The Witness Chair

Leading-edge Ideas for CPA Experts Providing Litigation and Dispute Resolution Services

WINTER 2007 ISSUE 43

How to Cage a Runaway Witness

by Roger J. Dodd, Esq.

Being a lawyer who is effective at cross-examination has nothing to do with the choice of clothes, the tone or loudness of the voice, or the theatrics displayed by TV lawyers. It is about teaching the cross-examiner's theory of the case to the judge and jury.

The lawyer's role in cross is to teach based on the logic behind the theory of the case. As a corollary, good cross-examination is designed to teach witnesses that if they disrupt the orderly introduction of facts to the jury they will get a negative reaction, including from the judge.

Today's courtroom fact-finders are averse to trials that drag on. Judges and jurors don't wait until the end of the trial to vote on whether the lawyer has presented the theory of the case. They are making rulings as the lawyer presents the cross-examination.

Lawyers are teachers. Their words, timing, and topics in cross should tell fact-finders in the case that they are going to cover things systematically. Three rules of cross-examination help maximize the amount of factual testimony that can be placed before the jury in the shortest amount of time. Using these rules confronts the witness more quickly with the facts the lawyer wants to get across.

Rule 1: Leading Questions Only

In direct examination, an attorney must let the witness carry the day without leading the witness. On cross-examination, there is nothing in the rules of evidence that restricts leading questions. This is the fundamental, distinguishing characteristic of cross-examination. Still, many lawyers fail to take advantage of this opportunity and ask open-ended questions.

> *The lawyer's role in cross is to teach based on the logic behind the theory of the case.*

In trial, the cross-examiner should consistently ask leading questions. Non-leading questions expose the lawyer to greater risks and occasions for less control. They invite long answers in which witnesses may volunteer information that the cross-examiner didn't ask for that can harm their case.

The well-learned "who, what, when, where, why," plus "how and explain" all precede open-ended questions. Avoid them on cross.

Most attorneys recognize "How do you feel about drinking?" as an open-ended question. Many trial lawyers view the question "Do you like to drink?" as a leading question because it indicates to the witness that they should respond "yes" or "no." But it doesn't require the answer that the cross-examiner wishes the courtroom fact-finders to accept as a fact of the case.

The question "You like to drink?" is clearly leading and very confining. It suggests the answer better than the other two questions. If the question mark were removed, it would be a short declarative sentence. These are the questions that juries and judges understand as declarative statements. The lawyer is proposing a fact that is immediately understood by them.

A few witnesses, especially experienced witnesses, are often trained to just stare at the cross-examiner as if it was not understood as a question. Or the witness will answer by saying, "Is that a question?" If so, the lawyer's answer is "yes." Say no more. The witness now must remember the question or ask the examiner to repeat it. The jury now realizes that the witness was being difficult. The effect is that the witness will become more cooperative.

Rule 2: One New Fact Per Question

Dr. Seuss repeatedly used the smallest component, a single word, in his work and expanded it to create a sentence:

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Section ACTION

Business Valuation
by Cindy Craig, CPA

For taxpayers making a non-cash charitable contribution of property valued in excess of $5,000, the IRS has required that they substantiate their deduction with a "qualified appraisal" prepared by a "qualified appraiser." Guidance on what was meant by "qualified appraisal" was provided in IRC Sec. 170(f)(11)(E) and Reg. Sec. 1.170A-13(c).

Public Law 109-280, passed on Aug. 17, 2006 and known as the Pension Protection Act of 2006, amended Sec. 170(f)(11)(E). The amendment expanded the definition of "qualified appraisal" and added and defined "qualified appraiser" to this section of the Code.

P.L. 109-280 defines a "qualified appraiser" as one who has earned an appraisal designation from a recognized organization or otherwise satisfied IRS requirements; regularly performs appraisals for compensation; can verify they have the education and experience appropriate for valuing the property; is not prohibited from practicing before the IRS; and is not excluded under applicable Treasury regulations.

A "qualified appraisal" is one that is prepared by a qualified appraiser "in accordance with generally accepted appraisal standards." P.L. 109-280 does not specify specific standards.

The IRS issued Notice 2006-96 in mid-October to provide transitional guidance on the new definitions.

Of significance, the Notice states that, "an appraisal will be treated as having been conducted in accordance with generally accepted appraisal standards … if, for example, the appraisal is consistent with the substance and principles of the Uniform Standards of Professional Appraisal Practice (USPAP)." The direct reference to USPAP is notable.

