the CPA’s objectives in investigating the suspicions or allegations, the CPA should consider asking the client to sign an acknowledgment copy of the engagement letter. In the letter, the CPA might consider stating the purpose of the fraud investigation, such as determining the facts, quantifying any loss, preparing an insurance claim, helping determine if there is any prosecution basis, identifying breakdowns in internal controls, evaluating whether management supervision is adequate, or identifying any other parties involved with any possible fraud.



Developing Fraud-Loss Estimates

.09 Investors, lenders, businesses, governmental and quasi-governmental organizations, and other parties may suffer damages or losses because of fraud. CPAs may be retained to investigate the facts of the case and to determine the amount of the damages or losses, if any. An assignment to determine damages may begin either just after the indicia of fraud are observed or after an alleged fraud has been further investigated and documented. In estimating fraud damages, the CPA usually assumes that the questioned transactions are fraudulent even though the ultimate conclusion of law regarding any fraudulent acts is a matter for the trier of fact, if applicable.

.10 In civil cases, victims of fraud may refer the matter to their insurance company or file a lawsuit to recover their losses. A plaintiff in a civil suit hopes to recover damages resulting from fraud and out-of-pocket costs from the defendant. Any court judgments or awards may be collected directly from the defendant or satisfied by levying execution on property belonging to the defendant. Criminal fraud cases can result in incarceration, in addition to monetary penalties or loss recoveries. Governmental agencies, such as the Securities and Exchange Commission and the Environmental Protection Agency, along with many other federal and state regulatory agencies, may assess fines, penalties and other sanctions against corporate defendants, their boards of directors, consultants, accountants, lawyers, and certain individuals who were responsible for the management of the business or associated with the perpetration of the fraud.

75/130 ENGAGEMENT SCOPE AND ACCEPTANCE CONSIDERATIONS

.01 Although every fraud may be different, the initial steps performed by the CPA in investigating fraud are generally similar. They include:

- a. Determining that the CPA has the competence and experience to perform the requested service, as required by the AICPA Code of Professional Conduct, Rule 201.
- b. Performing a conflict of interest inquiry as required and, if appropriate, a client background check.
- c. Evaluating scope of work and other engagement acceptance issues, including the proposed plan for payment of fees and expenses.
- d. Identifying the client and reaching an understanding with the client, including the client's authorization for work to be performed.
- e. Formulating the preliminary staffing plan.

Scope of Practice

.02 The range of fraud investigation techniques is wide. The techniques include procedures traditionally associated with CPAs, such as analysis of recorded transactions, as well as procedures

usually used by other professionals, such as private investigators and police. CPAs should consider carefully the nature of the fraud investigation assignment, their ability to competently perform the services, and the personal and professional risks that may be involved. As necessary, CPAs should review with counsel any applicable rules, regulations, or statutes that may influence their decision to accept the engagement. Some states, for example, limit the nature of unlicensed private investigations of any individual, firm, company, association, organization, partnership, or corporation. Such regulations cover a very broad range of investigation activities without granting specific exemptions to CPAs. CPAs should evaluate such possible constraints in defining the engagement's scope. When appropriate, CPAs should decline all or part of a potential engagement and consider deferring to others to provide the requested services.

Conflicts of Interest

.03 In compliance with the AICPA Code of Professional Conduct and the standard for communication set forth in SSCS No. 1, the CPA should inform the client of any conflicts of interest.⁸ Interpretation 102.2 of the Code indicates that a conflict of interest may occur if, while performing a professional service for a client, the CPA or the firm has a significant relationship with another person, entity, product, or service that could be viewed as impairing their objectivity. The rule provides, however, that if this significant relationship is disclosed to the client and other appropriate parties, and the client consents to the CPA's acceptance of the engagement, the rule shall not prohibit the performance of the professional service.

.04 A CPA who is approached to conduct a fraud investigation should promptly, and before beginning any work, conduct a thorough review of client relationships and other potential conflicts of interest. Before accepting an engagement, the practitioner usually will, to the extent possible considering confidentiality requirements, disclose to the client any situations that may be viewed as conflicts of interest so that each party can separately assess the possible impact of such facts. The CPA should also consider that later a divergence of interests may arise between the shareholders and management, internal and outside directors, or the audit committee and others, and such changes might impair the CPA's ability to objectively complete the assignment. Furthermore, to comply with SSCS No. 1, 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, the CPA should inform the client of significant engagement findings and events.⁹

.05 The SSCS No. 1 requirement for communication with the client is relatively broad: specific guidance is not provided to the CPA for satisfying the communication obligation. Conflict of interest considerations, serious reservations, or significant engagement findings and events may be

⁸ AICPA Code of Professional Conduct, Rule 102, Integrity and Objectivity states "In the performance of any professional service, a member . . . shall be free of conflicts of interest . . ." The topic is addressed in more detail in AICPA Consulting Services Special Report 93-2, *Conflicts of Interest in Litigation Services Engagements* (New York: AICPA, 1993).

⁹ Issues related to conflicts of interest in litigation services are addressed in AICPA Consulting Services Special Report 93-2, *Conflicts of Interest in Litigation Services Engagements* (New York: AICPA, 1993).

communicated to the client either orally or in writing, but, whatever format is used, the same professional standards apply.¹⁰

Engagement Acceptance Issues, Including Payment of Fees

.06 The CPA needs to use astute business judgment in deciding to accept or decline a fraud investigation engagement. Generally, fraud investigations expose the CPA to more risks than other consulting assignments. For example, the CPA may be asked to evaluate specific business transactions or practices prevalent in other companies in the same industry, including some clients. The CPA who is asked to help defend individuals accused of criminal activity, needs to anticipate that the CPA's name could appear in media reports about the proceeding or the CPA could be accused of helping the perpetrator to cover up the alleged wrongdoing. The CPA should assess the potential business implications of such factors before accepting the engagement. The CPA might also consider the exposure to personal threats or harm that may ensue. Finally, the CPA should ensure that he or she can enter the engagement with the requisite skills, training, experience, resources and, if appropriate, legal counsel.

.07 SSCS No. 1 requires the CPA to establish with the client a written or oral understanding about the responsibilities of the parties and the nature, scope, and limitations of the services to be performed. Also, the CPA could reach an understanding with the client regarding the fee arrangements. A retainer is common for the CPA investigating fraud, especially if the CPA is retained by a criminal defendant. Before accepting the engagement, the CPA might obtain assurance about the criminal defendant's ability to pay the fees and expenses. A criminal defendant convicted of wrongdoing often loses the desire or ability to pay the CPA. Therefore, the CPA may consider obtaining a sufficiently large retainer and using other means of security to help ensure that he or she is fully compensated, especially when expert testimony is expected. Billing and collecting from clients on a semi-monthly or more frequent basis may also be appropriate.

.08 If a client has not paid for services performed but continues to promise payment, the CPA may consider suspending work, especially if the engagement letter so provides. If ethical codes and laws permit, the CPA may retain any work product until new payment terms have been arranged. In addition, the CPA may consider not providing deposition or court testimony until the client has paid for the services rendered or to be provided,¹¹ assuming the CPA does not receive a valid and enforceable subpoena to appear as a witness. If the CPA has not been paid or has not arranged for payment in a reasonable period regardless of the outcome of the dispute, he or she, when testifying on behalf of the client, can expect that the opposing party may suggest the CPA's expert opinions are influenced by this fact. Even though a de facto contingent fee arrangement does not exist, the appearance of such an arrangement could have a negative impact on the perceived credibility of the CPA. In many states, a CPA is prohibited from accepting contingent fee engagements, especially for expert testimony.

¹⁰ A more detailed, but nonauthoritative discussion of the communication standard is provided in AICPA Consulting Services Practice Aid 96-3, *Communicating in Litigation Services: Reports* (New York: AICPA, 1997).

¹¹ Before taking such actions, the CPA should consider Rule 501.1 of the AICPA Code of Professional Conduct and the relevant rules of state CPA societies and state boards of accountancy regarding the retention of workpapers and client records and, if appropriate, consult with legal counsel.

.09 Some CPAs charge higher hourly rates for investigative work and expert testimony. This practice often is acceptable if the CPA consistently applies the same criteria for all clients. In bankruptcy matters, however, the CPA's hourly rates may not exceed the charges for similar services in non-bankruptcy matters.

