

# THE Witness Chair

Leading-edge Ideas for CPAs Providing Litigation and Dispute Resolution Services

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## The Foreign Corrupt Practices Act: Opportunities for Accountants, Lawyers

by Dan Ray, CPA

**The Foreign Corrupt Practices Act** (FCPA) was enacted in 1977 in response to reports and revelations of widespread bribery of foreign officials by U.S. companies to win or influence business. However, until around 2005, there was very little enforcement. Since 2005, there have been numerous cases brought resulting in criminal convictions, Deferred Prosecution Agreements (DPA) and Non-Prosecution Agreements (NPA), as well as civil actions.

Enforcement of the FCPA is shared between the U.S. Department of Justice and the SEC. FBI special agents specifically trained and assigned to these matters often conduct the underlying investigation. In addition to enforcement actions brought by these governmental agencies, shareholders often bring private civil actions following disclosure of suspected FCPA violations.

The magnitude of fines paid to settle FCPA enforcement actions shows why serious attention should be paid to this law:

- Siemens AG: \$800 million
- Alstom S.A.: \$772 million
- Kellogg Brown & Root LLC: \$579 million
- BAE Systems PLC: \$400 million
- Alcoa World Alumina LLC: \$384 million

Fines levied since 2005 total \$5.9 billion. In addition, many of these companies were required to appoint—and pay—a compliance monitor to oversee their operations and report findings to the DOJ and SEC.

The FCPA encompasses two main provisions:

**Anti-Bribery:** Prohibits offering or giving anything “of value” to a “foreign official” to

win or influence business.

### **Accounting or Books and Records:**

Requires those subject to the FCPA to keep accurate books and records of its business transactions, and to devise and maintain an adequate system of internal accounting controls. The provision also prohibits individuals and businesses from knowingly falsifying books and records, or knowingly circumventing or failing to implement a system of internal controls.

### **Compliance, Due Diligence and Investigations**

Given the broad scope of the FCPA, and significant ramifications for identified failures to comply, there is an abundant amount of work to be provided by both accountants and lawyers.

Virtually all multi-national companies have dedicated compliance officers. Regionally based compliance personnel and country managers typically support these headquarter-based corporate officers. The compliance team is responsible for drafting compliance policies; training employees and other third parties; and conducting proactive and reactive compliance investigations.

The compliance team is supported by the internal audit staff, forensic accountants and other due diligence professionals. Larger companies also have compliance auditors on staff who work in tandem with, but separate from, the internal audit staff. The compliance auditors are specifically trained to look for compliance concerns or “red flags” that may constitute FCPA violations.

Because a company can be deemed to have violated the FCPA by virtue of improper acts of its agents, distributors

or other third parties (i.e. travel agencies, logistics companies, etc.), it is critical that the company perform due diligence on these third parties to ensure that there is no history of corruption—and to seek a proper level of assurance that they will comply with the law.

It is also critical that compliance training be provided to all employees and select third parties. In addition, these third parties are usually required to execute “compliance certifications,” in which they commit to not violating the FCPA. These certifications should be both backwards and forwards (i.e., have not in the past and will not in the future violate the FCPA).

The required due diligence is typically performed by either forensic accountants or investigative firms that have access to worldwide public records sources, or, as required, the “boots on the ground” to fully investigate.

The FCPA’s core concerns are improper payments to foreign government officials, inadequate internal controls to prohibit such payments and the improper recording of such payments in the accounting records of the business. If such improper cash payments are made, they are usually paid

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## Section Action

### Business Valuation

by Lynda Setzke-Schauer, CPA

In business valuations, we observe that the “standard of value” for marital dissolution purposes is not clear and subject to interpretation. This has been a challenge for valuation experts and family courts in determining community goodwill.

Within non-divorce litigation, there are clear definitions as accepted by the IRS and found in the International Glossary of Business Valuation Terms. Here, the standard of value is defined as “the identification of the type of value being utilized in a specific engagement; for example, fair market value, fair value or investment value.”

Conversely, the California family courts have neither provided a definitive standard nor outlined rules for the determination of value of community goodwill. Many deem fair market value (FMV) to be inappropriate, but do not provide an alternative method.

Instead, separate court decisions have evaluated each case with their own set of facts and circumstances and offer varied definitions most closely identified as fair value, investment value and, more recently, marital value to determine a value of a marital asset.

In a recent appellate case, *In Re Marriage of Honer*, expert witness Tom Berg used a standard of value he called “marital value” to determine the community goodwill for valuation of the business. He defined marital value as, “. . . the economic value of the business to the spouse retaining it, and who will continue to operate it in the future.”

