IP Addresses: Forgotten Intangibles?

By Nathan E. DiNatale, CPA/ABV, CVA

Over the past few years, there has been a lot of discussion surrounding the new Internet Protocol version 6 (IPv6) numbers and their replacement of the original IPv4 numbers. There has been much concern over the dwindling reserve of IPv4 number blocks and the expensive, time consuming Internet transition to IPv6 numbers. However, more recently, companies found that they had an abundance of IPv4 numbers that were not being used and that there was a substantial market demand for them. As a result of the market activity, questions have arisen about whether these number blocks are owned or leased assets, how to account for them, their treatment in purchase accounting and potential tax implications upon their sale.

Background
An Internet Protocol number is known as an IP address when connected to a specific device on the Internet. The main purpose of an IP address is to provide an identity and location to a network device, much like...

continued on page 1

Chairman’s Corner

The FVS Executive Committee’s Civil Justice Task Force, in conjunction with the Institute for the Advancement of the American Legal System (IAALS), has published a new research paper, “Another Voice: Financial Experts on Reducing Client Costs in Civil Litigation.” The paper is the culmination of an effort to identify causes of and solutions to the problems caused by costs and delays encountered in the pretrial handling of civil disputes, and to develop key recommendations for streamlining the civil pretrial process and reducing costs for clients. The paper contains five recommendations approved by the FVS Executive Committee intended to enhance the effectiveness of financial experts and efficiency of their use in the civil pretrial process. They include calls for early and consistent case management by judges; early involvement of experts; more streamlining of expert depositions and discovery; prompt and appropriate attention to Daubert-like challenges; and better avenues for cooperation between opposing experts where appropriate.

We’re very proud of this contribution to efforts to improve the use of experts in civil litigation. I hope you’ll turn to this paper to see how your member section is contributing to this important dialogue.

Thomas F. Burrage, CPA/ABV/CFF, CVA
a computer, a point-of-sale terminal, a smartphone or any mobile device connected to the Internet. Each unique device requires an IP address to connect to the Internet. The original IP address format consists of a 32-bit number in the format 000.000.000.000 and is referred to as Internet Protocol version 4 (IPv4). IPv4 limits the number of unique IP addresses to $2^{32}$ or 4,294,967,296 (i.e., 32 bits), which are referred to in “blocks.” (/24, /16, /8, etc.) 24-bit blocks, a.k.a. /8 blocks, contain 16,777,216 IP numbers, 16-bit blocks, a.k.a. /16 blocks, contain 65,536 IP numbers and so on.

At the dawn of the Internet, when it was nothing more than a special research project, blocks of IP numbers were given away to members of the American military-industrial-university complex. The recipients did not pay for them and were not involved in any contract. There were also no formal terms and/or conditions for their use. The IPv4 numbers referred to are legacy numbers and can be found on Internet Assigned Numbers Authority (IANA) website. Alternatively, non-legacy numbers are contract-based and were distributed by the American Registry for Internet Numbers (ARIN), one of five regional Internet registries (RIR), beginning in early 1998. Non-legacy numbers are regulated by ARIN, which expressly states that the IP numbers are not the users’ property and that the user does not acquire any property rights through virtue of ARIN’s Registration Service Agreement (RSA). In addition, non-legacy numbers are distributed by ARIN on an as needed basis under RIR policies whereby recipients are required to pay fees.

Value Argument for Legacy Numbers
Worldwide Internet usage grew 528% from 2010 to 2011. On February 4, 2011, the Number Resource Organization (NRO) announced that the “free pool” of available IPv4 number blocks was fully depleted. The remaining pool was distributed equally to the five RIRs for distribution. As more of the population starts using the Internet and companies require additional IP number blocks to grow their business, the number of remaining IP number blocks distributable from the RIRs will continue to decline. While this is not the focus of the article, it is important to recall the scarcity of remaining IPv4 number blocks to determine the value of existing legacy numbers. Basic economics has taught us that shrinking supply can drive an increase in price.

Recent Activity in the Transfer of IP Numbers
Some believe that legacy numbers are the property of the company that holds title to them. Title to these assets can be traced through companies such as Addrex, an IP number block brokerage house, which helps buyers acquire, and sellers monetize, assets in a professional, trustworthy and discreet environment. Addrex facilitated the sale of Nortel’s 666,624 IPv4 number blocks to Microsoft in April 2011 for $7.5 million or $11.25 per IP number. An unrelated sale occurred in December 2011, when the bankrupt bookseller Borders sold a block of 65,536 IPv4 numbers to healthcare software vendor Cerner for $12 per number.

The opposing school of thought, primarily held by RIRs like ARIN, asserts that ownership and property rights should not exist in legacy numbers and that regardless of the date of distribution, all IP number blocks should be regulated by an RIR. As part of Microsoft’s acquisition of the Nortel IPv4 number blocks, ARIN stepped in after the actual sale and convinced Microsoft to sign a legacy registration services agreement (LSRA), which is substantially limited in scope compared with the RSA signed by non-legacy owners. That LSRA was never disclosed to the Bankruptcy Court or to the Internet community, so no one except the contracting parties knows the terms.

Implications of Owning Legacy Numbers
Some of the original legacy numbers have been transferred through business spinoffs, acquisitions or bankruptcies. Many of the original owners may not thoroughly understand which type of numbers they possess. In addition, many companies may not realize they own such assets, which raises the question: Are these legacy numbers being used and/or considered by their owners in their business plans?

Mergers and acquisitions. For companies that do own legacy numbers, it is important to understand their value in the context of acquisition accounting. Legacy numbers can be a key asset in the operation of a business and defining their value in an asset purchase agreement (APA) can be vital for obtaining a realistic acquisition price. Let’s take for example a company that owns a /8 block of legacy numbers that consists of 16,777,216 IPv4 numbers. If the company unknowingly owns this asset and enters into an APA for the value of the business, it may shortchange itself to the tune of approximately $200 million (16,777,216 x $12).