Oral or Written Understandings

.10 According to SSCS No. 1, understandings with clients for consulting services may be either oral or written. Many CPAs, especially in fraud investigations, use the engagement letter to establish a clear understanding about the nature and extent of professional services to be rendered, the degree of responsibility assumed by the CPA, and any limitations on liability established by the CPA. Often, the engagement letter describes the roles and responsibilities of the parties. However, it does not describe expected results or make any guarantees regarding the findings or outcome of the fraud investigation. The trier of fact determines guilt or innocence, so the CPA should avoid opinions regarding the guilt or innocence of any parties involved in the investigation, especially in the engagement letter and any other written communication to the client or other interested parties. Further, an engagement letter issued to or received from an attorney-client helps to clearly document any relationship protected by the attorney-client or attorney work product privilege. Appendix B presents examples of descriptions of the scope of work in fraud investigation engagements that could be used in engagement letters. Further nonauthoritative guidance is provided in AICPA Practice Aid 95-2, *Communicating Understandings in Litigation Services: Engagement Letters* (New York: AICPA, 1995).

Staffing Engagements

.11 CPA consultants performing fraud investigations often use assistants to inventory documents and data, identify relevant records, input, compile, sort, and analyze data, trace the flow of funds, conduct interviews, and perform other necessary accounting and support functions. The practitioner must ensure that assistants are adequately trained and properly supervised in accordance with the AICPA Code of Professional Conduct, Rule 201. When testifying as an expert, the CPA may be asked questions about the qualifications and experiences of assistants, the services performed, the specific instructions given, the supervision provided, their findings or comments made during the performance of the job, and other questions regarding their job performance. The CPA should consider these factors in staffing and performing the engagement. On occasion, assistants may be called upon to testify under oath as fact witnesses about the work they performed.

75/135 ENGAGEMENT PERFORMANCE CONSIDERATIONS

.01 A key objective of a fraud investigation is to gather sufficient relevant data¹² to help the client or trier of fact reach a conclusion on the merits of the suspected or alleged fraud. Although each fraud

¹² The CPA's relevant data gathered in accordance with the AICPA Code of Professional Conduct, Rule 201 may be admitted by a court as legal "evidence" for use by the trier of fact.

scheme may be different, the basic preliminary steps to perform a fraud investigation are normally similar. First, the CPA should determine if there is proper predication to initiate an investigation. Next, the CPA should obtain an understanding of all fraud suspicions or allegations, discuss the status of the case and work already performed by the attorneys or others, and review any relevant pleadings and declarations that have been filed. After taking these initial steps, the CPA begins gathering data. The CPA can obtain the relevant data by examining documents, interviewing possible witnesses, observing individual behavior, conducting background investigations, performing public-record inquiries, and performing other analyses.

Fraud Investigation Predication

.02 At the beginning of a fraud investigation, the CPA should have a sufficient fraud predication. Companies, individuals, and others often fear a loss of reputation if they are the target of or are implicated by a fraud investigation. The CPA may benefit from establishing that the fraud suspicions are alleged by others on whose behalf the CPA is working. This arrangement places the client between any target of the CPA's investigation and the CPA, and helps protect the CPA from legal complaints filed by any individual alleging reputation damage caused by the inquiry. In addition, some CPAs ask the client for written authorization to interview employees and other people, and to give them access to documents and files.

.03 Written allegations of fraud are generally preferable to support the CPA's fraud investigation. The investigation predication provided by the client should clearly state the nature and factual background of the suspected or alleged fraud and, if possible, summarize the basis for the belief. During the engagement, the CPA may encounter additional indicia of fraud beyond the scope of the original assignment. If so, the understanding with the client should be modified as necessary. Such modifications are often made in writing.

Notes of Conversations

.04 During an investigation, the CPA normally works with clients, client staff, attorneys, and others associated with the case. In addition, the CPA may talk with law enforcement officers, prosecutors, opposing counsel, members of the media, and others. For such encounters, the CPA often prepares notes of conversations with these individuals. The notes generally indicate the interview date, names of interview participants, questions, responses to questions (in summary form, not verbatim unless a quote is necessary), and any other information that could assist the CPA in the future. The CPA may retain the interview notes for later use, if needed, but would discuss the retention and content issues with the client-attorney or the CPA's own legal counsel. The CPA should avoid recording unnecessary, gratuitous, or unsupported comments and opinions in the interview notes.

.05 Conversations with an attorney who is either the CPA's client or his or her legal representative may be confidential and privileged under the attorney work product rule as long as the CPA is not designated as an expert witness. Any notes of such discussions may be discoverable if the CPA is called as an expert witness or receives an enforceable subpoena to produce records. The client's case

may be hindered if the CPA must disclose notes that contain legal strategy, conclusions, recommendations, or other advice from the attorney.

Conversations With Non-Client-Related Parties

.06 If approached by counsel for non-client parties for information, CPAs should not provide any without specific written instructions from the client's attorney. If CPAs receive a formal request for discovery from adverse parties, they would coordinate any response with the client, client's counsel, and, if needed, their own counsel. CPAs should also be careful to comply with Rule 301 of the AICPA Code of Professional Conduct concerning confidentiality of client information,¹³ as well as similar professional standards and regulations established by state CPA societies, state boards of accountancy, and state accountancy laws.

.07 Occasionally, law enforcement officers will ask for information and reports from the CPA's investigation. Even if these reports previously have been filed with the court or are deemed to be public documents, the CPA should obtain the appropriate permission before release.¹⁴ The CPA may also be asked to provide additional information to either supplement the initial report or clarify certain aspects of the report. Again, the CPA should confer with his or her client or the client's legal counsel before providing any information.

Working With Client Records

.08 Parties to a fraud scheme often falsify entries in the books and records to conceal their fraud. The perpetrators may also create false documents or generate fictitious transactions, often in collusion with other parties, to execute the fraud scheme. Therefore, the CPA should review records during a fraud investigation with skepticism and use them cautiously, understanding that they may be inauthentic, inaccurate, unreliable, and irrelevant.

.09 If records seem to be altered or falsified, the original documents or records should be safeguarded, but not necessarily by the CPA. The chain of records custody may become an issue, so the CPA should consider the risk of assuming responsibility for keeping the questionable documents. Most CPAs are neither forgery experts nor professional document examiners, so they should take appropriate precautions to protect the integrity of any original documents under suspicion. For example, they should handle documents suspected of being altered or forged with care to preserve latent fingerprints for later examination. Some fraud investigators wear surgical gloves when handling the original suspect documents, but this may not be a fail-safe measure. The document may have been handled numerous times in the course of business following fraudulent creation. Eventually, even non-fraudulent records may need to be fingerprinted for purposes of comparison.

¹³ A more detailed, but nonauthoritative discussion of Rule 301 is provided in AICPA Consulting Services Special Report 93-2, *Conflicts of Interest in Litigation Services Engagements* (New York: AICPA, 1993).

¹⁴ In one case, an individual who provided a complaint copy to the press was held liable for defamation although the court acknowledged that the reporter could have obtained a copy through the court.

.10 The CPA's fraud investigation findings may depend upon the existence of the questionable documents. Therefore, the CPA should make copies for his or her files, especially when someone else has the originals. If the original records are then altered, lost or destroyed, the CPA can reconstruct the apparently fraudulent financial and accounting transactions from the copies, taking care to label the work product as a reconstruction. In addition, the CPA might consider appending copies of suspect documents to any written report on the investigation. The CPA may also consider making two copies of suspect documents — leaving one untouched and intact, and using the other as a working copy.

Obtaining Third-Party Records

.11 During the course of an investigation, the CPA may seek to obtain third-party records. Third-party records are those held by others outside of the client's control, such as the records of banks, vendors, suppliers, investors, governmental agencies, competitors, CPAs, consultants, tax advisors, or investment bankers. Sometimes, third parties have records that corroborate the client's records or statements and may provide copies voluntarily or informally. Because of various banking laws and other regulations, financial institutions typically require a formal request for documents from the client, or the issuance of a subpoena or request for records production, before providing document copies. Often, third-party non-client records related to the activities of an investigation target are very difficult to obtain. For example, a new building owner may believe that the general contractor submitted falsified subcontractor invoices for cost reimbursable work and therefore asks the subcontractor to provide records documenting the incurred costs. The subcontractor may refuse to cooperate arguing that the owner has no contractual relationship with the subcontractor or any other legal right to examine its records.

