

The Past, Present, and Future of Forensic Accounting



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March 2020 Issue, News & Views, Featured |
April 2020

“Rather fail with honor than succeed by fraud.”

—Sophocles

This article is a broad-strokes review of what forensic accountants do, how the profession has developed, and where it appears to be going. It describes the role of the forensic accountant in the abstract, as an inclusive profession that at its core bridges that gap between perception and reality. The demographic makeup and career paths of forensic accountants are touched upon, followed by broad predictions for the coming decade.

The Origins of Forensic Accounting

The world of forensic accounting has been developing for the past 70 years. Some credit the beginning of the understanding of fraud as a subject of scientific study to the 1934 work of Donald Cressey and Edwin Southland, who coauthored *Principles of Criminology*. This authoritative text defined and described the fraud triangle, which made its way to the auditing standards with Statement on Auditing Standards (SAS) 99, *Consideration of Fraud in a Financial Statement Audit*, which makes reference to the elements of the “fraud triangle” (AU section 316). The concept of the fraud triangle is pervasive in the auditing standards and governs much of the work that is required of auditors. Laws have also been established around this basic understanding of fraud, with variations (i.e., the “fraud diamond”), such as the Sarbanes-Oxley Act (SOX), the Health Insurance Portability and Accountability Act (HIPAA), and the Gramm-Leach-Bliley Act (GLB).

In the past decade, the world of forensic accounting has become both more specialized in skills and broader in scope. CPAs were not the driving force behind the savings and loan scandal of the 1980s and 1990s; while regulations were lax and the real estate market was speculative, the role of the forensic accountant was unknown in the period. The crisis, which can be described as a “death by a thousand cuts” due to the failure of many banks, saw regulations as its solution; the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), the increased authority of the Federal Housing Finance Board (FHFB), and capital requirements enacted in 1994 for some lenders were among the reforms. In contrast, the failure of public companies such as Enron and WorldCom was the impetus for increased auditing requirements and ultimately contributed to the rise of CPAs as antifraud specialists and leaders in understanding and implementing internal controls. As much as the trend toward specialization may be simply evolutionary, it is still worth noting that the need for the field of forensic accounting as an applied science has become greater over the decades.

The changes in the practice and application of forensic accounting as a specialized field leave room to grow. While forensic accounting services are performed by non-CPAs and CPAs in various positions, the leverage rests with CPAs as a licensed profession. Furthermore, as the body of knowledge has widened, room for growth and professional satisfaction has followed suit.

What Is Forensic Accounting?

The work of a forensic accountant is generally performed by persons with financial or accounting training, who specialize in acquiring, analyzing, and reporting on financial events

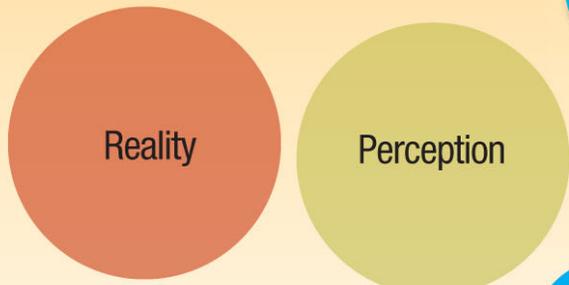
for the purpose of the “forum,” a decision-making body or a person. Webster’s explains “the noun forensic ... derives from the adjective forensic, whose earliest meaning in English is ‘belonging to, used in, or suitable to courts or to public discussion and debate.’ The English word was derived from a Latin word ... meaning ‘of the market place or forum, public,’ which in turn comes from the Latin word forum, meaning ‘market place, forum.’” The forum can be any decision-making authority within its context: judges, jury, public officials, insurance companies, or investors are all examples of forums for which the results of a forensic accounting analysis is delivered and decided upon.

In broad strokes, the body of knowledge—and the people who make it a professional pursuit—is an amalgamation of knowledge bases that applies to multidisciplinary fields. At its core, however, the forensic accounting field can be reduced to two competing concepts: perception and reality. Subfields of forensic accounting include securities and tax fraud, business valuation, computer forensics and electronic discovery, economic damages, bankruptcy and insolvency, and due diligence. All of these subfields, as well as others that may come in the future, can be framed as the intersection of perception and reality.