Acquisition accounting. Recognition of legacy number ownership is also important when performing purchase accounting under Accounting Standards Codification (ASC) Topic 805 on business combinations. ASC 805 provides guidance on the accounting and reporting for business combinations to be accounted for under the acquisition method. It

---

1 www.iana.org/assignments/ipv4-address-space/ipv4-address-space.xml
2 Available at www.arin.net/resources/agreements/rsa.pdf.
3 www.fcc.gov/working-papers/potential-impacts-communications-ipv4-exhaustion-ipv6-transition
4 www.internetworldstats.com/stats.htm
5 www.nro.net/news/ipv4-free-pool-depleted
6 http://addrex.net/
says that tangible and identifiable intangible assets must be considered as part of the allocation process and that an asset is identifiable if it meets either of the following criteria:7

a. It is separable, that is, capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, identifiable asset or liability, regardless of whether the entity intends to do so.

b. It arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.

Examples of other technology-based intangible assets currently recognized apart from goodwill include patented technology, computer software and mask works, Internet domain names, unpatented technology, databases and trade secrets. That raises questions about whether legacy numbers should be considered as tangible assets or intangible assets in an allocation. It appears that based on the criteria, they should be considered a technology-based intangible asset. Another question is whether these assets would be subject to depreciation/amortization or considered indefinite-lived assets subject to annual impairment testing. In addition, with such a thin sales market and minimal transactions, how should these assets be valued? These are questions that should be addressed in acquisition accounting. With sales of IPv4 numbers on the rise, it is a topic that should draw increased attention in the near future. CFOs are always looking for addition intangible assets to record in lieu of goodwill. A great place to start would be the assets that they already own.

Tax considerations. Companies considering the sale of legacy numbers should consider the federal, state and local tax implications. These assets were either given to the companies or transferred as part of a previous acquisition where they were assigned no value. As a result, substantial capital gains may be reportable upon their sale.

Careful Consideration Needed

Ownership of legacy numbers may have a substantial impact on a company’s overall value, so careful research into possible ownership is advised. Companies should also identify legacy numbers in business combinations and determine how to record them on the acquirer’s balance sheet so they do not artificially overstate goodwill. Lastly, numerous other considerations such as an LSRA agreement, tax implications and fair value accounting treatment must be addressed before the company unknowingly disposes of these assets as part of a sale.

Nathan DiNatale, CPA/ABV, CVA is a Senior Manager at SC&H Group LLC, where he manages the firm’s Business Valuation and Litigation Support services practice.

7 ASC 805, Paragraph 805-20-25-10

---

New Member Benefit: Discounted Day Pass Access to ktMINE® Royalty Rate Finder Database

As part of a new agreement between ktMINE® and the AICPA, FVS Section members (including ABV and CFF credential holders) will receive discounted access to the ktMINE Royalty Rate Finder database. ktMINE is an intellectual property information services firm focused on delivering IP protection and competitive advantage to IP owners and stakeholders across the globe. The Day Pass Access to the ktMINE Royalty Rate Finder database will be offered at a reduced rate of $495 per session and will include:

- 24 consecutive hours of access.
- Ability to search the full database of over 13,000 intangibles licensing agreements.
- Access to all search filters.
- Unlimited access to view agreement summaries and full text documents.
- Search guidance from the ktMINE analyst team, upon request.

Click here to access this new benefit.

---

AICPA Makes Navigating Around the Fiscal Cliff a Little Easier

Overwhelmed by the fiscal cliff noise and wanting one source of information? Come to www.aicpa.org/fiscalcliff, your one-stop shop to help you navigate through the uncertain tax landscape. The resources you need are here at your fingertips, including client communications tools, a primer on the health care reform law, news and analysis and tax planning insights from national experts. And coming soon will be our Health Care Reform Center with even more information to help you provide the expertise that or clients expect from CPAs.
Poor Richard’s Take on Fraud Prevention

By Howard Silverstone, CPA, CFF, CFE

“An ounce of prevention is worth a pound of cure” is oft-quoted advice from Benjamin Franklin. It was actually related to firefighting, but the expression has come to apply to many facets of life, including the business world, and it is perhaps best suited to fraud prevention.

Unfortunately, the spirit of another Franklin quote too often hinders this prevention advice: “A penny saved is a penny earned.” Many companies acknowledge the need for fraud prevention, but the cost-benefit mindset often deters management from implementing processes and controls against fraud.

Competing Ideas

Fraud and its prevention, for some reason, create an odd juxtaposition of stances and ideas. The Association of Certified Fraud Examiners (ACFE) 2012 Report to the Nations on Occupational Fraud and Abuse notes that the typical organization loses 5% of its annual revenue to fraud. Potentially, this means somewhere in the neighborhood of $3.5 trillion could be lost to fraud, based on gross world product. According to the 2011 AICPA Forensic and Valuation Services Trend Study, the most commonly reported frauds included false payment requests, check and credit card fraud and employee theft. Most occurred in operations, accounts payable, sales, as well as marketing, among others.

Consider this point, too: The ACFE survey indicates occupational frauds are more likely to be detected by tip than by other means, a fact noted consistently in the survey since this tracking started in 2002. The AICPA FVS confirms that fact: It revealed that internal tipoffs were among the most common fraud detection method, followed closely by external tipoffs. The ACFE survey also found that small companies are “disproportionately victimized by occupational fraud,” and that they typically lack anti-fraud controls. Apparently they consider themselves too small to justify the perceived cost of prevention.

Providing an overview of fraud prevention efforts, the AICPA study found that respondents from business and industry used various approaches to prevent fraud, including general internal controls, screening new employees, division of responsibilities, appropriate oversight, physical controls and computer-based controls. To detect fraud, they turned to general internal controls, appropriate oversight, physical controls and computer-based controls.

The ACFE also says, “Anti-fraud controls appear to help reduce the cost and duration of occupational fraud schemes.” It does not say, however, that such controls prevented fraud. The survey notes that more than 40% of the time, fraud was initially detected based on a tip and another 8% of the time by accident, adding up to more than half of the known cases. Reviews, audits, and other systematic measures therefore accounted for the other half. Does a detection system work? That depends upon whether you see the glass as half empty or half full.

In the June 2010 Journal of Accountancy, the ACFE’s Joseph Wells noted the “remarkable evenness in these trends.” He added that looking for fraud “adds cost to the audit,” and that “fraud prevention is a joint effort between management and employees.” Fraud education and communication within each company are key, he said, noting that if workers realize that fraud costs jobs and pay raises, they become “stakeholders in fraud prevention.”