Conducting Interviews

.12 Fraud schemes by definition involve deception, particularly in the preparation of altered, falsified, or fabricated documents, to disguise the misdeeds. The fraud scheme and fraudulent records are often difficult to identify without gathering information through interviews of individuals possibly having knowledge about the fraud scheme or its perpetrators. Such interviews are normally an important part of the fraud investigation, so the CPA should strive to maintain control of the interview and accomplish his or her objectives.

.13 The purpose of an interview is to gather background information and other relevant data. The CPA uses various techniques to solicit the needed information from potentially knowledgeable individuals or witnesses. Some CPAs approach the investigation interview as a friendly interchange, while other CPAs use a more stern approach. Some CPAs immediately start taking notes at the outset of the interview. Other CPAs initiate a casual conversation, then move to the delicate issues of potential fraud. When the interviewee seems at ease, the CPA may ask if it is acceptable to tape record or take notes of the conversation. Whichever method is used, the CPA wants the interviewee to cooperate in providing useful information and to help answer the five basic fraud questions—who, what, where, when and how?

.14 The types of information normally solicited from an interviewee, particularly a potential fraud witness or participant, include the following:

- a. Background information on the interviewee
 - (1) Name, address, phone number
 - (2) Job title, position, responsibilities and access to information or documents
 - (3) Job history, length of time on job
- b. Direct (percipient) knowledge of the fraud suspicions or allegations
- c. Names of other potential interviewees
- d. Documents supporting the interviewee's responses to questions about any potential fraud
- e. Information regarding the alleged or potential fraud participants
 - (1) Work habits
 - (2) Personal lifestyle
 - (3) Unusual activities
 - (4) Unusual behavior
- f. Any other relevant information or suggested sources of information

.15 The above areas of inquiry generally are covered in every interview, but not necessarily in the same order. Any interview notes or memoranda of the CPA may be retained in the engagement files. But, again, the CPA should consider exploring the issues of form, nature, content, legal privilege or confidentiality, and retention with appropriate legal counsel.

.16 Before conducting an interview, the CPA may plan the interview and topics of inquiry. While a broad outline of the areas of exploration may be helpful, it is usually inadvisable for the CPA to prepare specific questions in advance. They may be too limiting or not on point, or they may divert the CPA's attention from avenues of inquiry generated by previous answers. The CPA prepares for the interview by understanding the suspicions or allegations of fraud, the possible role, if any, of the interviewee in the suspected or alleged fraud scheme, the type of documents that may be needed or available, and methods to elicit specific information from the interviewee. The CPA might consider reviewing the interviewee's personnel file and related documents before the interview to learn about the interviewee's background, company position, and compensation, and to help evaluate the veracity of statements provided later. The CPA interviewer should control the interview, ask appropriate follow-up questions, and go beyond the immediate parameters of the planned interview, when necessary.

.17 Open-ended questions are generally more productive than closed questions, which can be answered "yes" or "no". Open-ended questions allow the interviewee to expand on answers, which

may produce unexpected information, especially if the CPA encourages the interviewee to continue talking.

.18 Potential fraud witnesses to be interviewed can be classified into three general categories—friendly, neutral, and adverse. Friendly interviewees tend to volunteer information and are usually willing to help the investigator. The CPA should maintain healthy skepticism, however, about information obtained from any witness, even an apparently cooperative one. Neutral interviewees respond only to specific questions and are less inclined to volunteer information. Adverse interviewees are generally uncooperative and often refuse to answer questions, making it extremely difficult for the CPA to obtain any helpful information. Adverse interview subjects are commonly the target of the investigation, the target’s friends or co-conspirators or people openly adverse to becoming involved.

.19 The fraud-investigation interview process typically begins with interviews of individuals believed to possess only peripheral knowledge of the potential fraud and progresses to interviews of individuals with information closer to the central issues of the investigation. CPAs usually do not interview an individual suspected of perpetrating a fraud until they have obtained all of the essential background information, facts, and circumstances.

.20 A major issue in performing a fraud investigation is obtaining and documenting sufficient relevant data, including information from percipient (fact) witnesses. Percipient witnesses are often reluctant to provide information for a variety of reasons, including fear of retaliation, reluctance to get involved, or discomfort with legal proceedings. Such witnesses initially may provide useful information, but may be unwilling to testify later. The CPA or an intermediary may try to persuade these witnesses to testify in the case. If these efforts fail, the CPA may use other sources of information to support his or her findings. If the CPA is unable to corroborate the information by any other means, the information may be difficult to use as the basis for any findings. The CPA should discuss the matter with appropriate counsel.

.21 If the interviewee is a target of the investigation, the CPA should consider how to introduce and explain the interview process to the interviewee and who should be present during the interview. The CPA should also consider exploring this topic with the client, particularly if the client is an attorney or the CPA’s own legal counsel. Under some circumstances, the CPA will inform the interviewee of the fraud suspicions or allegations, summarize the interview objectives, and inform the interviewee that he or she is free to leave or to consult with his or her own attorney before cooperating. Some interviews may be jointly conducted by the CPA and an attorney (the client or the client’s attorney), and the lawyer may initiate the interview, then allow the CPA to ask specific questions. This arrangement may be appropriate to protect the attorney-client privilege, especially when the CPA is engaged by a defendant to fraud charges.

.22 During an interview with a target of the investigation, the interviewee may reveal information that implicates him or her in the fraud scheme, and such information could be used against that individual in a subsequent legal proceeding. The interviewee may confess or “roll over.” If so, the CPA should have an observer present and take detailed notes. If the perpetrator is willing to issue a written statement, the CPA should allow the individual the opportunity to do so. A statement may be prepared by the CPA and signed by the interviewee, or the interviewee may prepare the statement and sign it.

Using Statistical Sampling Techniques

.23 CPAs engaged to estimate the losses suffered from the intentional misstatement of accounting information often use statistical sampling techniques, at least to establish the upper and lower limits of the damages. Such techniques are beneficial in detecting and estimating losses when “on-book” fraud has been perpetrated. When fraud is perpetrated “off book,” then statistical sampling techniques are not as useful because a sample population is difficult to define. Off-book transactions may include unrecorded cash transactions, asset disposals or liabilities, while on-book transactions encompass transactions related to suspicious parties, fictitious sales, and manipulations of recorded financial information.

.24 CPAs using statistical sampling to estimate the extent and amount of fraud losses may have difficulty convincing a jury of its probative value and to accept the difference between the damages apparently and specifically confirmed by the sample and the predicted total losses based upon the sample. Although the projection’s statistical reliability may be difficult to explain to a jury during cross-examination, the technique is less expensive than a complete investigation and documentation of every potentially fraudulent transaction or event. Before undertaking a comprehensive search for every fraudulent transaction, the CPA might consider using statistical sampling to detect the possible existence of fraud, to quantify the potential fraud losses, and to assess the cost-benefit of performing more detailed analyses. In any event, the quantification of the fraud loss can assist the injured party or parties to recover damages from insurance carriers, targets of the investigation, or others.

Using Private Investigators, Agents, Adjusters, and Other Professionals

.25 As either a consultant or expert witness, CPAs might rely on information provided by other specialists to support their findings. Such information should be obtained through appropriate and legal methods. Experts who rely on the work of other specialists which is not introduced into evidence are subject to the hearsay exception in matters involving statements made by others. CPA experts may review the Federal Rules of Civil Procedure¹⁵ or other pertinent regulations to understand the applicability of the hearsay exception to expert witness testimony.

.26 It is appropriate for the CPA to evaluate the scope of the investigation, given his or her expertise, and to consider relying on other professionals, private investigators, and independent contractors, as needed. Independent contractors could include other CPAs, private investigators, agents or adjusters. Private investigators may be used to check public records and backgrounds, locate witnesses, and conduct interviews. In addition, private investigators may perform physical surveillance and monitoring activities when asset diversion is suspected. Generally, the client’s attorney or the attorney-client hires the private investigators and other specialists and asks them to communicate their findings, if appropriate, to the CPA. Without specific client permission, the CPA generally

¹⁵ A summary of the applicable Federal Rules of Civil Procedure is provided in Consulting Services Practice Aid 96-3, *Communicating in Litigation Services: Reports* (New York: AICPA, 1997).

would not approach the agents, brokers, or other specialists for the opposing side to obtain confidential information.