Depending upon the circumstances, this standard of value may or may not include a minority interest discount or marketability discount. Thus, the marital standard of value is different from an investment value, as defined in the International Valuation Glossary, where the value to a particular investor is based on individual investment requirements and expectations.

The appellate court found the marital standard of value was in compliance with

the Uniform Standards of Professional Appraisal Practice and the evidence supporting Berg’s opinion

did not depart from the rules of business valuation. Thus, this marital value definition aligns more closely to what many experts are using and has provided others something to consider using in a valuation for dissolution.

**Lynda Setzke-Schauer, CPA, CVA** is Business Valuation Section vice chair and a principal with Zivetz, Schwartz & Saltsman, CPAs in Los Angeles.

### Economic Damages

by Haley J. Eckhart, CPA

Reasonable certainty was the hot topic for economic damages in 2015. In February, Jeffrey Klein and Christian Tregillis of LitiNomics discussed the issue with our Economic Damages section. Next came the publication of the AICPA Practice Aid, “Attaining Reasonable Certainty in Economic Damages Calculations.” Finally, in November, the AICPA Forensic & Valuation Services Conference offered a case study of reasonable certainty and discounting.

What is “reasonable certainty?” According to the Practice Aid, the courts’ articulation appears to recognize that the profits forming the basis for an economic damages calculation need not be certain to adduce a calculation of damages that has a reasonable basis. Reasonable certainty will have been attained when the (damage) amount is proven with a reasonable basis and sound methodology.

Through the use of illustrative case law, the Practice Aid addresses these aspects of economic damages calculations that appear to be particularly challenging for the courts in determining whether reasonable certainty has been achieved. (Practice Aid at 7):

**Client-Supplied Information:** The Practice Aid addresses issues confronted by damages experts when information integral to the damages analysis was provided by the client or retaining counsel (Practice Aid at 7). The cases suggest the courts consider a number of key issues posed by client-supplied information when evaluating the admissibility and weight of the expert testimony (Practice Aid at 13-14).

**Causation Considerations:** The Practice Aid analyzes common approaches by damages experts to this issue. One significant issue

is addressing whether portions of loss not attributable to the alleged wrongdoing have been excluded (Practice Aid at 7).

**Newly Established Businesses:** Historically, what has been called the “new business rule” has limited the recovery of lost profits sought by the plaintiff because a lack of historical profits made lost profits of the business inherently speculative. The Practice Aid examines the evolution of the “new business rule” from a *per se* “rule” to a more reasonable “standard” based on evidentiary sufficiency (Practice Aid at 66-68). The Practice Aid also provides an analysis of factors considered by courts to establish the reliability of benchmark data (Practice Aid at 7).

Ultimately, the core objective of the reasonable certainty standard is to ensure that plaintiffs are not awarded speculative, overly optimistic or unrealistic damages (Practice Aid at 10).

**Haley J. Eckhart, CPA, CFE** is Economic Damages Section chair and a principal with Freeman & Mills, Inc. in Los Angeles.

### Family Law

by Mike Radakovich, CPA

In *In Re Marriage of Brandes* (2015) [Cal. App.4th], H founded Brandes Investment Partners (BIP) prior to marriage. At date of marriage, August 1986, H owned 90 percent of BIP, which managed assets worth around \$20 million. When the couple separated in June 2004, BIP managed \$85 billion worth of assets and H had purchased the remaining 10 percent interest (10,000 shares).

In her appeal, W claimed:

- BIP was a community asset since BIP became a completely new business during the marriage, thereby losing its separate characterization.
- The 10 percent interest in BIP purchased during the marriage is community under the following rationale: The 4,000 shares purchased for cash were purchased with community funds and the 6,000 shares purchased with a note were community under the “lender’s intent” doctrine since H did not show that seller relied on his separate property.

The trial court agreed with H that BIP was—and remained—his separate property. To determine the equitable allocation to the community for its efforts to BIP’s increase in value, the trial court used a combination of the two standard methods: Pereira (community) and Van Camp (separate).

The trial court ruled that the early years of growth (1986–91) were due to H's personal (community) efforts. Accordingly, the trial court used a Pereira approach.

The evidence showed that growth from 1992–June 2004 was not due to H's personal effort, rather, from the management team he had hired. From 1992–June 2004 the trial court used a Van Camp analysis to determine an equitable allocation. The court determined that the community had been "substantially overcompensated" for H's services; accordingly, the community was not entitled to any more than it had already received.