Certainly the cost of educating employees about the costs of fraud will be less than implementing controls, spending more on audits and incurring the other expenses related to fraud prevention. Perhaps we have found a balance between Franklin’s two mantras because a reasonable prevention program can actually save an organization money.

The Importance of Education

In an Institute of Internal Auditors blog, Norman Marks (a vice president for SAP) asks, “For how many companies is fraud and theft of assets in the top 10 risks?” Marks noted, “I prefer to assess whether management has effective processes and controls to prevent or detect fraud. Those should include fraud risk

continued on page 5
assessment, as well as controls.” This brings us back to the issue of employee education, which should be considered paramount in the assessment of fraud risk, and every size organization should make it a priority.

As part of their education, employees should learn about the “Fraud Triangle.” Essentially, for fraud to occur, three elements typically are present: pressure, opportunity and rationalization. Pressure can arise due to financial problems or addiction, but most often from a financial need.

Without opportunity, a fraudulent scheme has less chance of succeeding. Fraudsters must believe they will not be caught and that their schemes will not be detected. That is why a company’s failure to establish controls will increase the opportunity for the fraudster.

The third point of the fraud triangle is rationalization. For the fraudster that means finding excuses or ways to minimize the import of their behavior. Many fraudsters believe they are just “borrowing” from the company, for example, or they are stealing to make up for a missed salary increase or promotion. In their minds, the action is justified.

At what cost, then, do we educate our employees? This is not simply a matter of financial costs. Many small businesses include family and friendships and aren’t as formal in nature as larger businesses. This creates a greater sense of trust, which must be tempered to some extent as part of a fraud prevention program. We also have to consider the intangible cost of fraud, such as possible negative publicity for the business, the effect on staff morale and the long-term ramifications for the business.

Many Ounces of Prevention

Although education may be paramount, when it comes to fraud prevention, there is no generic program that fits all. There are numerous ways business owners can address the issue of fraud at varying levels of cost. In the lexicon of Franklin, there are many ounces of prevention to be found.

• Employee education. Employees must first be made aware of the true cost of fraud, including the damage to the company’s reputation and the possibility of job loss. Among other things, this kind of education can make rationalization more difficult, because it’s harder to believe that no one is being hurt. In the words of British Prime Minister David Cameron, “At a time when we’re having to take such difficult decisions about how to cut back without damaging the things that matter the most, we should strain every sinew to cut error, waste and fraud.” (Manchester Evening News, August 10, 2010).

• Employee reporting. Establish a method that allows employees to anonymously report suspected fraud. In the AICPA FVS survey, 59% advocated the use of internal whistleblower hotlines. Be sure to have one person investigate claims and avoid the possibility of vendettas or other unscrupulous behavior. If possible, this should be someone from outside of a particular department who can be considered independent or impartial.

• Surprise audits. Scheduled audits and other internal checks are always recommended, but an element of surprise will keep people on their toes.

• Hiring methods and background checks. Include criminal background checks, education verification, and credit checks in the hiring process. However, be mindful of the ACFE survey data that shows that more than 85% of fraudsters had never been charged with or convicted of a fraud-related offense. Companies do not always alert the authorities when something untoward happens. A credit check on someone handling cash should be your minimum action. Lastly, the cost and type of coverage that a fidelity insurance policy offers should be evaluated so that any fraud-related loss may be covered by proper insurance.

• Employee support. Companies should have mechanisms to help employees who are dealing with addiction, emotional issues or financial problems to counteract the pressure sector of the fraud triangle. Giving employees outlets to discuss and possibly address the pressures they face is another ounce of prevention.

For smaller firms and family businesses that don’t have the resources to set up a fraud department or tip line, there are several relatively low-cost procedures that can help reduce the risk of fraud, including:

• Do not let the same person write the corporate checks, reconcile the bank statements, deposit the checks and have access to the company’s computer to record items in the general ledger. Break up some of these duties, have the bank statements sent to the business owner’s home and have someone else open the mail, add up the checks and give them to the bookkeeper. Be creative in segregating duties; one person should not have unfettered access to bank funds and the company’s books.

• Establish a basic policy for expense reports, what is covered and what is not, and have all reports approved by the owner before payment. Make sure these are supported with original documents and not copies.

• Make sure employees take vacations and take note if they seem to be living beyond their means.

Certainly employee education and support are key, but everyone rationalizes things in different ways. It is this aspect that will test the employer’s resolve as a good manager in the toughest way.

A Case in Point

Consider the case of a company’s CFO who made it up through the ranks from bookkeeper. Even as a CFO, he still
performed the corporate bank reconciliations, opened the bank statements and signed the checks. As we all know, this is a classic breakdown in internal controls. His children were growing up and he had many financial burdens: braces, school fees and a bigger house to pay for, all of which supplied the pressure. At the same time, moving up to CFO did not bring some of the financial rewards he was expecting, allowing him to begin rationalizing ideas about fraud. He had been with the company for many years. Management was located in another state and no one checked his work, creating the opportunity.

He began by padding his expense reports, then made a false worker’s compensation claim and then started getting kickbacks from vendors. After seven years, his fraudulent activities amounted to almost $700,000. It was only when he fired a secretary who “asked too many questions” that his various schemes were uncovered. Certainly this case-a model of the fraud triangle—forced the company to drastically alter its internal controls. All bank procedures were changed and management took greater control over day-to-day operations. The company recovered $500,000 from its insurance company and the former CFO did not go to jail. Under an agreement, he could seek non-financial employment and repay some of the money he stole. The company also drafted a fraud policy and changed the way it did business with its vendors.

In a Wall Street Journal article, “Small Businesses Face More Fraud in Downturn” (WSJ February 19, 2009), ACFE president Jim Ratley noted that “a lot of times a small business will close its doors, and may never know they were defrauded” and not the victim of a declining economy. Three years later, companies are still struggling and perhaps still being defrauded.

The Role of the Forensic Accountant
As forensic accountants, we are admittedly professional skeptics and we urge business owners to have the same mindset. The wisdom of Thomas Jefferson has also aged well. Jefferson said, “The natural cause of the human mind is certainly from credulity to skepticism.” Knowing the red flags and the war stories about how fraud affects business is the quickest way for owners to become skeptics.