.27 In some instances it may be advisable or necessary for the private investigator, or his or her findings, to remain confidential. If so, it is preferable that the client's attorney or an attorney-client engage the private investigator as well as the CPA to maintain the confidentiality and legal privilege of the investigator's name, any other identifying information, and work product. If the private investigator's identity is revealed to the CPA, he or she may be required to disclose the name and any information provided that supports his or her disclosed findings. Sometimes, the CPA may not be able to use only the direct work of a private investigator as the basis for the CPA's findings. For example, a private investigator might conduct a discreet background investigation of an individual. If the background information is helpful but not conclusive, the CPA may corroborate the information in another way, or disclose the name of the private investigator as the only source of the information. Other times, the CPA may use the testimony of a percipient witness resulting from the private investigator's efforts. In any case, the CPA needs to assess the value of the work product, the means of introducing the work product, and, as appropriate, confer with counsel regarding the issue of confidentiality.

.28 If a private investigator's photographs or other forms of evidence are to be introduced as testimony, the foundation usually must be established through the person taking the pictures or conducting the surveillance, including notes reflecting the date, time, and locations of the photographs or physical surveillance.

Working With Law Enforcement and Other Authorities

.29 CPAs involved in a civil fraud investigation should be aware that a criminal investigation may also be underway. This process is referred to as a *parallel proceeding*. The CPA's civil fraud investigation may be helpful to crime investigators, who may seek information about it. On the other hand, the CPA should appreciate that law enforcement authorities may not need the CPA's findings and may view the CPA's work as counterproductive to their investigation.

.30 Involvement in the criminal referral process can be a challenging experience for the CPA. Although the CPA may be interested in learning the status of a criminal investigation, law enforcement officers typically will not be at liberty to discuss the status. Therefore, the CPA should expect that communicating with law enforcement officers may be a "one-way street". They will gladly accept any information provided but usually will not give any information to the CPA. Under certain circumstances, it may be appropriate to contact the investigating officer or case agent to see if he or she needs any further information, especially if the objective is to bring the case to either prosecution or early resolution. Often, however, communications with prosecutors or law enforcement officers are conducted by a criminal law attorney, either as the CPA's client or on behalf of the client.

.31 Occasionally, law enforcement authorities subpoena or obtain records pursuant to a search warrant. Since the law enforcement authorities usually take control of the original records, the CPA should, if possible, obtain copies before authorities take the records. In addition, it may be appro-

priate for the CPA to discuss with counsel the need to obtain access to records held by law enforcement officials. After formal arrangements have been made, the CPA may be provided access to these records, but not always to the extent desired.

Criminal Referrals

.32 A fraud investigation may have two purposes for the benefit of the fraud victims. The first purpose is to determine whether the suspicions or allegations of fraud have merit. A detailed report by the CPA supporting such suppositions or assertions may satisfy this requirement. If so, the second purpose for the fraud investigation may be to assist the client to seek criminal prosecution. The CPA's investigative report can be a persuasive tool in convincing law enforcement officers that a criminal investigation is appropriate. The CPA's report may contain information needed by the criminal investigators and help them to identify witnesses, obtain documentary support, and prepare the records analysis. The CPA and client should understand that once the matter is referred to law enforcement, the fraud allegations may become a public record. Further, the CPA may be required to testify in the criminal trial and perform related work, so the CPA should discuss this issue with the client and arrange for the client to pay the fees and expenses.

.33 Criminal cases are brought on behalf of the people by a public attorney. For example, fraud against the United States under its laws is prosecuted through the Office of the United States Attorney for the pertinent jurisdiction. The inquiry begins at a grand jury hearing where a decision is made whether sufficient evidence is available to justify an indictment. If so, the U.S. Attorney prepares a signed indictment, which is followed by the filing of the necessary legal pleadings. Such cases include fraud cases in which the U.S. is the victim (for example, tax fraud, government contract fraud) or in which citizens are fraudulently harmed (for example, investment fraud schemes). The CPA may be engaged by the government agency prosecuting the fraud, the public defender, a private attorney representing the defendant, the defendant, or parties related to the defendant.

Minimizing the CPA's Exposure Regarding Fraud Engagements

.34 The CPA should avoid making statements or expressing other opinions that accuse the alleged wrongdoer of fraud or that attest to the innocence of the alleged fraud perpetrator. The trier of fact should reach these conclusions. The CPA should normally adhere to statements of fact that are supported by sufficient relevant data. The CPA should seek to minimize exposure to lawsuits for defamation, libel, wrongful termination, or other individual wrongful action complaints. Sometimes, a client may attempt to impose unreasonable time or monetary constraints that could impair the CPA's ability to perform adequate work. If so, the CPA should discuss the matter with the prospective client or existing client and decline or resign the engagement.

.35 Risk exposure results when restrictions are placed on the scope of the engagement. The CPA must be able to objectively assess the relevant facts and consider available pertinent data, not just information filtered by the clients. The CPA should always remain unbiased in the investigation and gather information with impartiality.

.36 If limitations on the scope of the engagement arise that are unresolvable or unacceptable, the CPA should decline the assignment or withdraw from the engagement. An unreasonable limitation of the engagement scope may arise, for example, when a CPA is engaged to conduct an investigation for a corporation and finds indications that the principal of the corporation also may be responsible for perpetrating a fraud. If the principal does not permit the investigation to continue or limits access to necessary documents, the CPA would be hampered in performing the engagement. This could constitute limitation of scope that may be unresolvable.

75/140 COMMUNICATION OF FINDINGS

Disclosing Findings of Potential Fraud

.01 After gathering sufficient relevant data to confirm or negate the suspicions or allegations of fraud, or even suggest that the findings are inconclusive, the CPA may prepare an investigative report that details the findings. In addition to a description of the work performed and the findings, the report could include memos of interviews, charts, exhibits, and copies of important documents. The report should reflect the neutral or objective posture maintained by the CPA throughout the investigation. If appropriate, and with the client's consent, the CPA might review the draft report with the suspected or accused wrongdoer and permit him or her to respond to the findings, recommendations, and conclusions. The CPA often asks the client or their representative to be present for this review. Then, if needed, the draft report can be amended. The CPA should avoid stating any conclusion about whether fraud does or does not exist, leaving that determination to the trier of fact. Stating any such conclusion may expose the CPA to legal liability.

.02 The CPA's findings can be communicated by a variety of oral or written means, which are discussed in more detail in Consulting Services Practice Aid 96-3, *Communicating in Litigation Services: Reports* (New York: AICPA, 1997).

.03 CPAs do not normally disclose an apparent fraud to law enforcement authorities, regulators, or potential victims of the fraud scheme without the clear consent of the client or the client's legal representative. Whenever there is a doubt concerning responsibilities, the CPA should refer to the applicable professional standards and consult with the appropriate legal counsel. In the performance of consulting engagements, including fraud investigations as a litigation service, the CPA is guided by the AICPA Code of Professional Conduct and SSCS No. 1. In particular, Rule 301 of the Code specifies that the CPA shall not disclose confidential client information without the consent of the client. Therefore, the CPA should obtain appropriate advice or legal counsel before unilaterally disclosing investigation findings.

Written Communications

.04 The CPA may be asked or required to communicate the engagement findings in writing. Although the SSCS No. 1 requires that the CPA communicate with the client, the standard does not require a written report, nor does it apply exclusively to written consulting reports. The information contained within a report may vary depending on the client needs, advice of counsel, the CPA's

preference or style, and the nature of the engagement. When the matter is subject to the Federal Rules of Civil Procedure, the CPA should consult with counsel to determine if the relevant district of the U.S. District Court has implemented or amended the requirement for expert written reports. The CPA should also consult with counsel to ascertain whether any similar requirements exist in relevant state or local courts.

.05 Like other litigation consulting reports, written communications about fraud investigation findings can take a variety of forms, including brief letters, memorandums, affidavits, declarations, and detailed reports. In any form, a written communication may describe the work performed and state the findings, and be accompanied by detailed schedules, exhibits, other work product, or copies of specific documents. If the CPA is designated as an expert witness, the written report may be subject to discovery by the opposing party. Therefore, before preparing the discoverable writing or any other writing, the CPA might discuss with the client or the CPA's attorney the need for the writing, the format, style, and content, and the timing of submission.

