

Forensic Accountants Society of North America

FASNA FORUM

January/February 2007 • Dedicated to Forensic Accounting and Related Issues • Volume 11, Issue 1

AN EXPERT'S DEDUCTIVE REASONING - IT'S ELEMENTARY, DEAR WATSON

By Kell B. Rabern, CPA, Benson & McLaughlin, P.S., FASNA Member

Forensic accountants are valuable assets to the legal system in that their expertise, specifically their deductive reasoning skills, help fill in the missing pieces of a case.

A court obtains evidence through the testimony of witnesses, i.e. observers of "what happened." Forensic expert testimony is given rather special treatment by the Federal and Washington Rules of Evidence, as well as by other states. Forensic expert testimony may go beyond observations to include opinions and inferences that are based on deductive reasoning.

Rule 702 of the Federal and Washington Rules of Evidence addresses **Testimony by Experts**, as follows:

If scientific, technical, or other specialized knowledge will assist the trier of fact to understand the evidence or to determine a fact in issue, a witness qualified as an expert by knowledge, skill, experience, training, or education, may testify thereto in the form of an opinion or otherwise.

Forensic accountants are skilled at the exercise of logic. Simply stated, based on known Facts A and B, the accountant

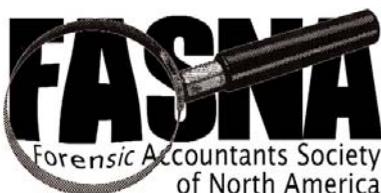
forms a reasoned opinion about the probability of (unknown) Fact C. A court is willing to allow that opinion about Fact C and consider the testimony almost on a par with direct observation of known facts.

The admissibility of expert testimony under Rule 702 is not necessarily guaranteed, however. It is up to the trial court to decide whether the specialized knowledge will assist in the particular case.

For example, in *Alpine Industries, Inc. v. Gohl*, 30 Wn. App. 750, 754-56, 637 P.2d 998, 645 P.2d 737 (1981), the court allowed expert testimony from an accountant who provided an opinion on the amount of profits lost by the plaintiff because the defendant delayed completion of a manufacturing facility. The determination of lost profits was an exercise of deductive reasoning.

Courts are willing to allow expert opinions about matters that may seem rather elusive as to factual basis. The court is free to evaluate the weight of the evidence and to control the process of examination and cross exami-

CONTINUED ON NEXT PAGE





CASEWORK EXPERIENCE

FASNA member casework includes, but is not limited to, cases involving:

- Inventory/property loss
- Employee dishonesty
- Business income loss
- Personal injury or wrongful death claims
- Truth in lending/truth in leasing
- Post judgement matters/calculations
- Loss of income/earnings
- Divorce and fidelity claims
- Business valuation
- Expert testimony
- Fraud

INDUSTRY EXPERIENCE

FASNA member experience includes, but is not limited to cases involving:

- Auto dealerships and transportation
- Colleges and universities
- Construction, contracting, and engineering
- Financial/money management, trust, and estate
- Healthcare
- State and Indian tribal government
- Insurance claims
- Manufacturing
- Real estate
- Restaurant and hotel industries
- Retailing/wholesale

An Expert's Deductive Reasoning continued from cover

nation. The expert opinions are often necessary to bridge the gap between known facts and missing information.

Courts are in control to prevent speculations from being treated the same as expert opinions. Because the expert is subject to cross examination, the court considers there to be adequate checks and balances in the system.

Rule 703 of the Federal and Washington Rules of Evidence addresses **Bases of Opinion Testimony by Experts**, as follows:

The facts or data in the particular case upon which an expert bases an opinion or inference may be those perceived by or made known to him at or before the hearing. If of a type reasonably relied upon by experts in the particular field in forming opinions or inferences upon the subject, the facts need not be admissible in evidence.

Does this excerpt mean that the forensic accountant can base opinions or inferences on hearsay, or on information or documents not admissible or not established as to source and authenticity?

The court controls the application of Rule 703 and holds the standard high. The standard actually allows the expert to base an opinion or inference on hearsay or on inadmissible evidence only if those facts or data are of a type reasonably relied upon by experts in the particular field. In other words, of a type regularly and routinely relied upon by experts in the field, in their regular practice of the discipline in their expertise. The standard is a high standard.