Most of the AICPA FVS survey respondents believed that, in the next two to five years, companies’ focus on fraud prevention and detection would lead to greater use of outside consultants versus in-house personnel, which means CPAs may find themselves called upon more often for help in this area. As accountants, we must convince our clients that fraud exists and could occur in their business. They must also realize the importance of fraud awareness and deal with the human side of their business, i.e., their employees. For a businessperson, protecting the bottom line from fraud is an ongoing challenge. The statistics tell us that fraud will never be eradicated. However, the odds against it can be improved through the implementation of effective prevention and detection strategies.

Again, we turn to the wise Benjamin Franklin, who summed up the issue the best: “By failing to prepare, you are preparing to fail.” These are words of advice our clients would be prudent to heed.

Howard Silverstone, CPA, CFF, CFE, is a director and co-founder of Forensic Resolutions, Inc. in Haddonfield, N.J., and Philadelphia.

Technology Tip
Disabling Windows Autorun
Care needs to be taken when examining suspect USB thumb drives and CDs. These types of media may contain Autorun viruses and malware that could potentially infect a workstation. Steps should be taken to disable Autorun on Windows computers and decrease the chance of damage by malware. Disabling Autorun stops programs that may attempt to run when suspect media are attached. It will also prevent MacLockPick from accidentally being run. It may still be run manually.

To protect your Windows forensic workstations, copy and paste the following into a .reg file and merge it into the registry:

```
REGEDIT4
[HKEY_LOCAL_MACHINE\SOFTWARE\Microsoft\Windows NT\CurrentVersion\Inet\FileMapping\Autorun.inf]
@="@SYS:DoesNotExist"
```  

Find more information on disabling Windows Autorun on this site.
The 60-Day Repayment Rule: How Do We Manage the Process?

By Cristine M. Miller, CMPE, CCP, CHC

Q: In light of the Supreme Court decision on the Affordable Care Act, healthcare providers are going to be targets for several new “opportunities” for federal and state agencies to recoup monies for rendered services. The most concerning of these new “opportunities” is the 60-day repayment rule. The Centers for Medicare & Medicaid Services (CMS) is still seeking comments on the rule, but most authorities believe that what will be implemented will be similar form to what was proposed. What do CPAs need to know about these developments?

A: Since the Supreme Court made its determination on the healthcare reform law, a large section of the population is not addressed within the current plan. Many individuals were to be covered under Medicaid expansion, but states must now decide if they will participate in that expansion. Because of lack of funding and healthcare access, both Medicare and state Medicaid agencies will be looking for dollars. This new recoupment regulation is just another method to find it.

Many Uncertainties
The 60-day repayment rule basically says that any overpayment identified by a provider must be repaid within 60 days of discovery. There are many uncertainties regarding the phrase “within 60 days of discovery”:

- How is discovery defined?
- Should this rule preclude healthcare providers from continuing ongoing internal audits as mandated by their facility compliance plan?
- If a large problem is discovered, how is it handled?
- Can a repayment plan be used when self-reporting a billing problem?
- When is a billing error determined to be fraudulent under this rule and is fraud automatically assumed when a repayment is determined?

Many experts are recommending the development of a new compliance plan or an addendum to an existing one. This compliance plan should address the process a facility uses to determine when an overpayment is identified. Because it is not specified within the proposed rule, providers can and should develop their own definition of identification of an overpayment. By doing so, they gain some control of their own destiny. Of course, the definition should be reasonable.

Within the compliance plan, compliance officers should be given broad authority to identify errors and to determine when an “overpayment” has been identified as defined under the new plan or the addendum to the old plan. This procedure maintains control by the provider and also creates an opportunity to monitor and maintain the ongoing billing process, as well as the process for identification and repayment of overpayments.

Healthcare provider leadership should always be kept informed of billing irregularities.

continued on page 8
and potential problems that may lead to identification of overpayments.

Providers must perform more prepayment reviews to avoid costly overpayments and monitor ongoing CMS changes, understanding that the CMS changes are voluminous and compliance staffers may overlook or miss a change in regulation. By using diligence with prepayment review, healthcare providers will have a better opportunity to avoid overpayments rather than having them recouped or having to submit repayment voluntarily.

Ongoing continuing education for billing and coding staff is a must. Keeping staff current on coding and documentation updates and compliance changes will work together with prepayment audits to avoid, as much as possible, overpayments.

**Worth the Time and Effort**

This process can be expensive and time consuming for providers, but without compliance plan changes, increased prepayment review and compliance plan oversight, the overpayment possibilities are endless.

*Cristine M. Miller is a partner with Mountjoy Chilton Medley, LLP. The company has offices in Louisville, Lexington, Frankfort and Cincinnati, Ohio, and is an independent member of Baker Tilly International.*

---

**Back to Basics: The Litigation Process**

The AICPA FVS Section’s webinars, “Creating a Niche Forensic Practice Series: Best Practices from Leading Experts,” provide a broad range of information on how to launch and run a forensics niche. This article offers highlights from one webinar in the series, on federal civil litigation. The webinar was presented by:

- **Moderator and speaker Thomas F. Burrage, CPA/ABV/CFF, CVA, Burrage & Johnson, CPAs, LLC, chair of the AICPA FVS Executive Committee.**
- **Presenter Bradley J. Preber, Grant Thornton LLP.**

This is a primer based on federal rules, which may differ from state rules. It is meant to be foundational for CPAs starting a litigation practice. It will also remind those who have a litigation practice of the federal rules they must follow.

**Civil Litigation**

Civil litigation is the formal legal process to resolve a dispute. (Other ways include alternative dispute resolution, arbitration and mediation.) Civil litigation actions include a breach of contract, in which one party does not fulfill a contract, and a tort, which is a civil wrong that might include a personal injury, property damage, unfair competition, unlawful misappropriation, negligence or fraud. Both of these actions have different civil litigation remedies. The one that CPAs deal with most often is damages, which are defined by law and may vary from accepted accounting or economic principles. In the second remedy, intervention, the court may intervene to force a party to do something or cease from doing it.