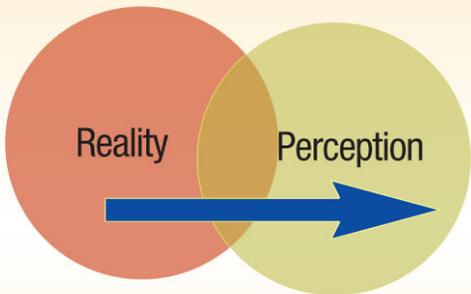
For example, a business valuation on the premise of fair market value attempts to draw a hypothetical reality based on the existing facts. The estimated value consists of a willing buyer’s perception as of the valuation date. As another example, in fraud investigations, typically persons or managers in positions of trust have benefited themselves at the detriment of others (e.g., the company, business partners). It is the fraudsters’ perception that they 1) will never be caught and 2) have done nothing wrong. The forensic accountant’s role is to bring the reality closer to those who perceive it, and report on the findings of the substance of that reality (see [Exhibit](#)).

EXHIBIT

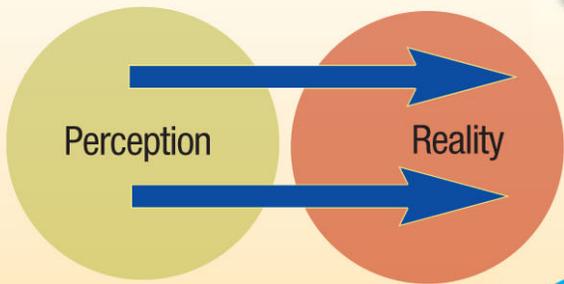
Bridging the Gap between Reality and Perception



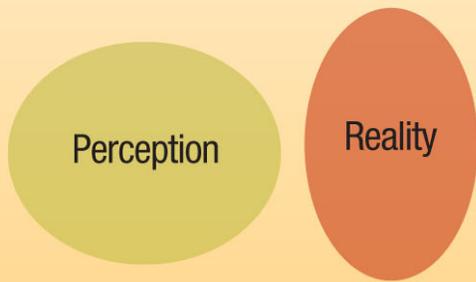
Valuation and damages calculation use reality to establish perception



Fraud investigations bring perception close to reality



Data visualization uses perception to observe reality



Due diligence compares the reality of a subject company to its perception

This “pull-me, push-you” tension between these two forces, in business and in personal lives, can help readers understand—in the abstract—what forensic accountants do: They bridge the gap between what someone perceives to be true and what the evidence shows is the reality. For example, documents, particularly unaltered documents, are what most people think of as “evidentiary matter.” An unaltered document expresses certain truths—in other words, certain realities. Beyond that, aggregation of data, assumptions that replace missing evidence, statements by individuals or even companies, and the experience of forensic accountants themselves can all play the part of evidence. Even an altered document is evidence in itself, as it connotes a motive to make the alteration and suggests the need to investigate motive. People who have a role in a forensic accounting engagement—for example, valuation of a stock—are also a source of evidence, as they provide information, albeit not always without bias, to forensic accountants for the purpose of analysis.

Why Did Forensic Accounting Become a Specialized Profession?

As discussed above, the specialization of forensic accounting evolved over time, with a marked increase in the mid-1990s in response to regulations that made CPAs responsible, in part, for antifraud measures in the financial markets. Asset misappropriation, another class of occupational fraud, also came within the purview of specialists, promoted in particular by the ascendancy of the Association of Certified Fraud Examiners (ACFE) in 1987.

At the same time, fraud investigation and the ensuing services, such as damage calculations and expert testimony by CPAs, have evolved, specialized, and extended beyond the scope of audit or compliance. In 2020, forensic accounting is a field unto its own, with subfields and specialties. Activities such as valuation or business appraisal, previously in the realm of every CPA by the nature of the profession, have been adopted into the field of forensic accounting. Damage calculation, for example, was once the purview of academic researchers and theorists, but has become a practiced field within what is now called forensic accounting.

Being a CPA provides a forensic accountant leverage in both providing the service and presenting the deliverable; educators and regulators know that the body of knowledge for passing the CPA exam is continually widening. Even older CPAs are finding new meaning to their specialty niche; tax accountants, for example, are not applying their skills just to compliance, but have added value in cost segregation, nexus determination, and even

criminal trials. CPAs, like many licensed professions, are ultimately generalists who have a body of knowledge that goes beyond their applied skill. As licensed professionals, they are easier for courts to accept as expert witnesses, and the CPA license carries greater weight—and responsibility—when a CPA is testifying.