.06 Specific items for a written report of a fraud investigation, in addition to those potentially applicable to any litigation services writing, might include a statement of the predication as the basis for the investigation, a list of interviews conducted, and a summary of interview information obtained. The report should avoid conclusions about the existence or absence of fraud, but should relate the procedures performed and the factual findings. Rarely should there be any assurance or guarantees of completeness.

.07 In insurance-related investigations, a CPA can help document fraud losses through a written communication commonly referred to as a *proof of loss*. The proof of loss is issued to insurance carriers, and summarizes the results of the investigation and the estimated loss amount. It also contains supporting calculations and relevant data and is examined by the insurance company. The insurance company can ask the insured to provide further proof of its claim. When disputes arise between the insurance company and the insured, the CPA may assist in resolving the disagreement or provide expert witness testimony.

Oral Communications

.08 Oral communications generally occur throughout an engagement whether or not the CPA prepares any written communication. The CPA normally presents oral statements about the fraud investigation privately to the client, but he or she may also present them in a deposition taking, a courtroom, or another dispute resolution forum, or before an administrative or regulatory body. As an expert witness, the CPA may give oral testimony as an adjunct to a written investigative report or without an accompanying writing. Criminal prosecutions generally restrict pre-trial discovery concerning experts, so many criminal defense attorneys, in particular, do not ask the CPA fraud investigator to prepare a comprehensive written report. Instead, they seem to prefer only oral testimony that is supported by demonstrative evidence and the CPA's working papers. The CPA must support any oral expressions of findings or expert opinions with sufficient relevant data. Furthermore, the CPA's oral statements should be sensitive to the same legal liability exposures as a written report.

75/145 LEGAL BASES FOR FRAUD ALLEGATIONS AND RELATED CPA SERVICES

.01 Many of the laws, regulations, and rules of the United States, state governments, and other governmental entities and regulatory bodies specify prohibitions, fines, and penalties for fraudulent activity. The intent is to protect the interests of the pertinent governmental entity and the public. Legal pleadings usually cite the germane law or regulation related to the purported wrongdoing. Examples of areas covered by laws or regulations with fraud provisions include, but are not limited, to the following:

- Antitrust
- Banking
- Bankruptcy
- Computer technology
- Environmental protection
- Financial statements
- Government contract procurement
- Health Care
- Insurance
- Intellectual property
- Racketeer influenced and corrupt organizations (RICO)
- Securities
- Tax

.02 The legal and regulatory guidance for fraud matters as listed above is not static, but continues to evolve. For example, the rapid pace of advances in computer technology continues to spawn new fraud opportunities and schemes, and the legislators and regulators attempt to respond, as needed. Therefore, a definitive, unchanging list of fraud-related laws, rules, regulations, and court decisions, along with associated CPA fraud investigative services, cannot be prepared and presented in this practice aid. Instead, selected examples of specific legal bases for fraud allegations are provided in appendix C, and a few examples of general fraud schemes are summarized in appendix D. If the CPA is approached to provide fraud investigation services in any of the listed areas, or for similar matters, the CPA might inquire about or research the current legal or regulatory guidance. Also, the CPA should assess the engagement team's skills, experience, and training to deliver the requested assistance in a professional and competent manner.

75/150 CONCLUSION

.01 This practice aid addresses only fraud investigations performed as a management consulting service, although the CPA skilled and experienced in and trained for such assignments may also provide professional services in a variety of other circumstances where prevention and detection of or response to fraud is a concern. This document builds upon the nonauthoritative guidance presented in other AICPA practice aids and special reports that address topics applicable to the full spectrum of litigation services, including fraud investigations. Therefore, the CPA should review those documents in conjunction with the practice aid, and comply with the standards set forth in the AICPA Code of Professional Conduct and Statement of Standards for Consulting Services No. 1.

APPENDIX A

SELECTED INDICIA OF FRAUD

The following listing of selected indicia of fraud is presented for illustrative purposes only and is not exhaustive. The conditions listed do not necessarily indicate the existence of fraud; rather, each is an indication that fraud may be present. Many times legitimate activity or other reasons may explain the indicia of fraud. For example, an employee enjoying a lifestyle not readily explained by his or her current earnings may have previously inherited a substantial sum of money. As a result, the CPA should exercise appropriate caution in forming opinions before an adequate investigation. Even then, the CPA should avoid offering opinions about guilt or innocence since the ultimate conclusion of law is a matter for the trier of fact.

Lack of written corporate policies and standard operating procedures

Lack of interest in or compliance with internal control policies, especially division of duties

Disorganized operations in such areas as bookkeeping, purchasing, receiving, and warehousing

Unrecorded transactions or missing records

Bank accounts not reconciled on a timely basis

Continuous out of balance subsidiary ledgers

Continuous unexplained differences between physical inventory counts and perpetual inventory records

Bank checks written to cash in large amounts

Handwritten checks in a computer environment

Continual or unusual fund transfers among company bank accounts

Fund transfers to offshore banks

Transactions not consistent with the entity's business

Deficient screening procedures for new employees

Reluctance by management to report criminal wrongdoing

Unusual transfers of personal assets

Employees living beyond their means

Vacations not taken

Frequent or unusual related-party transactions

Employees in close association with suppliers

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Expense account abuse

Business assets dissipating without explanation

Inadequate explanations to investors about losses

APPENDIX B**ILLUSTRATIVE PARAGRAPHS DESCRIBING
THE SCOPE OF WORK FOR ENGAGEMENT LETTERS**

Each fraud-investigation engagement is different. Therefore, it is impossible to develop standard paragraphs describing the scope of work for engagement letters for fraud investigations. However, all such paragraphs need to contain a summary of the predication and factual background for initiating the investigation, as well as a general description of the work that could be included in the investigation. The level of detail of the description will vary depending on the information available as of the engagement letter date, and the CPA's knowledge about the client's operations and accounting system. The following sample paragraphs illustrate how the scope of work could be described in engagement letters for fraud investigations.

Sample 1

You received an anonymous letter alleging that the president of your Anytown subsidiary owns the printing company that your subsidiary uses for its printing purchases (Vendor). In addition, the letter alleges that excessive prices have been paid to Vendor during the last three calendar years, especially compared with prices charged by other printing companies for the same work. You asked us to investigate these allegations. We expect to search public records to determine the ownership of Vendor, schedule the invoices submitted by Vendor noting the product (services performed) and prices paid, and obtain quotes of prices charged by other printing companies for the same products (services) purchased from the Vendor. As sometimes occurs in these types of investigations, we may identify other possible improprieties and different avenues for exploration. We will keep you informed of our findings, and we will discuss with you any change in the scope of our investigation that results from our preliminary findings.

Sample 2

Your accounting department has uncovered a material difference between the amount of accounts receivable in the general ledger and the detailed listing of accounts as of the end of your last fiscal year. You are concerned that, in addition to this difference, the amount of the listed accounts may also be in error. You have asked us to investigate this difference and the accuracy of the existing account balances. We will confirm the balances in the accounts receivable detail and search for the entries that caused the difference between the general ledger balance and the accounts receivable detail. We will also attempt to determine the cause for any differences. Since this type of investigation includes following leads that develop during the engagement, we may expand the scope of our work to trace all leads to their ultimate resolution, but only after we discuss using any additional procedures with you.

Sample 3

You recently determined that your costed physical inventory as of the end of your last fiscal year is significantly less than shown on your inventory records, and you have asked us to determine the cause for the difference. We will test this physical inventory to determine its accuracy and will gain an understanding of the accounting and physical controls over inventory. We will also interview your employees who handle either the physical inventory or are responsible for the inventory records. After completing these activities, we will suggest other procedures that could resolve this issue and determine the cause for the difference. We will also suggest improvements to the current systems to help prevent a recurrence.

Sample 4

You have discovered expense reports submitted by the officers of the company that are not properly documented and that contain certain expenses believed to be personal. You have also received an anonymous call suggesting that some of your officers are abusing their expense privileges. We will review all expense reimbursement requests for the twelve months ended [date] to determine if the company's documentation requirements are being met and to determine the actual purpose of each expense. We will also interview your officers and others who may have information related to these allegations. Our initial investigation may uncover conditions that will require further investigation. Before we expand the scope of our investigation, we will confer with you.

