

Forensic Accounting - What is it, who does it, and when do I need it?  
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## What is Forensic Accounting?

As it applies to the accounting profession, the term is rooted in the definition of “forensic” which is defined in Black’s Law Dictionary as “used in, or suitable to, courts of law or public debate”.

Forensic accounting services general involve the application of specialized knowledge and investigative skills by the accountant to collect, analyze, and evaluate certain evidential matter and to interpret and communicate findings. (AICPA - Statement on Standards for Forensic Services)

The discipline is broad and includes calculations of economic damages; business or asset valuations; fraud examination; asset and transaction tracing for concerns of financial exploitation or embezzlement; asset and transaction tracing for potential preferential payments in bankruptcy matters.

Terms commonly heard include forensic accounting (used as a noun), forensic audit, forensic examination, fraud examination. These services are generally designed to focus on examining or reconstructing past financial transactions for a specific purpose.

The need for the service often arises from a dispute, a tip, a concern, observed unusual behavior or unusual transaction(s). The purpose is defined at the start of the engagement and shapes the initial procedures that the forensic accountant undertakes.

Examples of the purpose of a forensic engagement (i.e., the question(s) the Engaging party wants answered):

- How much past and future lost profits or lost wages did the party suffer resulting from the alleged wrongful act?
- Were funds belonging to a Vulnerable Adult spent for the benefit of others during a defined time period?
- Did the Accounts Receivable clerk (the clerk who processes payments received by the Company from customers) properly process and deposit customer payments during a defined time period?
- Why is the Company’s cash balance at the end of the year very low when business was booming this past year?

Caution: The term “audit” in the CPA world is commonly associated with a financial statement audit - the objective of which is for the CPA to obtain reasonable assurance as to whether the organization’s financial statements are free from material misstatement. In this type of engagement, the CPA is concerned with the financial statements as a whole

(consisting of a balance sheet, income statement, statement of cashflows and statement of equity).

An “audit” (i.e., a financial statement audit) is not designed to answer the above types of questions. To avoid confusion when speaking with a CPA about a concern similar to one of the examples above, instead of using the word “audit,” ask about a “forensic accounting” or a “fraud examination” - the terms are basically interchangeable.

The chart below highlights nuances particularly in situations where asset misappropriation is suspected. (Chart credit to: Ahmed Khan, ACCA, CFE - “Relationship Between Fraud Examination and Forensic Accounting”, published Dec. 29, 2016)

Points	Fraud Examination	Forensic Accounting
<b>Timing</b>	Fraud examinations are conducted only with sufficient predication.	Forensic accounting engagements are conducted only after allegation of misconduct.
<b>Objective</b>	Fraud Examiner’s goal is to determine whether fraud has occurred and who is likely responsible.	Forensic Accountant’s goal is to determine whether the allegations are reasonable based on the financial evidence and, if so, the financial impact of the allegations.
<b>Relationship</b>	Fraud examinations involve efforts to affix blame which are adversarial in nature.	Forensic Accountant calculates financial impact based on formulaic assumptions.
<b>Methodology</b>	Fraud examinations are conducted by: (1) document examination; (2) review of outside data such as public records; and (3) interviews.	Gathering the required financial and nonfinancial evidence to examine the allegations independently and determine their financial impact.
<b>Presumption</b>	Fraud Examiner's approach is to resolution a fraud by attempting to gather sufficient evidence to support or refute an allegation of fraud.	Forensic accounting professionals will attempt to gather sufficient evidence to support or refute the allegation and related damages.

## Who is a forensic accountant?

A forensic accountant is an individual with specialized knowledge and training which typically involves earning a credential(s) beyond the CPA license. Some of the most well-known credentials obtained by CPAs who perform forensic accounting services are:

- Business valuation:
  - Certified Valuation Analyst (CVA) - National Association of Certified Valuators and Analysts
  - Accredited Senior Appraiser (ASA) - American Society of Appraisers
  - Accredited in Business Valuation (ABV®) credential - American Institute of CPAs
- Fraud Examination:
  - Certified Fraud Examiner (CFE) - Association of Certified Fraud Examiners
- Other - these programs cover a broad body of forensic accounting knowledge and are mostly damages-oriented:
  - Certified in Financial Forensics (CFF®) credential - American Institute of CPAs
  - Master Analyst in Financial Forensics (MAFF) - National Association of Certified Valuators and Analysts

## When do I need a forensic accountant?

You are meeting with a client and the issue discussed is:

- The client's estate currently includes a closely-held business interest - there are many issues that may need to be dealt with such as how much the business is currently worth; what is the client's succession plan for the business; etc.
  - Consider consulting with a qualified business appraiser to find out what the business is currently worth. This situation is not contentious, so you do not necessarily need someone who is experienced as an expert witness for business valuation matters. Many CPAs have a credential in business valuation; not all are comfortable serving in the expert witness role.
  - Documents to initially gather for the appraiser:
    - five years of financial statements and complete federal income tax returns;
    - record of ownership changes in the past five years;
    - articles of incorporation, by-laws and operating agreements;
    - recent appraisals (if any) of real estate or significant assets owned by the business;
    - list of any patents, copyrights, trademarks owned by the business

- The client is concerned that a family member or caregiver may be financially taking advantage of a vulnerable adult (VA).
  - Consider consulting with a forensic accountant for a forensic accounting examination. Since this situation is already or has the potential to be contentious, consider engaging someone who has a specialty credential and is comfortable serving as an expert witness in addition to performing the forensic examination.
  - Documents to initially gather for the forensic accountant:
    - VA's complete federal income tax returns for the past three years
    - VA's bank (financial institution) records for the period of time you want examined plus 3 months of records pre- and post-period.
      - Bank records should include monthly statements, cancelled checks, deposit items, signature cards, account opening agreement, any correspondence the institution has maintained on the account.
  - Other helpful information
    - Recent credit report for the VA
    - VA's current address and any prior addresses (for the period being examined)
      - Does the VA own or rent the home?
    - List of potential parties "related" to the VA such as VA's family members, caregivers, caregiver's family members
    - Statement or description from concerned family member or other "friendly" parties regarding the VA's mobility, lifestyle, observations of the home, VA's level of independence or care needed
    - Any known trips taken or major purchases made by the VA (for the period being examined)

## Closing thoughts...

- When meeting with your client, flush out what question(s) the client wants answered; what keeps you/the client up at night? This question is what you will want to communicate to the CPA regarding a possible engagement and is the basis for determining what services are needed.
- If you think you need a forensic accountant, remember to avoid asking the CPA for "an audit" - instead ask for someone who performs forensic accounting services or a forensic (or fraud) examination.