With regards to being considered a "qualified appraiser," the Notice requires appraisers to make a declaration regarding their education and experience. And, for returns filed after Feb. 16, 2007, the appraiser must include a statement that addresses the possibility that they could be subject to a civil penalty due to substantial or gross valuation misstatement.

To read the IRS Notice, go to *www.irs.gov/pub/irs-drop/n-06-96.pdf*.

Cindy Craig, CPA, ABV is Business Valuation Section chair and the director of Business Valuation Services at Andersen & Company LLP in Santa Rosa.

Economic Damages
by Colin A. Johns, CPA

Recent arguments before the U.S. Supreme Court have again focused on the Court's three guideposts as to whether punitive damages awards are grossly excessive and violate the constitutional right to due process.

These guideposts were set forth in the Court's decision in *BMW of North America, Inc. v. Gore,* 517 U.S. 559 (1996): 1) the degree of reprehensibility of the defendant's conduct, 2) the ratio between the plaintiff's compensatory damages and the amount of the punitive damages award, and 3) the difference between the punitive damages award and the civil or criminal sanctions that could be imposed for comparable misconduct.

Although the Court stated that considerable deference was given to state courts in determining the level of punitive damages, when the awards were "grossly excessive" they run afoul of due process concerns.

The Court reiterated that it had consistently rejected the notion that excessiveness could be determined by a simple mathematical formula, but cited its decision in *TXO Production Corp. v. Alliance Resources Corp.*, 509 U.S. 443 (1993), that the relevant ratio of the punitive damages to the actual harm was not more than 10:1.

In *State Farm Mutual Automobile Insurance Co. v. Campbell*, 538 U.S. 408 (2003), the Court expanded this guidance when it stated that "few awards exceeding a single-digit ratio between punitive and compensatory damages, to a significant degree, will satisfy due process." However, the Court did add that where conduct that was especially egregious resulted in only a small amount of economic damages, greater ratios might comport with due process. Conversely, where compensatory damages are substantial, a lesser ratio can reach the limit of the due process guarantee.

The Court also stated that the wealth of a defendant cannot justify an otherwise unconstitutional punitive damages award.

Colin A. Johns, CPA, CFE, CA is Economic Damages Section chair and a director in the litigation and forensic consulting practice of Hemming Morse, Inc. in San Francisco.

Family Law
by Tracy Farryl Katz, Esq., CPA

The IRS' recent private letter ruling PLR 2006 46003 has affirmed the payroll tax treatment of non-statutory stock options transferred in a divorce. This ruling follows previously issued Revenue Rulings (2002-22, 2002-1 C.B. 849, 2004-60, 2004-1 C.B. 1051) and addresses the issue of stock options that are transferred under a property settlement agreement and are subsequently exercised. This ruling applies to community property and non-community property states.

The non-employee spouse must report the income from the option exercise and receive credit for income taxes withheld from the proceeds by the employer. However, the non-employee spouse is not entitled to a credit for the FICA taxes withheld from the proceeds.

In the instant case, the wife asked for a letter ruling on the tax treatment of options that she received pursuant to a property settlement agreement.

Under the agreement, she was entitled to receive some of the vested options that the company had granted to the husband. The husband

retained physical custody of the options, but was to comply with written instructions from his wife regarding the exercise of "her" options. He exercised the options pursuant to his wife's request. The stock was then sold and the proceeds, less the federal income and employment taxes, were given to the wife. The transaction was reported on the husband's W-2.

This PLR is in accordance with previously issued revenue rulings indicating that FICA tax needs to be deducted from the amount paid to the non-earning spouse, and the amount included in the non-earning spouses' gross income is not to be reduced by FICA withholding. The relevant code sections discussed by the IRS are Sec. 1041, 3101, 3111, 3402(a) and 3401(a) and 31.

Practitioners should be aware of the recent revenue ruling reiterating the precise tax treatment of non-statutory stock options.

Tracy Farryl Katz, Esq., CPA is Family Law Section chair and a partner with Gursey Schneider & Co. LLP in Los Angeles.

Fraud

by B. Marie Ebersbacher, CPA

The three critical components to a successful fraud engagement, whether preventative or investigative, include having control over the documents, the right tools, and qualitative skill. While qualitative skills come with experience and continuing education, it is the ability to analyze the documents and use the tools to develop a big picture that is then drilled down to the weaknesses or defalcations. Here are some valuable tools in fraud engagements, including these Microsoft Excel tips and tools discussed at the November Fraud Section meeting:

• *www.asaputilities.com*. This is an add-in tool for Excel that contains useful macros, including one to format all pages the same, including repeating rows, columns and print ranges; shading alternate lines to make multiple lines of data easier to read; and informational tools for filename, sheet, file properties, etc.