Further, the court stated that since the 4,000 shares were purchased during the Van Camp period, those shares were H's separate property. The rationale was that during this period, community expenses (\$150 million) exceeded the value of H's community services to BIP (\$31 million, net of taxes), so, since "... there were no community funds available for the purchase of Brown's stock, it was necessarily purchased with Charles' separate property." There was no tracing.

The court reasoned: If (community expenditures) were more than community income, and there are separate funds available, then all the stock purchases are separate, even though the purchase funds came from a joint account! Wow.

The appellate court held for W as to the "intent of lender" doctrine when it came to the 6,000 shares of BIP. The court held that H failed to show that when he purchased the 6,000 shares for \$4.7 million down and an \$18.7 million note, seller was looking solely to H's separate property for payment.

The appellate court ruled that H had the burden of proof to show this, not the community. This is interesting, given the court found that there was no excess community income to make the payments.

Look for more information on *Brandes* in the next issue of *The Witness Chair*.

**Mike Radakovich, CPA, ABV, CFF, CVA**

is Family Law Section chair and a partner with Radakovich, Shaw & Blythe, LLP in San Luis Obispo.

## Fraud

by Anne Renna, CPA

Many companies use non-financial data to measure, for example, customer satisfaction or product quality. Auditors are increasingly using non-financial data to assist in their understanding of a client's business and to

## Message From the Chair

by Martin G. Laffer, CPA



**It seems that** every organization I belong to has a mantra of "get involved." And CalCPA's Forensic Services Sections is no exception. Clichés such as "you get out of it what you put into it" also ring true. We all belong to a myriad of organizations, such as CalCPA, AICPA, ACFE and ASA. So the question is, "what value am I receiving from my membership?" The value of FSS is in networking with experienced practitioners; belonging to a professional community that serves as a resource for ideas; discussing issues; meeting leaders in the profession and specialty areas; and obtaining relevant continuing professional education.

So, how do you get involved? It's easy! Commit to attend one or more of the FSS section meetings to meet others practicing in your area. I guarantee you'll get hooked after the first one! The sections meet individually in February and August, and together in June and October. Then, consider applying for an officer position in your favorite section. Or, decide to lead your chapter's forensic services committee.

The Education Foundation is seeing a marked increase in conference webcast participation, which is equating to fewer attendees at the in-person events. By sitting in the office and clicking the mouse on command, you are missing out on interacting with fellow practitioners.

This is the last issue of *The Witness Chair* in print. We are going digital! Please provide your email address by using the enclosed postcard, or email [witnesschair@calcpa.org](mailto:witnesschair@calcpa.org) to be added to the distribution list.

— **Martin G. Laffer, CPA** is a partner with Laffer & Gottlieb in Beverly Hills.

perform a fraud risk assessment as required by auditing standards.

In a fraud investigation, analysis using a non-financial measure (such as number of employees or square footage of a warehouse) when compared to certain expenditures can be particularly effective and efficient. Depending on the fraud scheme and who is involved, either the non-financial measure or the general ledger account balance will have been manipulated, causing a relationship between the two to be inconsistent.

The following are examples of two non-financial measures that were used relative to a manufacturing plant and quickly resulted in the detection of a fraud scheme. The total number of units as being produced by the plant had been falsely under-reported to cover up an ongoing theft. In one year, this reduction was significant enough to create inconsistencies, as follows:

**1. Packaging.** Typically, companies do not pay much attention to packaging because of its minimal cost. Perpetrators don't think about their usage either. A calculation was made using the cost of packaging in the general ledger and

reducing it for an allowance for waste. (Note: The cost of packaging in the general ledger had already been adjusted for beginning and ending packaging inventory). This calculated packaging cost amount was then converted to number of units, which was significantly greater than the amount of product reported on the production records as being produced during the same period.

**2. Number of Units Produced.** All manufacturing plants track in their production records the number of units produced, including those units that are not perfect and units that are discarded. In this case, the number of good units sold to customers, the number of units sold as second-quality or scrap and the number of units given to charity was significantly greater than the total number of units reported in the production records.

**Anne Renna, CPA, CFF, CFE** is a sole practitioner in Santa Monica whose practice focuses on forensic accounting and fraud investigations.