In the regular practice of professional accounting and auditing, an accountant obtains an understanding of the client's industry and the key economic factors affecting the business and obtains an understanding of the client's internal controls over financial transactions and reporting. Much of that process of "obtaining an understanding" is a cumulative process of gathering and filtering facts, data and observations from a wide range of sources, in a wide range of cir-

cumstances, and over a wide range of time. An accountant also makes inquiries of a number of persons and needs to evaluate how much reliance to place on answers received. Such professional understandings are reasonably relied upon by accountants as they go about performing audits or other regular professional services. It would be quite difficult to draw a "box" around all of the facts or data taken into account by the accountant in the formation of each opinion or inference. Accountants tend to be "documentation extremists," but that expectation is nearly impossible!

It would be a waste of the court's time to try to examine the contents of the "box of reliance." Ultimately, the expert needs to be accountable for being convincing about the basis for his or her opinions and inferences. The "box" cannot be laid out on the evidence table, but the expert's deductive reasoning can be explained with honesty, clarity and logic.

In looking at trends and tendencies, forensic accountants also develop skills at applying deductive reasoning to form inferences about the motives of persons. There are clues about why certain activities are performed in a certain way or documented (or not) in a certain way. Underlying motives of conduct may become clear enough to the expert as a reasonable inference. This inference may be valuable in assisting the court to:

...understand the evidence, or

...determine a fact in issue

Deductive logic is a forensic accounting expert's forte. It is exercised in the judicial system, almost like the expert witnessed an event just because he or she "reasoned" it to have happened.

Problem Claims and “Emotional Expectation”

By Roger Nearmyer of Cremers, Holtzbauer & Nearmyer, P.C., FASNA Member

“Diplomacy is the art of letting someone else have your way.”

~ Daniele Vare, author

Daniele Vare wasn't referring to the often-complicated negotiations between an insurer and the insured, but she could have been. Too often, these negotiations dissolve into fiery disagreements, legal wrangling and the loss of a good, long-term relationship. Indirectly, these disputes can also have a larger and longer impact to the insurance industry's goodwill, image and reputation.

Successfully working with a “difficult insured” is more of an art than it is a science. It requires equal parts of diplomacy, experience, communication, business knowledge, curiosity and compassion.

We have a term we use to describe when an insured and the insurance company or adjuster don't see eye-to-eye on a claim. We call it “Emotional Expectation.”

An insured's Emotional Expectation usually results from a combination of factors that include:

- 1) The insured is facing a traumatic event that impacts their daily life and/or livelihood.
- 2) An insured who feels entitled to a return on years of insurance premium payments without any claims (and has others pushing them to fight for every last cent).
- 3) An insured who views the adjuster as methodical and unemotional as the adjuster goes through the “routine” of cutting the insurance company's losses without trying to understand the insured's business.
- 4) An insured who misunderstood their insurance coverage and feels distrust of the insurance company due to a perceived lack of communication.
- 5) The insured's general view of insurance adjusters as “hatchet-men” employed by the insurance industry to negotiate and save the insurance company money.

6) An adjuster who asks the necessary questions which the insured may consider uncomfortable or even accusatory - or give the insured the impression that the adjuster doesn't fully understand their business.

When a claim is heading toward the point of unnecessary Emotional Expectation, it is wise to consider using the services of a respected forensic accounting firm. Forensic accountants are trained to investigate and resolve these issues fairly and to determine the proper amount for a claim. But beyond that, their business knowledge and experience help them play several roles in the claims process that can help settle the claim more quickly, accurately and with better understanding and agreement.

THE ROLES

The “Good Cop”

Whenever a claim reaches the point of Emotional Expectation, the primary contact for the insured is the adjuster. Often, introducing another person between the two sides can go a long way to resolving personality conflicts that can result from these situations. As a disinterested third party, a forensic accountant often has more credibility in the eyes of the insured.

The Expert

A CPA is a highly respected business professional whose job it is to understand business - especially the “business-side” of business. A forensic accountant often has the experience and training to better understand how a loss affects the rest of the business. In most claims, it's not the damage to the property that is disputed, but the resulting interruption to the business, handling of the inventory and other business processes. Forensic accountants understand the company's structure and accounting processes and can usually help determine these losses accurately, based on a very specialized approach to gathering information. This approach can also help eliminate fraudulent claims and prevent overpayment on losses - especially in complex claims.

