

SOLUTIONS CHAPTER 1

Introduction to the World of Forensic Accounting

COVERAGE OF LEARNING OBJECTIVES

LEARNING OBJECTIVE	QUESTIONS	WORKPLACE APPLICATIONS	CHAPTER PROBLEMS
LO1. Explain what forensic accounting is.	1, 2, 3, 4, 5, 23		
LO2. Identify common types of forensic accounting engagements.	6, 7, 8, 9, 24, 25		
LO3. Compare and contrast the role of the forensic accountant with the roles of transactional accountants and auditors.	10, 11, 12		
LO4. Identify the necessary skills of forensic accountants.	13, 14, 15, 16, 17, 18, 27, 28, 29, 30	33, 35	36, 37, 38
LO5. Recognize major providers of forensic accounting certification and continuing education.	20, 31		39
LO6. Identify potential careers in forensic accounting.	21, 25	34	

Questions

- 1-1. Al Capone was sentenced to eleven years in federal prison in 1931 for tax evasion and failure to file income tax returns for years 1928 and 1929.
- 1-2. Frank J. Wilson is commonly recognized as the first forensic accountant and rightfully credited with bringing down Al Capone. His net worth method was the first indirect method to receive judicial approval and continues to be used by IRS and FBI agents and, of course, forensic accountants. The net worth method is conducted using the following steps:

Step		
1	Determine	Ending Net Worth
2	Determine	Beginning Net Worth
3	Calculate (–)	Change in Net Worth (= \$ used for asset acquisitions)

4	Determine	Expenditures (= \$ consumed)
5	Calculate (+)	Total Acquisitions and Consumption
6	Determine	Reported Income + Legitimate Sources
7	Calculate (–)	Unreported Income

1-3. Forensic accounting is defined in a number of ways by different organizations. Forensic accounting can be broadly defined as applying accounting, finance, economics, statistics, law, research, and investigative methods used in the collection, analysis, and communication of findings for a specific engagement.

1-4. Mindset is a person's mental state, which evolves from education, experience, and prejudices. Specifically, a mindset consists of mental processes that dictate how a person responds to situations or challenges. Activating one mindset instead of another may change a person's observations; for example, a particular mindset will impact what you see, how you see it, which questions you ask, which judgments you form, and which decisions you make.

For example, students must have a different mindset for different types of exams. If the exam is taken in essay format, students need to approach the exam with comprehensive knowledge of the concepts to be covered, but the mindset must be focused on how to present question responses in a logical and readable manner, with attention to grammar and punctuation.

On the other hand, if an exam is structured in multiple-choice format, students still need to approach the exam with comprehensive knowledge of the concepts to be covered, but the mindset must be focused on how questions are structured, what specifically is being asked by each question, and what models and techniques might be useful in determining a correct response. Unlike an essay exam, the presentation of the response is not a mindset consideration for a multiple-choice exam.

1-5. The four phases of a forensic accounting engagement are: (1) defining the engagement (i.e., why are we doing this?); (2) discovery, through the gathering of evidence; (3) analysis, which involves interpreting the evidence; and (4) communication, which involves presenting evidence or opinions, either orally or in writing.

1-6. Investigative services provided by forensic accountants are:

- a. Forensic accounting *investigations* are engagements that do not involve (at least at the outset) actual or threatened litigation.
- b. *Fraud detection* is the actual discovery of fraud. Fraud detection includes a variety of techniques, such as internal control procedure review, statistical analysis, financial statement analysis, and the use of anonymous reporting channels (e.g., hotlines).
- c. A *fraud examination* is conducted after a crime has been committed. The immediate challenge is to investigate the allegations or suspicions of fraud—that is, who, when, how, how much, and who else.

- d. *Fraud deterrence* describes proactive (rather than reactive) strategies to prevent fraud.
 - e. *Other investigations* include merger and acquisition evaluations, insurance claims, divorce, and small business valuations, to name a few.
- 1-7. Litigation services offered by forensic accountants are provided in connection with actual, pending, or potential legal or regulatory proceedings. These may be criminal or civil. The two broad categories are expert witness and consulting expert services.
- a. An *expert witness* is an individual who possesses specialized knowledge or expertise and is engaged to assist a judge or jury in evaluating complex evidence.
 - b. A *consulting expert* assists an attorney in advocating for a client. The duties are similar to those of an expert witness, except that the forensic accountant does not offer expert testimony in front of a judge or jury.
- 1-8. The primary differences between an expert witness (testifying) and a consulting expert (nontestifying) include the following:

	<u>Expert Witness</u>	<u>Consulting Expert</u>
a. Has specialized expertise	Yes	Yes
b. Gathers evidence	Yes	Yes
c. Analyzes quantitative data	Yes	Yes
d. Prepares an expert opinion report	Yes	May or may not
e. Prepares questions for witnesses	Yes	Yes
f. Prepares trial exhibits	Yes	May or may not
g. Testifies at a deposition or trial	Yes	No
h. Remains objective	Yes	May advocate
i. Covered by attorney/client privilege	No	Yes
j. Helps develop key arguments	May or may not	May or may not