• In the standard version of Excel, you can subtotal, multiply, and average, among eight other functions, data that has been autofiltered. Use the "=Subtotal" formula and the Help link within the formula box to choose the function you need. This gives you the ability to quickly compute subsets of data. Remember that each time you filter, you must rerun the calculation by a different attribute.

• When searching for duplicates in large data sets, search for "Street" also as "St." and as a null value when matching addresses, as data entry is rarely uniform. Try matching the first four numbers in a ZIP code when you look for duplicates. If the last number is incorrect, the post office will still deliver the mail nearly every time.

Many other techniques are out there. Send your tips to *mebersbacher@cbiz.com* and we'll try to add at least one to the end of each column.

B. Marie Ebersbacher, CPA is Fraud Section chair and a shareholder with CBIZ & Mayer Hoffman McCann P.C. in Bakersfield.

Message from the Chair

by Mark Luttrell, CPA

CPAs have expressed growing concern about the mobility of their license across the 54 U.S. licensing jurisdictions. The AICPA has been aggressive in responding to these concerns.

In 1984 the AICPA and the National Association of State Boards of Accountancy published the Uniform Accountancy Act. The thrust of the UAA, and the subsequent efforts of the AICPA and NASBA, was to enhance interstate practice by CPAs and protect public interest by establishing uniformity among the jurisdictions. The most recent edition of the UAA was published in December 2005.

Unfortunately, these efforts have not met the desired results. Each of the 54 licensing jurisdictions maintains unique rules regarding certification, interstate practice, and interpretation of the UAA. In an increasingly complex economy, many of our clients transact business and require our services on an interstate and international basis.

The responsiveness of state boards, combined with the rigidity and lack of uniformity in their rules, may be insufficient to meet business and client needs.

This lack of uniformity is considered by many to have created artificial barriers to commerce and interstate trade.

This issue presents a unique problem for litigation practitioners, who must be aware of the rules of each jurisdiction in which they practice. Timing is often critical, and one may not be able to navigate the complex regulatory process in sufficient time to serve the client.

The AICPA appointed a Mobility Task Force to make recommendations to resolve issues relating to CPA license mobility. Mike Ueltzen, former CalCPA chair and past Litigation Sections chair, is on the task force. The task force is working on recommendations to reform practice privilege and amend the UAA so its original impetus—providing licensees the ability to practice across state lines—can become a reality.

In the meantime, refer to the AICPA Alert for steps to take now to comply with regulations.

Mark Luttrell, CPA, ABV is the managing director of the southern California offices of CBIZ & Mayer Hoffman McCann P.C.

Keepin' It Legal

The Certified Public Detective

by Keith Slotter, CPA

The corporate fraud crisis of the past five years has evolved into the FBI's most significant focus of white-collar crime resources in the history of the agency, dwarfing previous commitments addressing fraudulent practices in the savings and loan and health care industries.

At its peak, the FBI's Enron Task Force included more than 200 agents and 150 investigative and financial analyst personnel, making it the single largest fraud investigation in FBI history, foreshadowing the larger corporate fraud crisis lingering on the horizon.

Today's CPA faces similar challenges from internal and external audit perspectives to detect material frauds pursuant to recent regulations, particularly SAS 99, which states that CPA audit team members have an obligation to search for and detect material financial statement fraud.

Corporate financial records provide a wealth of data that can help CPAs navigate the path to potential fraud. However, such records tell only a portion of the story. Keen interviewing skills are critical to eventual success in detecting corporate fraud, particularly in situations involving large-scale illicit and collusive activity.

The question I've most frequently been asked throughout my career is, "So, what do FBI agents really do?" Anticipating exciting tales involving high-speed chases, infiltrating notorious organized crime families, or uncovering critical forensic evidence in the vein of *CSI*, my response invariably leaves the listener disappointed: "Well, we talk to people. Lots of people."

And yes, while all of the aforementioned activities can be exciting and rewarding at times, the main function of an FBI agent is to move the case forward by interviewing as many people as possible in support of the investigation at hand.

If agents are not effective interviewers, they will not be successful investigators. More to the point, agents must be successful in eliciting key information as part of the interview. That's why we spend a significant chunk of time teaching and refining these skills throughout new agent training at the FBI Academy.

Keen interviewing skills are critical to eventual success in detecting corporate fraud.