APPENDIX C

**LEGAL REFERENCES RELATED TO SELECTED
CRIMINAL VIOLATIONS ASSOCIATED WITH FRAUD**

The following listing of legal references to selected criminal violations related to fraud is presented for illustrative purposes only and is not necessarily exhaustive.

CRIMINAL VIOLATION	REFERENCE
Bankruptcy fraud	Title 18 USC Sections 151–157
Computer fraud	Title 18 USC Sections 1030–2701
Procurement fraud	Title 18 USC Sections 3729–3733
RICO—Racketeer Influenced and Corrupt Organizations Statute	Title 18 USC Sections 1961–1968
Bank fraud	Title 18 USC Sections 1014, 1032, 1344
Tax fraud	Title 26 USC Sections 7201, 7203, 7205, 7206, 7207, 7212, 7214
Tax shelter fraud	Title 26 USC Section 6111

APPENDIX D

SELECTED FRAUD SCHEMES

The following fraud schemes are described for illustrative purposes only.

Bustout

A bustout scheme can take many different forms. The basic approach is for an apparently legitimate business to order large quantities of goods on credit, dispose of those goods either through legitimate or illegal channels, and then close shop, absconding with the proceeds and leaving suppliers unpaid.

Bustout schemes are often perpetrated by individuals soon after the formation of a new company or through the takeover of an existing company, and are accomplished as follows:

1. Credit is established with numerous vendors, and initial payments are made promptly. Vendors therefore feel comfortable with the company and extend existing credit lines.
2. The perpetrators build inventory by ordering everything possible from vendors (regardless of the type of products) and promising to pay soon, then ordering more merchandise.
3. The perpetrators sell the inventory at deep discounts or move it to another related business before vendors can repossess it.
4. The business fails or just closes and, perhaps, files bankruptcy unless creditors take preemptive legal action.

Check Kiting

Check kiting, one of the more common types of employee embezzlement, involves the transfer of money between bank accounts and the improper recording of these transfers. In check kiting, the perpetrator takes advantage of the "float" period, which is the time between the date the check was deposited and the date that the funds are collected. The perpetrator deliberately uses the same funds in two or more banks to build apparently large balances. Check kiting can involve numerous banks and checks. The more banks and broader geographical distance involved, the harder it is to control check kiting.

Kickback

The Anti-Kickback Enforcement Act of 1986 defines a kickback as anything of value provided improperly to obtain or reward favorable treatment in connection with contract actions. In the commercial sense, kickbacks are the giving or receiving of anything of value to influence a business decision, without the employer's knowledge and consent.

A kickback is a form of off-book fraud. Off-book refers to those schemes in which the funds used for illegal payments or transfers are not drawn from the regular company bank account of the payer and the payments do not appear on the payer's books and records. If the employee responsible for the purchasing function of company is receiving kickbacks, the company usually is paying more than competitive prices for products or services. The financial statements may reflect reduced net income, as well as overstated inventory values.

Lapping

Lapping is one of the most prevalent types of internal fraud relating to accounts receivable. Lapping is a method of concealing a defalcation wherein a customer's payment is recorded sometime after payment receipt. The general lapping scheme is as follows: Cash or a bank check received from a customer is appropriated by the employee. At a later date, funds received from a second customer are credited to the first customer's account, and the second customer's account is credited still later by funds received from a third customer. As a result, there is a delay of credits, namely lapping. The lapping will continue until the fraud is detected, the funds are restored, or the scheme is covered up, for example, by a credit to the proper customer and a fictitious charge to operating accounts.

Lapping schemes may involve fund diversions to an employee's personal use or to pay other expenses to keep the business operating. Often, a lapping scheme involves falsification of documents to conceal the misappropriation of funds.

Ponzi

A Ponzi or pyramid scheme is usually any venture wherein earlier investors are repaid principal plus interest with funds provided by later investors. There may or may not be a legitimate business purpose for the venture, but the need for capital creates and continues the scheme. Often, unusually high investment returns or other inducements are offered by the promoters to attract investors.

Each Ponzi scheme typically shares three common characteristics:

1. The business activity depends on outside investor money.
2. The investor money is not used according to the stated purpose. Some of the investor money is used to pay the returns promised to earlier investors.
3. The business enterprise lacks profits sufficient to provide the promised returns and, therefore, depends on an ever increasing supply of investor money.

GLOSSARY OF SELECTED LEGAL AND FRAUD-RELATED TERMS

Admissions	<p>Confessions, concessions, or voluntary acknowledgments made by a party of the existence of certain facts. More accurately, they are statements by a party, or someone identified with the party in legal interest, of the existence of a fact that is relevant to the cause of an adversary.</p> <p>A voluntary acknowledgment made by a party of the existence of the truth of certain facts inconsistent with the party's claims in an action. An admission is not limited to words, but may also include the demeanor, conduct, and acts of the person charged with a crime.</p>
Affidavit	A written or printed declaration or statement of facts, made voluntarily, and confirmed by the oath or affirmation of the party making it, taken before a person having authority to administer such oath or affirmation.
Allegation	The assertion, claim, declaration, or statement of a party to an action, made in a pleading, setting out what the party expects to prove.
Allege	To state, recite, assert, or charge; to make an allegation.
Alter Ego	Second self. Under the doctrine of alter ego, the court merely disregards a corporate entity and holds an individual responsible for acts knowingly and intentionally done in the name of the corporation.
Arson	At common law, the malicious burning of the house of another. This definition, however, has been broadened by state statutes and criminal codes. For example, the Model Penal Code, §220.1(1) provides that a person is guilty of arson, a felony of the second degree, if he or she starts a fire or causes an explosion for the purpose of: (a) destroying a building or occupied structure of another; or (b) destroying or damaging any property, whether his or her own or another's, to collect insurance for such loss. Other statutes include the destruction of property by other means.
Bill of Indictment	A formal written document accusing a person or persons named of having committed a felony or misdemeanor, lawfully laid before a grand jury (usually by a prosecutor) for their action upon it.
Bill of Particulars	Form or means of discovery in which the prosecution sets forth the time, place, manner, and means of the commission of the crime as alleged in complaint or indictment. It is one method available to the defendant to secure default of the charge against him or her. The purpose of a bill of particulars is to give notice to the accused of the offenses charged in the bill of indictment so that he or she may prepare a defense, avoid surprise, or intelligently raise pleas of double jeopardy and the bar of the statute of limitations.
Bribe	Any money, goods, right in action, property, thing of value, or any preferment, advantage, privilege or emolument, or any promise or undertaking to give any, asked, given, or accepted, with a corrupt intent to induce or influence action, vote, or

opinion of person in any public or official capacity. A gift, not necessarily of pecuniary value, bestowed to influence the conduct of the receiver.

Bribery

The offering, giving, receiving, or soliciting of something of value for the purpose of influencing the action of an official in the discharge of his or her public or legal duties. The corrupt tendering or receiving of a price for official action. The receiving or offering of any undue reward by or to any person concerned in the administration of public justice or a public officer to influence his behavior in office. Any gift, advantage, or emolument offered, given, or promised to, or asked or accepted by, any public officer to influence his or her behavior in office. The federal statute includes any "officer or employee or person acting for or on behalf of the United States, or any department or agency or branch of government thereof, . . . in any official function."

Any direct or indirect action to give, promise, or offer anything of value to a public official or witness, or an official's or witness's solicitation of something of value is prohibited as a bribe or illegal gratuity.

At common law, the gist of the offense was the tendency to pervert justice; the offering, giving, receiving, or soliciting of anything of value to influence action as a public official; a corrupt agreement induced by offer of reward. The term now, however, extends to many classes of officers and is not confined to judicial officers; it applies both to the actor and receiver, and extends to voters, legislators, sheriffs, and other classes. All persons whose official conduct is connected with the administration of the government are subjects, including persons acting under color of title to office.

Commercial bribery. Commercial bribery, as related to unfair trade practices, is the advantage that one competitor secures over his or her fellow competitors by his or her secret and corrupt dealing with employees or agents of prospective purchasers.

Bustout Scheme

See app. D.