## In Re Marriage of Honer Brings New Light to Valuation in Family Law

by Terry M. Hargrave, CPA

We have a new valuation case in family law and ... the subject of the valuation is a business, not a professional practice. *In Re Marriage of Honer* (2015) 236 Cal.App.4th 687, 186 Cal.Rptr.3d 607 addresses several aspects of our appraisal work, including the foundational subject of standard of value.

### Fair Market Value

When I entered the family law world in 1991, I read the valuation cases and learned that most of the cases use the term fair market value (FMV).

Revenue Ruling 59-60 and the Estate Tax and Gift Tax Regulations define FMV as the price at which the property would change hands between a willing buyer and a willing seller when the former is not under any compulsion to buy and the latter is not under any compulsion to sell, both parties having reasonable knowledge of relevant facts.

I found this interesting because the cases also state an enterprise has value in a marital dissolution even if it is not salable. Hence, there is an inherent contradiction between FMV and the standard of value in California marital dissolutions because an enterprise may have value to the community even if it is not salable.

### Investment Value

*In Re Marriage of Hewitson* (1983) 142 Cal.App3d 874, 191 Cal.Rptr. 392 acknowledged this contradiction and

presented investment value as the standard of value. *Hewitson* defines investment value as the value to a particular investor based on individual investment requirements and expectations.

This cleans up the contradiction between using FMV as our standard of value in family law when the business does not need to be saleable, but also adds a new problem. In the U.S. and U.K., investment value is the market value for the investor who has the capacity to put the property to its highest and best use—its most valuable use.

As an appraiser, I do not want that responsibility and I do not want to be held accountable for knowing and opining on the excess amount one strategic buyer might pay that is well in excess of what the rest of the buyers in the market would pay.

*Honer* has now affirmed marital value as "... the economic value of the business to the spouse retaining it, and who will continue to operate it in the future."

### Marital Value

When reading *Hewitson*, strategic value is not what the court intended. Hence, many of us went rogue and began using the term marital value as the standard of value in our reports, even though it had previously never been cited in a published opinion.

*Honer* has now affirmed marital value as "... the economic value of the business to the spouse retaining it, and who will continue to operate it in the future."

### Foundational Work Emphasized

Another reason I am excited about *Honer* is that both the trial court and the appellate court emphasized that the foundational valuation work the husband's appraiser performed before reaching his conclusion is important and made a difference to them and affected their conclusions. This foundational work included researching the industry, inspecting and touring the

business, interviewing management and analyzing past and expected performance.

Both courts state, "... His report appears to be comprehensive, balanced and well-reasoned."

Included in the well-reasoned report was the use of public company data. The appraisers were charged with valuing the parties' business that operates two local full-service supermarkets. Both appraisers relied on public company data. At the date of value, the gross revenues were approximately \$30 million. In contrast to *In Re Marriage of Lotz* (1981) 120 Cal. App3d 379, 174 Cal.Rptr 618, and *Hewitson*, the *Honer* court validated the use of guideline and public company data when valuing a family owned business.

*Honer* is a continuation of *In Re Marriage of Ackerman* (2006) 146 Cal. App4th 191, 52 Cal. Rptr.3rd 744: "No rigid rule applies for determining the value of goodwill." The court is expecting us to do what makes sense.

Furthering this thinking, while neither of the *Honer* appraisers used the discounted cash flow method in their analysis, the appellate court includes this method when describing the income approach in footnote 4 of its opinion.

It seems to me that in some instances, most notably when valuing a company that is profitable but has not yet reached stabilized earnings because of its youth, a rationally applied discounted cash flow approach could be very helpful to the court.

### Valuation Date

*Honer* is also discussed because husband's expert's appraisal was dated well over a year before trial. Family Code Sec. 2552 states that unless there is a motion to value an asset at a different date and the court concurs, the court shall value the assets and liabilities as near as practicable to the time of trial.

From reading the statement of decision, it seems apparent that in the *Honer* case, the out of date appraisal was allowed because wife had been so difficult in delaying and not cooperating and because the judge added an amount to husband's expert's appraisal.

Many appraisers prefer to value a business at its year-end so seasonality and year-end adjustments do not incorrectly skew the current year earnings. In *Honer*, the business earned substantial earnings after the date of the appraisal and after trial that were not considered in the property division.

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# AICPA Alert

by Ted Israel, CPA

**The AICPA's 2015 Forensic and Valuation Services Conference** was held Nov. 8-10 in Las Vegas. As in the past, attendees were offered an overwhelming number of sessions—72 in all—on a wide range of topics geared for multiple experience levels.

Due to positive feedback, the “hands-on” track was carried over from last year, wherein participants progress from session to session following one set of case facts through to conclusion.