These same interviewing skills are crucial for CPAs to detect fraud during the early stage of the case. In large part, interviewing success directly relates to structured training for CPAs on the art of the interview. There is no one way to conduct an interview. A multitude of variables, including setting, personalities, significance of the alleged crime, corporate dynamics, and personal motivations all play a role in deciding an appropriate plan of action.

Probative interviews involving an existing degree of suspicion are not just routine fact-finding endeavors. In the end, there are three main reasons why CPAs are often unsuccessful interviewers and fail to dig to the heart of potentially fraudulent activities.

Absolute Trust of the Client or Employer

CPAs tend to place a great deal of faith in what our client or employer is telling us when questioned. Healthy skepticism is an important concept and should not be confused with cynicism or paranoia. People will lie to you, repeatedly if necessary, to avoid anything bad from happening.

I'm unaware of any official psychological studies to support the assertion, but I believe that the greater the potential exposure to fraudulent activities and falsifications, the more frequent and drastic, and ultimately implausible, the stories become.

Take the case of Walter Pavlo, a former executive vice president with MCI in Atlanta. Pavlo was in charge of MCI's delinquent accounts and had authority to cut deals with corporate customers who were having difficulty paying their communications bills.

Over a period of years, he and several other MCI employees constructed a scheme involving fictitious creditors and straw buyers of debt, resulting in millions of dollars that were due to MCI being channeled to Pavlo and his colleagues. He was eventually convicted of his crimes and served an extended jail sentence.

Today he frequently speaks to corporate security departments about corporate fraud risks, and he is clear about why he wasn't caught by MCI's internal and external auditors. "I always felt they were just one question away from unraveling the whole scheme. With each question, I became more and more uncomfortable, but when the really key question was never asked, I simply felt more powerful, more emboldened in what I was doing," he said.

CPAs should never be left in the position of having to answer questions as part of an inquiry simply because the important questions weren't asked during the early investigative stage.

Misinterpreting a Willingness to Answer Questions

In addition to not always asking the right questions, CPAs sometimes fail to recognize just how far we can go in asking questions before the inter-

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AICPA Alert

by Christian Tregillis, CPA

In light of the practice privilege and mobility issues highlighted by California law, the AICPA, NASBA, and the 54 licensing jurisdictions in the U.S., the AICPA has developed *State Mobility Licensing Requirements*. This guide provides contact information for each state board of accountancy and the requirements for different types of work, including forensic accounting and expert testimony, performed by a CPA licensed in another jurisdiction.

The guide also outlines the processes for obtaining some form of temporary licensure or approval, if needed. In some states there have been indications that practicing as a CPA includes providing services to an entity that has a presence in that state or testifying in a court in that state.

Although the guide may be used to assist in contacting local boards of accountancy, it is not an authoritative definition or interpretation of state law and it is best to do a final check with each board of accountancy.

For a copy of the guide go to *http://bvfls.aicpa.org/Resources/*.

The second exposure draft of the AICPA's *Proposed Statement on Standards for Valuation Services—Valuation of a Business, Business Ownership Interest, Security, or Intangible Asset* was released in October with a comment period through Dec. 15, 2006. The Litigation Sections has submitted a comment letter, which is available at *www.calcpa.org/LIT*.

Of note for those performing analyses of damages, the Standards have been revised since the first exposure draft and now explicitly do not apply to lost profits damages calculations and the reporting requirements do not apply for a valuation performed for litigation purposes.

Christian Tregillis, CPA, ABV is managing director of Kroll Financial Advisory Services in Los Angeles.

Runaway Witness

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"Hop
"Pop
"We like to hop.
"We like to hop on top of Pop.
"Stop. You must not hop on Pop."
— *Hop on Pop*

To teach the witness to answer only "yes" to a question, offer only one fact at a time, and then add it to a body of facts established by previous questions. Tight control over the scope of a question controls the scope of the answer.

Q. You caught the red ball well?
A. What do you mean by "caught the ball well?"
Q. You caught the red ball?
A. Yes.
Q. You caught it with one hand?
A. Yes.
Q. You did not drop it?
A. True.
Q. You did not bobble or fumble it?
A. True.
Q. You caught it cleanly?
A. Yes.
Q. You caught the red ball well?
A. Yeah, pretty well.

To keep the trial moving, the tendency of cross-examiners is to move quickly to conclusions, opinions, generalities, and legalisms. But the effect is just the opposite. Worse, these conclusions, opinions, etc. inadequately teach the cross-examiner's theory of the case. Precise, detailed facts—one at a time—will always trump other conclusions and the like because they paint a mental image.