There are 13 circuits in the federal court system. More information can be found at [www.uscourts.gov](http://www.uscourts.gov). The phases of the litigation process are:

**Dispute.** Two parties have a dispute that they haven’t been able to resolve successfully. The plaintiff is asserting the allegation, fact or claim and the defendant is opposing it. Services that CPAs might provide in this phase include damages quantification, discovery of evidence, facts, claims or allegations, early dispute resolution, evidence preservation, forensic analysis and investigation. The webinar noted that evidence preservation has been elevated in recent years in the wake of a case called *Zubulake v. UBS*, which produced a landmark...
decision on the duty to preserve potentially relevant evidence. Since a wide range of material may comprise evidence, CPAs can identify and secure that potentially relevant evidence and coach employees on what to preserve.

Pre-complaint. This is the information and fact-finding phase before a civil complaint is filed. Services in this phase include complaint preparation, early case assessment and budgeting and liability assessment.

Complaint. It’s critical for CPAs to analyze the information in the formal civil complaint before litigation to ensure they can provide the needed assistance.

Answer. Once the complaint is filed, the defendant must answer it and may make a cross complaint. Services that might be needed in this phase include case management; case strategy (in a consulting role); class action certification; counterclaim preparation; motion support; and response preparation.

Discovery. This is the phase in which CPAs do most of their work. It involves obtaining evidence and information to prepare for trial. Discovery methods may include interrogatories; requests for admissions; stipulations; requests for production; sworn statements; expert reports; and depositions. Service needs during this phase include deposition assistance; acting as an expert witness; forensic evidence identification, recovery, analysis and management; interrogatories and production; and opposing expert rebuttal. This process can last several months to several years and typically ends two to three months before trial.

Pretrial. CPAs may be asked to help attorneys prepare information for trial.

Trial. This phase begins with jury selection and opening statements, then the plaintiff’s and defendant’s cases are presented through direct and indirect examination and re-direct and cross examinations. That is followed by the closing arguments and then the trial results. The results include the verdict, which is the formal decision of the judge or jury; the judgment, which is the judge’s formal decision about the case; and the opinion, which is the judge’s written formal opinion, including the reasons for it and references to relevant law. CPAs aren’t usually involved in jury selection, but may sit in on opening statements to understand opposing counsel’s strategy. They may be involved in case presentation as expert witnesses. Services that CPAs may provide during the pretrial and trial phases include direct and cross examination support; demonstratives; expert witness testimony; settlement support; trial preparation and support; and witness and key document preparation.

Post-trial. CPAs may be called on to assist in preparing briefs, on an appeal and on final damages calculations and distributions.

Throughout the litigation process, settlement is also an ongoing option. Settlement refers to a variety of formal or informal actions taken to resolve the dispute before trial.

In civil litigation, the parties can decide between a trial by jury or judge. The choice may be based on a variety of factors, including the nature of case and the client. In a bench trial, the judge can be expected to have a greater dialogue throughout and to ask additional or clarifying questions. The judge may also respond to objections differently in a bench trial if he or she feels, for example, greater information or clarity is not needed. One challenge in a jury trial is presenting complex material in a way that will be understandable to people who have potentially limited education and understanding of the concepts involved. Simple demographics may also be a concern. In some circumstances, if the jurisdiction is in relatively poor area, a bench trial may be preferable if the client is rich. If the client can be perceived as sympathetic, on the other hand, then a jury trial might be best.

Motions and rulings may be made throughout the course of the litigation. A motion is a request for the judge to render a decision on a legal or administrative issue. A ruling is the outcome of a decision by the court or judge. An order is a direction of command by the court or judge.

The Role of the CPA
There are several typical roles for the practitioner in civil litigation:

- An expert witness, who’s qualified to render an expert opinion in trial.
- A fact or lay witness, who can testify only about first-hand knowledge.
- A percipient witness, who provides perception testimony based on knowledge of certain facts.
- A consultant, who advises about facts, issues and strategy and consults on case management.
- In other roles, which can include as a trier of fact, special master, court-appointed expert, arbitrator or mediator.

Guidance available for practitioners working in civil litigation includes:

- AICPA professional and ethics standards and bylaws, consulting standards, special reports and practice aids and material in Appendix B to Special Report 09-1 Introduction to Civil Litigation Services. In a deposition or trial, CPAs should expect to be asked about the standards with which

continued on page 10
they must comply and the guidance they used to prepare their testimony.

- Relevant laws, statutes and regulations of that court or jurisdiction.
- Case precedent.
- Court and other authoritative orders.
- Internal literature. This refers to specific firm guidance that CPAs use, including firm policies, etc. CPAs should be sure they comply with appropriate laws, rules or regulations and that they follow their own guidance.

The Federal Rules of Civil Procedure
Among other regulations, CPA should be aware of Rule 26 of the Federal Rules of Civil Procedure. Failure to comply with it may cause the expert's report to be excluded or modified. The rule requires disclosure of the expert witness's identity, mandates a written report from the expert, sets rules on the disclosure of the expert's testimony, includes the opposing party's right to depose the expert, but requires them to pay the expert for time spent on the deposition.

More specifically, required disclosures by the expert witness include:

- Identification of the dispute.
- The expert's qualifications.
- Compensation.
- Data considered.
- Work performed.
- Basis for opinions.
- Opinions.
- Trial exhibits.

Optional disclosures include the expert's:

- Background.
- Assignment.
- Resume or CV.

Rules 702 through 706 also apply to experts. The federal rules for qualifying as an expert can be remembered using the acronym SKEET:

- Skills.
- Knowledge.
- Education.
- Experience.
- Training.

Experts must have one or more of these qualifications to be deemed an expert in a federal case. In addition, their opinions must be based on sufficient facts and data, they must be the product of reliable principles and methods and they must be applied reliably to the case facts. The bases of the opinion must be those that could be reasonably relied upon by those in the field and, somewhat surprisingly, expert witnesses can rely on hearsay. The expert's opinion must be on the ultimate issues in the case and he or she must disclose the facts and data underlying the opinion.

General Considerations in Civil Litigation Cases

Legal privilege. CPAs typically encounter four types of privilege:

- CPA privilege, which is the protection CPAs provide to clients. This is a limited privilege that may not apply in every state.
- Attorney-client privilege, which involves the client's right to refuse disclosure of attorney communications.
- Attorney work product, which is immune from disclosure.
- Marital. The spouse has the right to refuse disclosure.