- 1-9. Nonfraud engagements that a forensic accountant might perform are numerous. Students will select different engagement types from among the following:
- a. Family law, including business valuations
 - b. Merger and tax (estate or gift) business valuations
 - c. Calculation of economic damages
 - d. Bankruptcy
 - e. Insolvency and reorganization
 - f. Computer forensic analysis

- 1-10. The role of a transactional and forensic accountant are different in the following ways; see Table 1-2 in the textbook for additional comparisons:

Role	Transactional Accountant	Forensic Accountant
Timing	Day-to-day and month-to-month	Conducted on an as-needed (nonrecurring) basis
Scope	Manage the organization's accounting and internal control system	Defined by the specific engagement
Objective	Capture and record all economic transactions of the organization	Address a specific question/issue

Purpose	Prepare financial statements for decision makers	Defined by the specific engagement
Value	Information useful for decision making purposes	Completion of stated engagement objective
Source of Evidence/Methodology	Original transactions for the acquisition and employment of assets, liabilities, equity, revenue, and expense in the conduct of business	Review detailed financial and nonfinancial data, search public records, conduct interviews, and make observations.
Sufficiency of Evidence	Reasonable assurance	Establish facts to support the conclusion/opinion
Audience	Management at all levels and the BOD	Engaging party

- 1-11. The role of an external auditor and a forensic accountant is different. Some differences are set forth below (see textbook Table 1-2 for additional comparisons):

Role	External Auditor	Forensic Accountant
Timing	Conducted on a recurring basis	Conducted on an as-needed (nonrecurring) basis
Scope	Examination of financial data	Defined by specific engagement
Objective	Form an opinion on the overall financial statements taken as a whole	Address a specific question/issue
Purpose	Usually required by third-party users of financial statements	Defined by specific engagement
Value	Adds credibility to reported financial information	Completion of stated engagement objective
Source of Evidence / Methodology	Inquiry, observation, examination, and reconstruction of accounting transactions to support financial statement representations	Review detailed financial and nonfinancial data, search public records, conduct interviews, and make observations
Sufficiency of Evidence	Reasonable assurance	Establish facts to support the conclusion/opinion

Audience	Serves the public interest, specifically investors and other stakeholders	Engaging party
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- 1-12. The role of an internal auditor and a forensic accountant vary in a number of ways as set forth below (additional comparisons can be seen in Table 1-2 of the textbook):

Role	Internal Auditor	Forensic Accountant
Timing	Conducted according to a plan or because a deficiency has been identified	Conducted on an as-needed (nonrecurring) basis
Scope	Validate effectiveness of controls in various processes or areas of the organization	Defined by specific engagement
Objective	Ensure compliance with policy and procedures; offer recommendations for improvement of internal controls	Address a specific question/issue
Purpose	Required by the BOD based on overall corporate risk assessment	Defined by specific engagement
Value	Provides assurance that management is adequately identifying and mitigating risks	Completion of stated engagement objective
Source of Evidence / Methodology	Inquiry, observation, examination, and testing of processes	Review detailed financial and nonfinancial data, search public records, conduct interviews, and make observations
Sufficiency of Evidence	Reasonable assurance	Establish facts to support the conclusion/opinion
Audience	Executive management and the BOD	Engaging party

- 1-13. The three essential characteristics and core skills possessed by a forensic accountant are critical thinking, reasoning, and communicating.
- 1-14. Critical thinking is the ability to reason results from what is known, the motivation to acquire additional relevant information, and the ability to employ this information in a rational manner to solve problems. Attributes associated with this process are:
- Rational—Considers all known evidence in an unbiased manner
 - Skeptical—Suspends judgment to allow proper consideration of evidence, context, and methodologies
 - Reasonable—Measures behaviors and conclusions with sound judgment and common sense

- Well-informed—Possesses adequate and reliable information
- Open-minded—Free of bias and receptive to new information and ideas from others
- Self-aware—Cognizant of one’s own emotions and biases and how they impact decisions
- Persistent—Resists jumping to conclusions

1-15. Inductive reasoning starts with the specific and works toward the general, whereas deductive reasoning starts with the general and works toward the specific. Student examples will vary, but for inductive reasoning an example will start with a set of facts, and those facts will be used to arrive at a conclusion. For example:

	<u>Read Text</u>	<u>Did Assignments</u>	<u>Grade</u>
Student A	Yes	Yes	A
Student B	Yes	Yes	B
Student C	No	No	D
Student D	Yes	Yes	A

The conclusion is that students who read the text and do the assignments earn As and Bs, whereas students that do not earn Ds.

For deductive reasoning, a student’s example will start with the general and work toward the specific. For example:

Major premise	All dogs have four legs.
Minor premise	Brutus is a dog.
Conclusion	Brutus has four legs.

1-16. A forensic accountant uses both inductive and deductive reasoning, along with intuition during a forensic examination. Much of a forensic investigation uses inductive reasoning, where a pattern of activity is analyzed to arrive at a hypothesis or a conclusion.

1-17. Written and oral communication skills are important to a forensic accountant because they provide information that will assist the trier of fact (judge or jury) in understanding the evidence. To that end, an expert’s opinion must be stated in a legally sufficient manner and must be based on reliable facts, data, and methodology.