CalCPA's Forensic Services Sections' leadership was well-represented in the conference leadership, as well as the roster of speakers. Greg Regan served as conference co-chair and Annette Stalker served on the planning committee. Annette will return as conference co-chair for the 2016 conference in Nashville.

Something of interest to all CPAs is the AICPA's advance toward expanding eligibility for its specialty credentials to non-CPAs.

In May it was announced that, in response to deficiencies perceived by the SEC, the AICPA had decided to move ahead with two new valuation credentials focused on the financial reporting of valuation issues of publicly traded companies.

After development of appropriate technical requirements (e.g. body of knowledge, experience and testing) the AICPA will

offer the new credentials to CPAs and other qualified valuation professionals.

In October, we learned the AICPA is considering granting its existing specialty credentials to non-CPAs. The AICPA's goal in expanding eligibility to other qualified professionals is to strengthen the credentials' brand by broadening membership and recognition outside the usual CPA space.

Non-CPA applicants for the credentials will have to satisfy all other technical requirements (i.e. testing, etc.). Only the CITP (Certified Information Technology Professional) and PFS (Personal Financial Specialist) designations are under consideration for credentialing to non-CPAs. There are no immediate plans for opening eligibility for the ABV (Accredited in Business Valuation) and CFF (Certified in Financial Forensics) credentials to non-CPAs.

However, there is no indication that those two credentials will not also be offered to non-CPAs in the future, especially if the expansion of eligibility for the CITP and PFS goes smoothly.

Concurrently, the AICPA and CIMA (Chartered Institute of Management Accountants) are planning to expand eligibility for the CGMA (Chartered Global Management Accountant) credential to non-CPAs. Non-CPAs earning the aforementioned credentials will be non-voting members of the AICPA.

New in the AICPA's Forensic and Valuation Services Library: *FVS Practice Management Toolkit*. The new toolkit contains useful guidance on engagement letters, fee structure, staffing, quality control and marketing. It updates and replaces the *2013 Business Valuation Practice Management Toolkit*. AICPA FVS members can access the toolkit by logging on to the AICPA's website and going to the FVS Library.

**Ted Israel, CPA, ABV** is co-founder of Israel Frey Group, LLP in San Rafael.

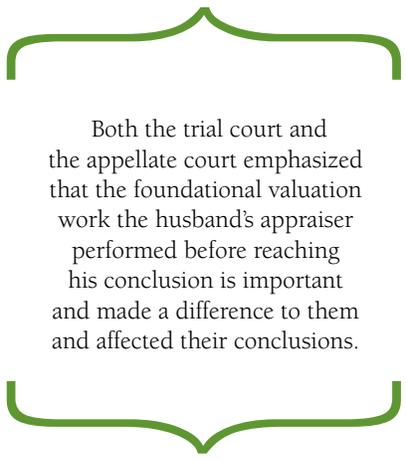
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The motion to reopen was denied. In almost every case there will be a period of time between the date of the appraisal and settlement or trial. How can the out-spouse receive their share of the business' earnings that are in excess of the amount on which support was based that occur in that interim period? I recommend this be considered at the initial hearing for support (RFO) or when entering into the pendelite stipulation for support.

If a percentage of income above a base will be paid as additional support (Ostler & Smith provision from *In Re Marriage of Ostler & Smith* (1990) 223 Cal.App.3d 33, 272 Cal. Rptr. 560), then the out-spouse will receive a share of the earnings as additional support.

If there are reasons to not have an *Ostler & Smith* provision, I recommend the out-spouse request a provision stating that the profits in excess of the amount used to set support be considered as community property and divided.

If the income above the base does not come to fruition, then there is nothing to divide. Hence, this provision will provide



Both the trial court and the appellate court emphasized that the foundational valuation work the husband's appraiser performed before reaching his conclusion is important and made a difference to them and affected their conclusions.

equity to both spouses and also provide a mechanism for the case to come to closure.

The *Honer* case validates the use of the marital standard of value in dissolution cases and validates the benefit to the court of the appraiser doing the foundational valuation work that underlies a complete and competently performed appraisal, and is a reminder to the professionals working for the spouse not operating the business to request a provision that will allow for the division of profits between the valuation date and closure of the case.