Engagement. Considerations surrounding acceptance of the engagement include a conflict search, special confidentiality measures and the role, scope and limitations involved. The engagement letter is usually written to the attorney, although it's a good idea to have the underlying client acknowledge the engagement. There are certain court approvals required in some cases for the engagement.

Among other considerations, CPAs should be aware that attorneys may call on short notice, so practitioners should confirm that they will be able to do the appropriate work. Timekeeping, fees and billings may be discoverable, so notes in this area should not disclose strategy or other sensitive information.

Marketing litigation services. Many litigators hire based on personal referral, which means the most effective way to get started is to form relationships with effective litigators. Case research will involve Internet searches, so CPAs should be aware of

continued on page 11
the need for a professional presence online. Trade associations, publications and advertising are other marketing possibilities. In addition, local professors called on for expert witness assignments may often need CPAs to provide assistance.

Selection for services. When being interviewed, CPAs will be expected to know the applicable federal rules and pertinent legal terms (Special Report 09-1 contains a glossary of terms).

CPAs should know their limitations in terms of timing and fees. They should expect the initial interview to be conducted much like a deposition and be prepared for tough questions. They should also expect to have a background check done on them and disclose any issues that might come up. They are also advised to meet the underlying client because that relationship may be lucrative in further expanding their services.

---

**LEGAL BRIEF**

**Buy-Sell Agreement Does Not Control Law Firm Value**

*By Sylvia Golden, Legal Editor, Business Valuation Update*


The husband directed the litigation department of a large national law firm in Phoenix. At his divorce trial, his expert relied primarily on the firm’s stock redemption agreement, which limited the value of the husband’s partnership interest to the $140,000 in his capital accounts. Although the expert admitted that the husband had “personal” goodwill with the firm, he determined its value was neither realizable nor transferable. In particular, any goodwill value related to the husband’s employment depended on his continuing to work at the firm and earn substantial compensation following the divorce. “This raises the question regarding the existence of goodwill should [the] husband elect to leave the practice,” the expert wrote in his report. Although the husband might continue to earn “significant compensation,” if he left, it would be inappropriate to attribute value to “a distributable marital asset” that depends entirely on his “post-marital” earnings. (Emphasis in the report.)

For these reasons, the expert excluded any goodwill value, personal or professional, from the value of the husband’s law firm interest, and ultimately concluded it was worth no more than the $140,000 return of capital. On further examination, the expert admitted the husband enjoyed great success with clients, had a 96% collection rate, a strong skills set, and a good reputation, such that any firm would consider him an asset and would have to pay a large amount to replace him.

By contrast, the wife’s expert attached little value to the firm’s buy-sell agreement. Instead, he applied a capitalization of earnings approach, examining the husband’s tax returns, historical income performance, earning sustainability, reputation, and client loyalty. He also adjusted the husband’s compensation to account for his higher-than-average productivity. In all, the wife’s expert valued the husband’s interest in the law practice at nearly $1.3 million.

The trial court rejected this approach as too speculative. It would require the court to assume that the husband could leave his present practice and continue to earn substantial income, without accounting for the difficulties arising from such a move, including client-related conflicts of interest as well as the new firm’s “platform” for bringing in new clients. Importantly, the court also relied on prior case law that restricted the value of a law firm to its “realizable benefits.” (See *In re Marriage of Molloy*, 888 P.2d 1333 (Ariz. App. 1994) *(Molloy II)*, available at BVLaw). Accordingly, it limited the value of the husband’s interest to the $140,000 in the buy-sell agreement, and the wife appealed.

Is the standard ‘realizable benefits’? As a preliminary matter, the Arizona Court of Appeals clarified the case history of Molloy:

- Initially, in *Molloy I*, the trial court precluded the wife from presenting evidence regarding the husband’s goodwill interest in his law firm.
- On appeal, the reviewing court recognized that “future earning capacity per se is not goodwill.” However, it also found that when “future earning capacity has been enhanced because reputation leads to probable future patronage from existing and potential clients, goodwill may exist and have value.”
- On remand, the wife presented evidence of both the firm’s goodwill value and its net tangible asset value, but, this time, the trial court considered only goodwill.
- In *Molloy II*, the appellate court found that, in addition to goodwill, a law firm’s value must also include its realizable benefits.

Thus, read together, the two Molloy decisions require a trial court to consider “the value of the husband’s entire interest” in the law firm, the appellate court explained, both the net tangible asset value and the goodwill value.

Given this backdrop, the trial court misread Molloy by limiting goodwill to its “realizable” value, or “something that can
be bought or sold on the open market," the appellate court said. In fact, additional state precedent (see Wisner v. Wisner; 631 P.2d 115 (App. 1981)) specifically permits a trial court to value private practice goodwill by considering such factors as the practitioner’s age, health, past earning power, reputation in the community, and comparative professional success. The appellate court added “expert testimony [can] help guide the court in its examination of enhanced future earning capacity.”

Under Wisner, the partnership agreement may also be a factor to consider in valuing goodwill, but in general such agreements “are designed to deal with particular aspects of the business, and simply do not address the considerations involved in [a] valuation” for purposes of divorce, the appellate court observed.

For all these reasons, the trial court “should have considered [the] husband’s personal goodwill in valuing [the] husband’s law practice beyond his stock redemption interest in the firm,” the court held. Here, even though the court recognized that professional practice goodwill was “the most intangible of intangibles,” it found evidence that the husband’s law practice interest exceeded the $140,000 stock redemption value.

Arizona remains firmly in the minority. In the alternative, the husband argued, even if the appellate court rejected the “realizable benefits” approach, any valuation of his law firm interest should at least exclude “personal goodwill.” The court acknowledged that a majority of states recognize the distinction between personal and enterprise goodwill, but Arizona does not. To the contrary, the Wisner factors demonstrate that Arizona does “in fact consider qualities that are attributable to the individual in determining community property values,” the court held, and affirmed the minority rule in the state.

Noting that state law “allows great flexibility on a case-by-case basis in the choice among valuation methodologies,” the court remanded for a new valuation of the husband’s law firm interest.