Rule 3: Break Cross-Examination Into a Series of Logical Progressions to Each Specific Factual Goal

Too often, lawyers view cross-examination as having an overriding single goal, such as destroying the witness' credibility, showing the defendant acted negligently, or that the defendant committed a crime. Cross-examination is best suited for establishing factual goals and is not conducive to making conclusions the goal.

Developing specific factual goals allows the jury to follow any line of questioning as it clearly and logically moves toward a specific goal. Even a reluctant jury member can focus attention when there is a clear sense of organization and defined points being made by the cross-examiner.

Also important for breaking cross-examination into individual factual goals is that it allows the judge to know where the cross-examiner is headed and why the witness is being cross-examined. Eventually the trial judge and the opposing counsel learn that the cross-examiner always has a goal, thereby both discouraging the opposition from objecting to a line of questioning and the judge from sustaining an objection, if made.

Again, each goal within the cross should either assist cross-examiners in building their theory of the case or in undermining the opponent's theory. Think of the fact the lawyer wishes to prove and work backwards in preparing the questions. Move from the very general to the very specific. The general questions lock in and make easier the specific questions.

These three rules are the building blocks for all the more advanced techniques of cross-examination including putting a cage on the runaway witness, which will be discussed in the next issue.

Roger Dodd is a trial attorney and is regarded as one of the most knowledgeable experts on cross-examination. He has co-authored several publications and is a regular contributor to Trial magazine. His practice is based in Valdosta, Georgia.

HAPPENINGS

Litigation Sections Meetings

Business Valuation	Thursday, Feb. 8, LAX
Economic Damages	Wednesday, Feb. 28, LAX
Family Law	Friday, Feb. 9, LAX
Fraud	Tuesday, Feb. 27, LAX

Each section will send individual meeting notices.
Download a copy at *www.calcpa.org/LIT*
or contact Bobbie Nochenson at (818) 546-3502.

Education Foundation Course Offerings—(800) 922-5272 or www.educationfoundation.org

Advanced Litigation Institute	Thursday-Friday, May 3-4, TBD
Finding & Evaluating Frauds: A Case Study Approach	Friday, Jan. 26, SFO
Fraud: Exposures & Solutions in the Non-Audit Environment	Wednesday, Jan. 31, SF
Internal Controls: Your Number One Defense Against Errors & Fraud	Tuesday, Jan. 23, SAC area Friday, Jan. 26, SD area
Searching for Fraud: Assessing Risk and Addressing Red Flags	Friday, Feb. 9, SF

Certified Public Detective

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view may be terminated. In other words, where is that threshold for a person who is being questioned and quite possibly accused of seriously fraudulent behavior?

The answer depends on the circumstances at play, but regardless of where we suspect such a threshold might lie, it is usually far beyond that which we suppose.

In the early 1990s, I was involved in a large, two-year undercover operation targeting illicit telemarketing schemes perpetrated by hundreds of fraudsters throughout the country. When working in an undercover assignment, a prime consideration is maintaining your *bona fides* and ensuring the case is not compromised.

Covertly operating as a team of salespeople, we questioned our subjects thoroughly and carefully, getting as much information as possible without arousing suspicion. In December 1992, the FBI announced that there would be a national takedown with all subjects charged and arrested three months hence.

With limited time left for the operation and hoping to gather as much evidence as possible, we threw caution to the wind and our interviewing methods became much more pointed and deliberate. Questioning became significantly more probative and intrusive than one would experience during the normal course of business. Guess what happened. Nothing. Every person we spoke with remained cooperative and compliant no matter how hard we pushed.

This doesn't mean the possibilities are endless. It simply illustrates that, like Walter Pavlo, people will generally allow themselves to be pushed beyond the thresholds of our preconceived limits.

Failure to Incorporate Appropriate Interviewing Techniques

Determined to maintain a healthy degree of skepticism and push across any preconceived threshold barriers, we're now ready to begin the interview. Remember that you may only get one shot, so best to get it right the first time. It is imperative to develop an interview plan with predetermined questions and strategies before walking through the door.

Your goal is to make this a conversation, to the best of your ability, as opposed to an interrogation. Interviewing is more art than science and no matter how sharp your skills may be, there is no guarantee of success. The next issue will describe key techniques you can utilize to improve your chances of success.

Keith Slotter, CPA has been an FBI Special Agent for 19 years, serving in various cities throughout the U.S. Currently, he is responsible for all operations at the FBI Academy in Quantico, Virginia.

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