**Terry M. Hargrave, CPA, ABV, CFF, CFE** is a shareholder in Hargrave & Hargrave, AAC, in Santa Monica.

## Last Printed Issue: *The Witness Chair* is Going Digital

The Forensic Services Section has determined that a more effective method of delivering *The Witness Chair* is electronically. This is the last printed issue before the transition to digital only. If you would like to continue receiving *The Witness Chair*, please send an email to [witnesschair@calcpa.org](mailto:witnesschair@calcpa.org) that includes: your name, preferred email address and firm/court name.

# HAPPENINGS

## FORENSIC SERVICES SECTION 2015-16 MEETING DATES

All Sections Joint Meeting	June 10 Nov. 17	Northern CA LAX
Business Valuation	Aug. 18	OAK
Economic Damages	Aug. 25	OAK
Family Law	Aug. 19 Nov. 18	OAK LAX
Fraud	Aug. 26	LAX

You may register online: [www.calcpa.org/fss](http://www.calcpa.org/fss).

For more information, call (818) 546-3502.

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from “extra” funds provided to employees, commissioned sales agents or distributors.

Other non-cash “value” given to government officials include travel opportunities (i.e., side trip to Disneyland while visiting the factory); the hiring of the spouse or children of the governmental official; or “donations” to charities as directed by the government official.

The compliance officer and supporting forensic accounting staff (internal and external) should also perform proactive tests of the compliance controls to ensure they are in place and are adequate to prevent corrupt payments or improper accounting entries.

These investigations typically employ a risk-based approach. Sources such as Transparency International rank countries by their perceived corruption. Compliance professionals and forensic accountants must also perform reactive investigations, typically initiated by whistleblower information, such as calls to a company’s hotline.

### Compliance Monitorships

In certain situations the DOJ and/or SEC will require the offending company to retain the services of a compliance monitor for a defined period of time. The role of the monitor, in its simplest description, is to work within the company to ensure there are no future FCPA violations.

This is accomplished by ensuring necessary changes have been made to the offending company’s compliance framework; through interviews and other means determining whether the company has the appropriate “tone at the top” regarding doing business in a compliant manner;

and assessing whether the company has implemented strong internal controls.

The compliance monitor works within the company, is paid by the company and issues periodic reports and recommendations to the DOJ and SEC. The monitor is a person (rather than a firm) and is most often an attorney. However, on a number of occasions non-lawyers such as CPAs have been selected and appointed by the government to fill this role. I have twice served as a compliance monitor with companies in the life science field (a medical diagnostic company and a medical device company).

Because monitors need to address legal and accounting issues, they typically retain lawyers and forensic accountants to assist in carrying out the required duties.

The attorneys typically assist in reviewing and modifying sales agreements with consultants and distributors; reviewing and modifying compliance policies and procedures; addressing issues of attorney-client assertions made in accessing company documents; participating in interviews with employees and non-employees for the purpose of assessing the effectiveness of the training performed by the company and their commitment to anti-corruption policies; and helping draft the report of recommendations and findings.

Forensic accountants assist the monitor in a variety of ways, including analyzing the books and records of the business to ensure that improper payments are not being made; participate in interviews with the finance and accounting personnel to understand and assess the internal controls established by the company; work with the company’s internal auditors or compliance auditors to

assess what procedures they follow to ensure improper payments are not made; and help address any corruption concerns that might arise during the monitorship.

The first company I monitored was for three years, and required semi-annual reports to the DOJ and annual reports to the SEC. The second monitorship was under a new program called a “Hybrid Monitorship.”

In this matter, the company was subject to a three-year DPA, with a monitor in place for at least 18 months. Thereafter, if both the monitor and the government agree that the company has made sufficient improvements to its compliance program, the company could then self-report to the government for the remaining 18 months of the DPA.

Given that international commerce continues to expand, the opportunities for attorneys and forensic accountants to provide professional services in this space will also continue. If you would like additional information regarding the role of corporate monitors, see the cover story in the December 2014 edition of California Lawyer Magazine titled, *The Secret Life of Corporate Monitors*.

Further information on the FCPA can be found at [www.justice.gov/criminal-fraud/foreign-corrupt-practices-act](http://www.justice.gov/criminal-fraud/foreign-corrupt-practices-act).

**Day Ray, CPA, CFF, CFE** is a partner with *Hemming Morse, LLP* in San Francisco and Walnut Creek.

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#### Editor

Susan Bleecker

#### Associate Editors

Leslie O. Dawson  
Emily Ku

#### Section Chair

Martin G. Laffer

#### Individual Section Chairs

Business Valuation	Daniel M. Ross
Economic Damages	Haley J. Eckhart
Family Law	Mike Radakovich
Fraud	Coral M. Hansen

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