Valuation and damages calculation, in particular “before-and-after” presentations, were also at one time a generalized accounting field that required some input assumptions and understanding of accounting and even bookkeeping. Standardized valuation approaches and methods evolved into a specialized field because accountants were using some, but not all, of these approaches and leaving the task of deciding between them to the forum.

In forensic accounting, no two cases are exactly alike, and the adaptive use of electronic discovery, big data, and visualization are the latest addition to the toolkit of forensic accountants. Because such technologies are cheaper to set up and apply, what started as a meeting of the minds from finance and information systems became the latest borrowed technology to serve in simulations, case-demonstration presentations, and various forensic reports to address unique questions.

Who Are Forensic Accountants?

Forensic accountants are not always CPAs. Internationally, they are less likely to be chartered accountants and more likely to be certified professionals such as Certified Fraud Examiners (ACFE) or Certified in Financial Forensics (AICPA). In the ACFE’s 2018 *Report to the Nations*, 48% of occupational fraud and abuse cases reported were from the United States (<https://go.aws/2HzHKd0>). The second region was sub-Saharan Africa with 13% of reported cases, followed by the Asia-Pacific region with 11%. In the same report, the ACFE observed that 53% of respondents worked “in-house, conducting fraud examinations on behalf of a single company or agency,” while only 27% worked at professional services firms for client organizations. Although many U.S. CPAs elect to specialize in forensic accounting, non-CPAs who work as internal auditors and other consultants commonly obtain the specialized knowledge associated with fraud investigation, valuations, and due diligence.

Forensic accountants also work in fraud prevention. Training efforts can have significant effects, not only on a single company or agency, but on an entire economy. The United Nations, the Global Fund organizations, and the World Bank are increasingly adjusting their funding resources toward the objective of empowering fraud investigators and increasing awareness of the perils that fraud specifically presents to developing economies.

The trajectory of a forensic accounting career often follows two possible paths. The first is a focus on financial accounting, and more specifically auditing, from which many types of analysis are derived in fraud, damages, and due-diligence assignment. The other is the application of tax laws and economics, which provides a solid foundation for valuation and appraisal services. While some U.S. forensic accountants enter the field with finance, economics, or other business degrees, most are trained as accountants and are often CPAs. Increasingly in the past few years, information system professionals have also entered the field of forensic accounting, augmenting their skill sets with forensic computing, electronic discovery, data mining, and data visualization.

What Does the Future Hold for Forensic Accountants?

As this article aims to draw the state of forensic accounting in broad strokes, it would be inappropriate to make specific predictions. Here, however, are a few emerging trends that could point to developments in the coming decade:

- **Technology:** Forensic accountants are increasingly relying on and developing new uses for technology. This augments the required skill set from pure critical analysis to working knowledge of technical aspects such as data set management, various data sources, normalization techniques, visualization, and delivery of analysis that goes beyond the plain numbers.
- **Interpersonal skills:** The ability to really listen, to analyze responses based on data and facts, to interpret nonverbal cues, and to understand varying cultural backgrounds will set the forensic accountant of the future apart from the pack.
- **Skeptical mind:** The skeptical mind receives and fully understands what it is being said and then proceeds to verify the purported facts with diligence. Developing a skeptical mind is a lifelong pursuit. These skills, if applied and directed with ample training, could serve the next generation of forensic accountants well.
- **International effects:** Anticorruption skills will be the “make-or-break” test for developing countries. Leaders looking to deter and prevent fraud and corruption will find ready partners in forensic accountants. This will have the added benefit of enabling investment in these local economies by internal and international resources, which other, less forthcoming leaders may not enjoy in the long run.
- **Pressure on valuation services:** Financial modeling often refers to the “valuation” of companies, especially start-ups, and the current valuation standards carve out an exclusion for valuation services rendered in connection with litigation. Both these trends threaten to dilute the time-tested valuation services that CPAs perform. The profession may see a change in terminology to, for example, “certified valuation,” to distinguish it from the colloquial financial market use. In addition, it may be helpful to have litigation-based standards to enable a level playing field between professionals who adhere to the standard and those who provide valuation services under the cover of the current exception.

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A Robust Profession

Today, forensic accounting is a fully formed profession that has evolved as the business world has changed and progressed, both domestically and internationally. The nature of the job remains broadly the same as always—answer the “who/what/when/how much” in situations where perception and reality are not aligned, whether that be a calculation of damage, valuation, fraud, or another class of questions that is brought before a deciding forum for deliberation and adjudication.

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