• Anthony Bracco, CPA/CFF, joins Anchin, Block & Anchin LLP, New York, as a partner in the firm’s Litigation, Forensics and Valuation Services Group.
• Patricia Etzold, CPA/CFF, a partner in PwC’s U.S. Forensic Services practice, has received Consulting magazine’s “Women Leaders in Consulting” award for her outstanding achievements in client service. Each year, Consulting magazine bestows this honor on ten industry standouts and rising stars who have made a mark within the consulting profession. At PwC, Etzold leads the securities litigation practice and is a co-editor of the firm’s annual study on the topic. With over 30 years of accounting and global business experience, she serves a broad range of clients, including boards of directors, audit committees, and internal and external counsels of multi-national companies. Among notable accomplishments over the course of her career, Etzold has worked alongside the U.S. Department of Justice in its prosecution of fraudulent matters and has assisted numerous companies’ counsels in response to Securities and Exchange Commission and Department of Justice inquiries.

continued from page 11

continued on page 13

**Member Corner**

- The Legal Intelligencer recently published their third annual Best of 2012 survey where readers cast their votes on the best providers of products and services to the legal community.

  The following firms were recognized under the forensic accounting category:

  Deloitte (Gold)
  ParenteBeard (Silver-tie)
  KPMG (Silver-tie)
  Smart Devine (Bronze)

- Brent Bersin, CPA/CFF, CLP has recently joined the firm of Grant Thornton as an FVS Managing Director in Forensic, Investigative, & Dispute Services (FIDS) in Houston, Texas.
Graham & Graham, PC, CPA and consulting firm located in Springfield and Essex Junction, Vermont and Laconia and Concord, New Hampshire acquired Peter C Brankman and Company. The firm will continue to provide forensic, litigation, business valuation and other services to a wide variety of clients in the states of Vermont, New Hampshire, Maine, Delaware, Maryland, Virginia, Utah, Colorado, Connecticut and Massachusetts.

Robert Gray, partner in ParenteBeard’s forensic, litigation and valuation services group, was a panelist at the American Bar Association’s seventh annual National Institute on Securities Fraud in New Orleans, LA, on November 15, 2012. In the discussion, Receivers / Trustees / Monitors: Navigating the Minefield, Mr. Gray will demonstrate the critical role that receivers, trustees and monitors play in reconstructing and resolving matters involving securities fraud.

The National Association of Certified Valuators and Analysts (NACVA) has named Jim Koerber, CPA/ABV/ CFF, CVA, CFE as Outstanding Member for the Fourth Quarter 2012. Koerber is a shareholder in The Koerber Company, PA, a Hattiesburg, Mississippi CPA firm that provides business valuation and litigation services for attorneys, CPAs, and their clients. NACVA is a national business valuation and litigation services organization with approximately 7,000 members. Koerber has been an active member of NACVA for over 15 years.


David Sawyer, CPA/CFF/CITP, CIA, CFE, CGMA has joined the CPA and Advisory firm of Frazier & Deeter as a Partner in the firm’s forensic accounting practice. In addition to his 20-year background in public accounting, internal audit and forensic consulting, Sawyer is past president of the Georgia Chapter of the Association of Certified Fraud Examiners (ACFE) and is a licensed private detective. He is a recognized expert in forensic accounting, including investigation of fraud, corruption and white collar crime. Prior to joining Frazier & Deeter, he managed his own forensic consulting firm for nearly a decade, and previously served with forensic units of two global accounting firms.

BDO Consulting, one of the nation’s leading professional service organizations, announced the growth of its Litigation & Fraud Investigation practice with the addition of Maryellen K. Sebold, CPA/CFF, CIRA, as a Managing Director in the Los Angeles office. In this role, Ms. Sebold will lead a range of litigation consulting matters, including forensic accounting, economic damages consulting, bankruptcy and business restructuring.

Dana Smith, CPA/CFF, has joined EisnerAmper LLP as a Partner in the firm’s Litigation Services practice. Smith provides expert witness services in intellectual property and complex commercial disputes. Her forensic accounting experience also includes assisting clients in post-acquisition disputes, fraud investigations, insurance claims, and in performing contract compliance examinations. Dana has consulted for clients in many sectors, including software, pharmaceutical, biotechnology, medical device, manufacturing, high technology, financial services, and the service industry.

New Member Resources!
As an FVS Section member, CFF or ABV credential holder, you can download these resources. You must be logged in to receive complimentary access.

Quick Reference Guide: Top Misappropriation Schemes - helps practitioners identify common indicators, resources and prevention tips for some of the most prevalent asset misappropriation schemes.

Computer Forensic Services and the CPA Practitioner Whitepaper - provides CPAs with a background in computer forensics and related data analytic services, as well as evidence and discovery management services (“e-discovery” or “EDM”).

Calculating Intellectual Property Infringement Damages Practice Aid - learn about the theoretical, legal, economic and accounting foundations of intellectual property and methodologies commonly employed in the calculation of intellectual property damages.
FVS Awards

Congratulations to the following volunteers!

Greg Regan, CPA/CFF, was presented with the 2012 FLS Volunteer of the Year Award during the AICPA Forensic and Valuation Services (FVS) Conference in Orlando, Florida. Greg is currently a member of the Forensic and Litigation Services (FLS) Committee, chair of the FLS Damages Task Force, and a member of the 2012 FVS Conference Planning Committee. He is a Director in the Litigation and Forensic Consulting Services Group in the San Francisco office of Hemming Morse, Inc.

Travis Chamberlain, CPA/ABV, was presented with the 2012 BV Volunteer of the Year Award during the AICPA Forensic and Valuation Services (FVS) Conference in Orlando. Travis recently completed a three year term on the FVS Executive Committee after having previously served on the Business Valuations Committee. While serving on the FVS Executive Committee, Travis served as Chair of the FVS Emerging Issues Task Force and served as a member of the Standards Task Force. Travis currently serves on the Valuation of Privately Held Company Equity Securities Task Force. He participated in the Contingent Consideration Round Table and frequently serves a national speaker on valuation topics. Travis is a Partner in the Indianapolis office of CliftonLarsonAllen, LLP.

Harold Martin, CPA/ABV/CFF, was presented with the 2012 AICPA Business Valuation Hall of Fame Award during the AICPA Forensic and Valuation Services (FVS) Conference in Orlando. Harold has a passion for educating the valuation profession. He has taught extensively for the AICPA including the BV School, the ABV Review Course and many conference presentations. He also teaches at the collegiate level helping soon-to-be CPAs become more knowledgeable regarding business valuation. Harold is a former member of the BV Committee, a former Chair of the BV Conference, and a two-time recipient of Volunteer of the Year award. He has also served as an advisor, editor and contributor to the AICPA CPA Expert and ABV e-alert newsletters.