Check Kiting

Practice of writing a check against a bank account in which funds are insufficient to cover it then, before the check clears the bank, depositing funds sufficient to make up at least the shortfall. Transfer of funds between two or more banks to obtain unauthorized credit from a bank during the time it takes the checks to clear. In effect, a kite is a bad check intentionally used to temporarily obtain credit.

Also see App. D.

Complaint

The original or initial pleading by which an action is commenced under codes or Rules of Civil Procedure. The pleading that sets forth a claim for relief. Such complaint, whether it be the original claim, counterclaim, cross-claim, or third-party claim, shall contain: (1) a short and plain statement of the grounds on which the court's jurisdiction depends, unless the court already has jurisdiction and the claim needs no new grounds of jurisdiction to support it, (2) a short and plain statement of the claim showing that the pleader is entitled to relief, and (3) a demand for judgment for the relief to which he or she deems himself or herself entitled. Relief in the alternative or of several different types may be demanded. The complaint, together with the summons, is required to be served on the defendant.

In criminal law, a charge, preferred before a magistrate having jurisdiction, that a person named (or an unknown person) has committed a specified offense, with an offer to prove the fact, to the end that a prosecution may be instituted. The complaint can be "taken out" by the victim, the police officer, the district attorney, or other interested party. Although the complaint charges an offense, an indictment or information may be the formal charging document. The complaint is a written statement of the essential facts constituting the offense charged. In the federal courts, it is to be made upon oath before a magistrate. If it appears from the complaint that probable cause exists that the person named in the complaint committed the alleged crime, a warrant (q.v.) for his or her arrest will be issued.

Conspiracy	A combination or confederacy between two or more persons formed for the purpose of committing, by their joint efforts, some unlawful or criminal act, or some act that is lawful in itself, but becomes unlawful when done by the concerted action of the conspirators, or for the purpose of using criminal or unlawful means to the commission of an act not in itself unlawful.
Deceit	A fraudulent and deceptive misrepresentation, artifice, or device, used by one or more persons to deceive and trick another, who is ignorant of the true facts, to the prejudice and damage of the party imposed upon. To constitute "deceit," the statement must be untrue, made with knowledge of its falsity or with reckless and conscious ignorance thereof, especially if the parties are not on equal terms; made with the intent that the plaintiff act thereon or in a manner apparently fitted to induce him or her to act thereon, and the plaintiff must act in reliance on the statement in the manner contemplated, or manifestly probable, to his or her injury.
Declaration	<p>In common-law pleading, the first of the pleadings on the part of the plaintiff in an action at law, being a formal and methodical specification of the facts and circumstances constituting his or her cause or action. It commonly comprises several sections or divisions, called <i>counts</i>, and its formal parts follow each other in this general order: Title, venue, commencement, cause of action, counts, conclusion. The term complaint is used in the federal courts and in all states that have adopted rules of civil procedure.</p> <p>In law of evidence, an unsworn statement or narration of facts made by a party to the transaction, or by one who has an interest in the existence of the facts recounted.</p>
Defalcation	The act of one guilty of a breach of trust especially in money matters; act of embezzling; intentional failure to meet an obligation; misappropriation of trust funds or money held in any fiduciary capacity; intentional failure to properly account for funds or other property that has been entrusted. Commonly spoken of officers of corporations or public officials.
Defendant	The person defending or denying the party against whom relief or recovery is sought in an action or suit or the accused in a criminal case.
Deposition	The testimony of a witness taken upon oral question or written interrogatories, not in open court, but in pursuance of a commission to take testimony issued by a court, or under a general law or court rule on the subject, and reduced to writing and duly

authenticated, and intended to be used in preparation and upon the trial of a civil action or criminal prosecution. A pretrial discovery device by which one party, through his or her attorney, orally asks questions of the other party or of a witness for the other party. The person who is deposed is called the *deponent*. The deposition is conducted under oath outside the courtroom, usually in one of the lawyer's offices. A transcript, a word for word account, is made of the deposition. Testimony of witness, taken in writing, under oath or affirmation, before some judicial officer in answer to questions or interrogatories.

Direct Evidence	Evidence in form of testimony from a witness who actually saw, heard, or touched the subject of questioning. Evidence, which if believed, proves the existence of facts at issue without inference or presumption.
Embezzlement	The fraudulent appropriation of property by one lawfully entrusted with its possession. To embezzle means to willfully take or convert to one's own use another's money or property, which the wrongdoer acquired lawfully, by reason of some office or employment or position of trust. The elements of offense are that there must be a relationship such as that of employment or agency between the owner of the money and the defendant, the money alleged to have been embezzled must have come into the possession of defendant by virtue of that relationship, and there must be an intentional and fraudulent appropriation or conversion of the money. The fraudulent conversion of the property of another by one who has lawful possession of the property and whose fraudulent conversion has been made punishable by statute.
Evidence	<p>Any species of proof, or probative matter, legally presented at the trial of an issue by the act of the parties and through the medium of witnesses, records, documents, exhibits, concrete objects, and such, for the purpose of inducing belief in the minds of the court or jury as to their contention. Testimony, writings, or material objects offered in proof of an alleged fact or proposition. The probative material, legally received, by which the tribunal may be lawfully persuaded of the truth or falsity of a fact in issue.</p> <p>Testimony, writings, material objects, or other things presented to the senses that are offered to prove the existence or nonexistence of a fact.</p> <p>As a part of procedure, evidence signifies those rules of law whereby it is determined what testimony should be admitted and what should be rejected in each case, and what is the weight to be given to the testimony admitted.</p>
Expert Witness	One who by reason of education or specialized experience possesses superior knowledge respecting a subject about which persons having no particular training are incapable of forming an accurate opinion or deducing correct conclusions. A witness who has been qualified as an expert and who thereby will be allowed to express opinions to assist the jury in understanding complicated and technical subjects not within the understanding of the average lay person.
False Entry	An untrue statement of items of account by written words, figures, or marks. One making an original false entry makes a false entry in every book that is made up in regular course from the entry or entries from the original book of entry.

An entry in books of a bank or trust company that is intentionally made to represent what is not true or does not exist, with intent either to deceive its officers or a bank examiner or to defraud the bank or trust company.

False Statement

A statement, knowingly made falsely or recklessly without honest belief in its truth, and with purpose to mislead or deceive. An incorrect statement made or acquiesced in with knowledge of incorrectness or with reckless indifference to actual facts and with no reasonable ground to believe it correct. Such statements are more than erroneous or untrue and import the intention to deceive.

Under statutory provision making it unlawful for an officer or director of a corporation to make any false statement in regard to the corporation's financial condition, the phrase means something more than merely untrue or erroneous, but implies that statement is designedly untrue and deceitful, and made with the intention to deceive the person to whom the false statement is made or exhibited.

The federal criminal statute governing false statements applies to three distinct offenses: falsifying, concealing, or covering up a material fact by any trick, scheme, or device; making false, fictitious, or fraudulent statements or representations; and making or using any false documents or writing.

Falsify

To counterfeit or forge; to make something false; to give a false appearance to anything. To make false by mutilation, alteration, or addition; to tamper with as to falsify a record or document. The word *falsify* may be used to convey two distinct meanings: either (1) being intentionally or knowingly untrue, made with the intent to defraud, or (2) mistakenly and accidentally untrue. To disprove; to prove to be false or erroneous; to avoid or defeat. Spoken of verdicts, appeals, etc.

Forensic

Belonging to courts of justice. Refers to activities or materials used to aid the judicial process, such as forensic medicine, forensic accounting or forensic evidence.

Forgery

The false making or the material altering of a document with the intent to defraud. A signature of a person that is made without the person's consent and without the person otherwise authorizing it. A person is guilty of forgery if, with purpose to defraud or injure anyone, or with knowledge that he or she is facilitating a fraud or injury to be perpetrated by anyone, the actor: (a) alters any writing of another without his or her authority; or (b) makes, completes, executes, authenticates, issues, or transfers any writing so that it purports to be the act of another who did not authorize that act, or to have been executed at a time or place or in a numbered sequence other than was in fact the case, or to be a copy of an original when no such original existed; or (c) utters any writing that he or she knows to be forged in a manner specified in (a) or (b).

Crime includes both act of the forging the handwriting of another and the act of uttering as true and genuine any forged writing knowing the same to be forged with intent to prejudice, damage, or defraud any person. Crime is committed when one makes or passes a false instrument with the intent to defraud, and the element of loss or detriment is immaterial. The false making of an instrument that purports on face of it to be good and valid for purposes for which it was created, with a design to defraud any person or persons.