The Referee

In some cases, a centralized authority is needed to establish and enforce the ground rules and separate the issues when needed. As the referee, a forensic accountant can help eliminate some of the “claim gamesmanship” that can accompany a disputed claim and establish a fair structure that serves as the basis for finding a resolution that is fair for both sides.

The Judge

Too often, disputed claims go to court because one side - or both - refuse to listen to the other. Often there are legitimate points to be made on both sides of the claim - and having an impartial judge who is willing to listen and weigh the facts can avoid a lengthy and expensive legal process. An experienced forensic accountant knows what questions to ask and how to weigh the fact for both sides.

The Witness

As a last resort, a forensic accountant can serve as an important expert witness in a claim dispute. The impartiality and business knowledge that a forensic accountant brings in these cases is invaluable. However, the best results come when we are brought into the claim process early so that we have access to information from the beginning and have time to analyze the information to provide the best information to the court.

In the insurance business, maintaining a good, long-term relationship is just as important as settling claims. By involving an experienced forensic accountant in a difficult claim, you greatly improve your ability to determine the proper amount that should be paid for a claim. But even more importantly, you show the insured (your customer) that you are interested in resolving the issue fairly. And when it comes to growing an insurance company that people trust, nothing is more important than that.

“Those disputing, contradicting, and confuting people are generally unfortunate in their affairs. They get victory, sometimes, but they never get goodwill, which would be of more use to them.”

FASNA Board of Directors

Benson & McLaughlin, PS
Steve Bishop, CPA, CVA

1400 Blanchard Plaza
2201 6th Ave
Seattle, WA 98121
Phone (206) 441-1447, ext. 305
Fax (206) 441-1551
Email steveb@bensonmcl.com
Website www.bensonmcl.com

Bland & Associates,
CPAs, PC

Dave Riley, CPA
8712 W. Dodge Road
Suite 200
Omaha, NE 68114
Phone (402) 397-8822
Fax (402) 397-8649
Email dave@blandcpa.com
Website www.blandcpa.com

Cremers, Holtzbauer
& Nearmyer, PC

Roger Nearmyer, CPA
6200 Aurora Ave
Suite 600 W
Urbandale, IA 50322-2871
Phone (515) 274-4804
Fax (515) 274-4807
Email info@chncpa.com
Website www.chncpa.com

Latz, Maudlin & Knowles, Inc
Michael Harding, CFE, CFS

8777 Purdue Road
Suite 230
Indianapolis, IN 46268
Phone (317) 875-0667
Fax (317) 875-4252
Email michaelharding@lmkcpa.com
Website www.lmkcpa.com

Mellen, Smith & Pivoz PLC

Mike Pivoz, CPA, JD
30600 Telegraph Road
Suite 1131
Bingham Farms, MI 48025-4531
Phone (248) 642-2803
Fax (248) 642-7236
Email mpivoz@mspcpa.com
Website www.mspcpa.com

Sterling & Tucker, Inc

Michelle Tucker,
CPA/PFS, JD, CFE
Haseko Center
820 Mililani Street, 4th Floor
Honolulu, HI 96813
Phone (808) 531-5391
Fax (808) 538-3949
Email michelle@sterlingandtucker.com
Website www.sterlingandtucker.com

Forensic Accountants, Inc.
David Glodstein, CPA, CFE

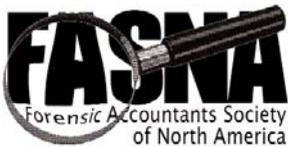
P.O. Box 745
Jericho, NY 11753
Phone (516) 681-2772
Phone (516) 935-3332
Fax (516) 681-5353
Email 4nsiccpa@optonline.net
Website www.investigativecpas.com



The *FASNA Forum* is a bi-monthly newsletter sponsored by:

FASNA / 4248 Park Glen Road / Minneapolis, MN 55416 / Phone (952) 928-4668 / Fax (952) 929-1318 / www.fasna.org

FASNA is a non-profit association dedicated to promoting and developing the forensic accounting industry. Statements of fact and opinion in this publication are the responsibility of the authors alone and do not imply an opinion on the part of the members, directors or staff of FASNA. Material may not be reproduced without written permission.



4248 Park Glen Road
Minneapolis, Minnesota 55416

www.fasna.org