Bill Howell, MBA, ASA, CPA/ABV/CFF, was presented with the 2012 ABV Champion of the Year Award during the AICPA Forensic and Valuation Services (FVS) Conference in Orlando, Florida. Mr. Howell is the Principal with William E. Howell, LLC, a firm providing professional services in business valuation, litigation support, and management consulting. Bill is a Board member of the NH Society of CPA's as well as Chair of its Business Valuation Committee. He is currently forming a Business Valuation Group with the Maine Society of CPA's. As an ABV Champion, he is an excellent resource for professionals in New Hampshire and Maine who would like to learn more about the ABV credential. Mr. Howell has spoken on numerous occasions on business valuation and exit strategy planning matters for CPAs, attorneys, business owners and banks.

Bill Barker, CPA/CFF, CFE was named 2012 CFF Champion of the Year during the AICPA Forensic and Valuation Services (FVS) Conference in Orlando, Florida. Barker is a partner at Barker Jones, CPA in Wilmington, North Carolina. Barker was recognized for his leadership and accomplishments within the CFF Champion community. In the last three years, Barker has educated the community about the CFF Credential through exhibiting and presenting at several NC Bar Association conferences as well as numerous other events. He has also been instrumental in exposing students at UNC-Wilmington's Master of Accounting Program to the forensic accounting niche and CFF Credential. The CFF Champion Program is an AICPA initiative that offers CFF credential holders the support, structure and resources to inform CPAs and clients about the importance of forensic accounting services.
FVS Calendar of Events

Learn more about FVS Section events and learning opportunities on the FVS site.

<table>
<thead>
<tr>
<th>Conference</th>
<th>Date</th>
<th>Location</th>
<th>Why You Should Attend</th>
</tr>
</thead>
<tbody>
<tr>
<td>AICPA Family Law Conference</td>
<td>May 8-10</td>
<td>Las Vegas</td>
<td>FVS Section members save $100 on registration for this ground-breaking conference, which focuses on the interrelated aspects and financial implications of business &amp; family, litigation &amp; divorce, valuation &amp; tax issues of property division.</td>
</tr>
</tbody>
</table>

### Web Seminars

- **The Truth is in the Numbers - Financial Statement Analysis for Valuation Purposes**
  - December 4, 3 to 5 pm ET
  - Free for FVS Section members

- **To Normalize or Not to Normalize - Adjustments to Financial Information for Valuation Purposes**
  - December 11, 3 to 5 pm ET
  - Free for FVS Section members

### Live Courses

- **AICPA Expert Witness Skills Workshop**
  - January 24-26
  - Phoenix
  - A $100 discount for FVS Section members and ABV/CFF credential holders on a workshop that offers a thorough introduction to the process.

- **2013 AICPA National Business Valuation Schools**
  - May 20-24
  - June 24-28
  - July 15-19
  - Atlanta
  - Denver
  - New York
  - The 2013 AICPA National Business Valuation Schools can help CPAs and financial professionals broaden their skills to assess and maximize the value of a client’s business. FVS Section members save $100 on registration for each.

---

**Working Draft of a new chapter of the Accounting and Valuation Guide**

*Testing Goodwill for Impairment*

Released November 8, 2012

The AICPA’s Financial Reporting Executive Committee (FinREC) has issued a working draft of a new chapter of the AICPA Accounting and Valuation Guide *Testing Goodwill for Impairment* (the Guide). The new chapter - chapter 2, Qualitative Assessment - discusses and illustrates how to perform the optional qualitative assessment to determine whether it is necessary to perform the two-step goodwill impairment test described in FASB ASC 350-20. This new chapter was developed in response to feedback received on the working draft the Guide which was released in November of 2011. Interested parties are encouraged to submit their informal feedback on the new chapter by December 31, 2012.
Technical Advisory Board

James Ashe, CPA/CFF, CFFA
Marcum LLP
Melville, New York

Rosanne J. Aumiller, CPA/ABV/CFF, ASA
BBP Partners LLC
Cleveland, Ohio

Don Barbo, CPA/ABV
Deloitte Financial Advisory Services LLP
Dallas, Texas

Candice Bassell, CPA/ABV/CFF
Grant Thornton LLP
Seattle, Washington

Brent Bersin, CPA/CFF, CLP
Grant Thornton LLP
Houston, Texas

Joseph G. Emanuele, CPA/ABV/CFF, CFA
Burr Pilger Mayer
San Jose, California

Richard Hilliard, CPA/CFF, CFE
ParenteBeard LLC
Pittsburgh, Pennsylvania

Hubert Klein, CPA/ABV/CFF, CVA, CFE
Eisner Amper LLP
Hackensack, New Jersey

Karen J. Kaseno, CPA/ABV/CFF, CVA, CFE, CFFA
The Kaseno CPA Firm, APC
San Diego, California

Louis D. Maglione, CPA/ABV/CFF
Barnes Wendling Valuation Services, Inc.
Cleveland, Ohio

Michael D. Morhaus, CPA/ABV/CFF, ASA, CVA
Anders Minkler & Diehl LLP
St. Louis, Missouri

W. Marc Schwartz, CPA/CFF, CFE
Hill Schwartz Spilker Keller LLC
Houston, Texas

Holly Sharp, CPA/CFF, CFE
LaPorte Sehrt Romig Hand
New Orleans, Louisiana

Glenn Spinello, CPA/ABV/CFF, CVA
ParenteBeard LLC
York, Pennsylvania

Peter Thacker, CPA/ABV/CFF, ASA, CFE
Keiter Stephens
Glen Allen, Virginia

Linda B. Trugman CPA/ABV, MCBA, ASA, MBA
Trugman Valuation Associates
Plantation, Florida

Alan D. Westheimer, CPA/CFF, CFE
Alan D. Westheimer, CPA/CFF, CFE
Houston, Texas

Allen Wilen, CPA/CFF, CIRA, CFA
Eisner Amper LLP
New York, New York

Vickie Wolf, CPA/ABV/CFF, CFE
Brinig & Company, Inc.
San Diego, California