Fraudulent	Based on fraud; proceeding from or characterized by fraud; tainted by fraud; done, made, or effected with a purpose or design to carry out a fraud.
Fraudulent Concealment	The hiding or suppression of a material fact or circumstance that the party is legally or morally bound to disclose. The employment of artifice planned to prevent inquiry or escape investigation and to mislead or hinder the acquisition of information disclosing a right of action; acts relied on must be of an affirmative character and fraudulent. The test of whether failure to disclose material facts constitutes fraud is the existence of a duty, legal or equitable, arising from the relation of the parties; failure to disclose a material fact with intent to mislead or defraud under such circumstances being equivalent to an actual fraudulent concealment.
Fraudulent Conversion	Receiving into possession the money or property of another and fraudulently withholding, converting, or applying the same to or for one's own use and benefit, or to the use and benefit of any person other than the one to whom the money or property belongs.
Fraudulent Misrepresentation	A false statement as to material fact, made with intent that another rely thereon, which is believed by the other party and on which he or she relies and by which he or she is induced to act and does act to his or her injury, and the statement is fraudulent if the speaker knows the statement to be false or if it is made with utter disregard of its truth or falsity. As a basis for civil action, establishment of representation, falsity, scienter, deception, and injury, are generally required.
Hearsay	<p>A term applied to that species of testimony given by a witness who relates, not what he or she knows personally, but what others have told him or her, or what he or she has heard said by others. A statement, other than one made by the declarant while testifying at the trial or hearing, offered in evidence to prove the truth of the matter asserted.</p> <p>Hearsay evidence is testimony in court of a statement made out of the court, the statement being offered as an assertion to show the truth of matters asserted therein, and thus resting for its value upon the credibility of the out-of-court asserter. Evidence not proceeding from the personal knowledge of the witness, but from the mere repetition of what he or she has heard others say. That which does not derive its value solely from the credit of the witness, but rests mainly on the veracity and competence of other persons.</p>
Indicia	Signs; indications. Circumstances which point to the existence of a given fact as probable, but not certain.
Indictment	An accusation in writing found and presented by a grand jury, legally convoked and sworn, to the court in which it is impaneled, charging that a person therein named has done some act, or been guilty of some omission, which by law is a public offense, punishable on indictment. A formal written accusation originating with a prosecutor and issued by a grand jury against a party charged with a crime. An indictment is referred to as a true bill, whereas failure to indict is called a no bill.

Kickback	<p>Payment back by a seller of a portion of the purchase price to buyer or public official to induce purchase or to improperly influence future purchases or leases.</p> <p>Also see appendix D.</p>
Lapping	See appendix D.
Larceny	<p>Felonious stealing, taking and carrying, leading, riding, or driving away another's personal property, with intent to convert it or to deprive the owner thereof. The essential elements of a larceny are an actual or constructive taking away of the goods or property of another without the consent and against the will of the owner or possessor and with a felonious intent to convert the property to the use of someone other than the owner.</p> <p>Common-law distinctions between obtaining money under false pretenses, embezzlement, and larceny no longer exist in many states; all such crimes being embraced within the general definition of larceny. Some states classify larceny as either grand or petit, depending on the property's value.</p>
Mail Fraud	The use of the mails to defraud is a federal offense requiring the government to prove a knowing use of the mails to execute the fraudulent scheme. Elements of mail fraud are a scheme to defraud and the mailing of a letter for the purpose of executing the scheme.
Malfeasance	Evil doing; ill conduct. The commission of some act that is positively unlawful; the doing of an act that is wholly wrongful and unlawful; the doing of an act that the person ought not to do at all or the unjust performance of some act that the party had no right, or had contracted not, to do. A comprehensive term including any wrongful conformance of official duties. Malfeasance is a wrongful act that the actor has no legal right to do, or any wrongful conduct that affects or interrupts, or for which there is no authority or warrant of law, or that a person ought not to do at all; or the unjust performance of some act that the party performing has no right, or has contracted not, to do.
Misapplication	Improper, illegal, wrongful, or corrupt use of application of funds, property, etc.
Misappropriation	The unauthorized, improper, or unlawful use of funds or other property for a purpose other than that for which intended. Misappropriation of a client's funds is any unauthorized use of the client's funds entrusted to an attorney, including not only stealing but also using temporarily without authority for the lawyer's own purpose, whether or not he or she derives any personal gain or benefit therefrom. The term may also embrace the taking and use of another's property for the sole purpose of capitalizing unfairly on the good will and reputation of the property owner.
No Bill	This phrase endorsed by a grand jury on the indictment, is equivalent to "not found", "no indictment", or "not a true bill". It means that, in the opinion of the jury, evidence was insufficient to warrant the return of a formal charge. (See Indictment .)
Percipient	Capable of or characterized by perception. (See Direct Evidence .)

Perpetrator	Generally, this term denotes the person who actually commits a crime or by whose immediate agency it occurs.
Ponzi Scheme	See appendix D.
Predication	An act or instance of proclaiming or affirming something (e.g., suspected or alleged fraud) about another.
Presumption	An inference in favor of a particular fact. A presumption is a rule of law, statutory or judicial, by which the finding of a basic fact gives rise to the existence of presumed fact, until presumption is rebutted.
Prima Facie Evidence	Evidence good and sufficient on its face. Such evidence as, in the judgment of the law, is sufficient to establish a given fact, or the group or chain of facts constituting the party's claim or defense, and which if not rebutted or contradicted, will remain sufficient. Evidence which, if unexplained or uncontradicted, is sufficient to sustain a judgment in favor of the issue that it supports, but that may be contradicted by other evidence.
Relator	An informer. The person upon whose complaint, or at whose instance certain writs are issued such as information or writ of <i>quo warranto</i> , and who is <i>quasi</i> the plaintiff in the proceeding.
Target Offense	In crime of conspiracy, the crime contemplated by the illegal agreement.
Target Witness	A person whose testimony the investigating body is principally seeking as in the case of a grand jury, which has, as its objective, the information that such a person may give. A witness called before a grand jury against whom the government is seeking an indictment.
True Bill	The endorsement made by a grand jury upon a bill of indictment, when they find it sustained by the evidence laid before them, and are satisfied of the truth of the accusation. The endorsement made by a grand jury when they find sufficient evidence to warrant a criminal charge. An indictment. (See Indictment .)
White Collar Crimes	Term signifying various types of unlawful, nonviolent conduct committed by corporations and individuals including theft or fraud and other violations of trust committed in the course of the offender's occupation (for example, embezzlement, commercial bribery, racketeering, anti-trust violations, price-fixing, stock manipulation, insider trading, and the like). RICO laws are used to prosecute many types of white collar crimes.
Witness (noun)	<p>In general, one who, being present, personally sees or perceives a thing; a beholder, spectator, or eyewitness. One who is called to testify before a court. One who testifies to what he or she has seen, heard, or otherwise observed.</p> <p>A person whose declaration under oath, or affirmation, is received as evidence for any purpose, whether such declaration be made on oral examination or by deposition or affidavit.</p>

Witness (verb) To subscribe one's name to a deed, will, or other document, for the purpose of attesting to its authenticity, and proving its execution, if required, by bearing witness thereto. To see or know by reason of personal presence.

READER'S RESPONSES TO FRAUD INVESTIGATIONS IN LITIGATION AND DISPUTE RESOLUTION SERVICES

Your assessment of this practice aid will help to ensure that future publications of the Management Consulting Services Division will be valuable to practitioners. Please photocopy this questionnaire and complete and mail or fax it to **MCS Division Coordinator, 1211 Avenue of the Americas, New York, NY 10036-8775**, facsimile number (212) 596-6025.

Thank you for your assistance.

-
-
1. How familiar were you with this subject before you read this practice aid?

0 1 2 3 4 5
Unfamiliar Somewhat familiar My area of expertise

2. How useful is the practice aid to your practice?

0 1 2 3 4 5
Not useful at all Extremely useful

3. Is there additional information that you think should have been included or information that should be modified in this practice aid? Yes _____ No _____

If yes, please explain _____

4. Do you think that an advanced level practice aid on this subject should be available?

Yes _____ No _____

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