The forensic accountant expects his or her reports, and every word contained therein, to be closely examined and challenged. Thus, all written reports must be clear, concise but comprehensive, and grammatically correct, employing a professional tone.

Oral communication, whether the communication is with an attorney, a client, a law enforcement officer, or a judge or jury, is facilitated by an ability to relate findings in a simple, professional, and convincing manner. The path to effective oral communication

is an understanding of the communication process and practice. Effective communication results in shared meaning and understanding between the sender (writer or testifier) and the receiver (reader or listener) of information.

- 1-18. A forensic accountant must consider these attributes (characteristics) when crafting a written report:

- a. Must be clearly written
- b. Must be concise but comprehensive
- c. Must be free from grammatical errors
- d. Must have a professional tone

Instructors might emphasize the need to proofread, proofread, proofread. Proofreading is essential, as the manner and wording of a presentation can impact how well the message is received. Thus, poorly crafted documents could impact the outcome of a case negatively.

- 1-19. The CSI effect as it relates to forensic accounting is the enhanced level of expectation among jurors with regard to forensic evidence. The portrayal of trials on television may cause jurors to expect an abundance of such evidence in each trial. If valid, forensic accountants may need to “jazz up” a presentation, which can be difficult given the nature of financial information presented by a forensic accountant.

- 1-20. Several organizations provide forensic accounting certifications. Students will select from among the following: National Association of Certified Valuation Analysts, and American Institute of Certified Public Accountants, Association of Certified Fraud Examiners.

Obtaining a certification has value because a specialized certification conveys an understanding of a specific body of knowledge or expertise and thus differentiates holders from their competitors.

- 1-21. A variety of organizations hire forensic accountants. These include CPA firms and national, state, and local governmental agencies, such as the IRS and FBI (national) and the state police or sheriff’s department (local/regional). Entry-level positions earn in the \$30,000 to \$60,000 per year salary range. Positions seeking experience pay from \$60,000 to six digits and can reach \$500,000 per year for those at the top of the forensic accounting profession.

Multiple-Choice Questions

- 1-22. C
- 1-23. B
- 1-24. D
- 1-25. D

- 1-26. B
- 1-27. C
- 1-28. D (The argument presented does not flow logically. Instructors might discuss why.)
- 1-29. C
- 1-30. D
- 1-31. D
- 1-32. A

Workplace Applications

- 1-33. A solution to this workplace application will vary by student, but most of the following education and experience components will be present in a well-thought-out response.
 - a. Earn an undergraduate degree, accounting major preferred.
 - b. Earn a master's degree.
 - c. Obtain the CPA certificate.
 - d. Gain workplace experience—auditing, tax, business valuation, and forensic experience, or other related areas.
 - e. Add certifications in the forensic and business valuation area.
 - f. Continue to add workplace experience.
 - g. Consider adding a PhD or DBA as well as teaching experience while building your resume in steps (a) to (f).
- 1-34. Students will identify different job opportunities when doing a job search on the Internet. Websites such as Monster.com, CareerBuilder.com, Duff & Phelps, and similar sites will be the most commonly referenced. In addition, job postings can be located on the IRS, FBI, and other workplace provider web sites.
- 1-35. Preparation of a ten-year personal professional development plan will vary by student. However, all should include the following components, in terms of goals to be achieved and the timing of such achievement:
 - a. College education—undergraduate and master's degrees
 - b. Professional certifications
 - c. Workplace experience—types of firms and experience desired
 - d. Other career possibilities—PhD or DBA, teaching experience, continuing education

Chapter Problems

- 1-36. Critical thinking research study. Students will select different literature and different ideas related to critical thinking and the scientific approach to problem investigation. The memo should include the following steps normally considered part of the scientific method:
- Identify an issue.
 - Collect information.
 - Develop a preliminary hypothesis.
 - Test the hypothesis through additional analysis.
 - Draw conclusions.
 - Communicate results.
- 1-37. Each student's paper will be different based on the specific inductive and deductive reasoning articles they select. The paper should present deductive reasoning as moving from the general to the specific, and inductive reasoning as moving from the specific to the general.
- 1-38. Each student's paper will use different research, but should arrive at the idea that professional communication has solid content and that difficult concepts should be presented in an easy-to-read and understandable manner. The paper should not be wordy but should make all appropriate relevant points. Humor should be used sparingly, if at all. Finally, the memo should be free from errors. Proofreading is a key to error-free writing. In addition to self-editing, it is useful to have others read it. Finally, reading the memo out loud will help find troublesome spots that diminish the readability of the memo.
- In addition, the manner in which the memo is written and presented will provide firsthand evidence as to whether a student has grasped the key learning objectives in this area.
- 1-39. Students will select different organizations from among those included in Table 1-3 of the text and others, not included in the table, that offer similar certification opportunities. For each professional certification organization chosen, a student's analysis should include:
- Organization offering certification
 - Nature of exam—computer or paper-based
 - Number of testing sections and concepts tested
 - Cost of the exam
 - Testing locations
 - Certification achievement requirement (score needed to pass)
 - Workplace experience needed