



LITIGATION
AND VALUATION

ADVISER

Even Important People Can Be Exposed by Forensic Accountants

When someone creates a web of transactions designed to hide illegal actions, it is the job of the special agents from the IRS Criminal Investigation Division to uncover this activity. This division was in the spotlight in the recent matter alleging that former New York State Governor Eliot Spitzer tried to hide alleged payments for prostitution.

Criminal Investigation is a separate division of the Internal Revenue Service. Its special agents investigate financial crimes, especially those pertaining to tax evasion and money laundering. As part of their training, these agents are required to hold a college degree with at least 15 credits in accounting and to spend three months at the IRS National Training Academy for a specialized course on forensic accounting.

The United States Department of Treasury, within which the IRS resides, is responsible for all of the currency-reporting laws in the country. Financial institutions regularly report currency transactions and suspicious activity to the IRS Computing Center in Detroit, where they are analyzed. These reports are then forwarded on to the appropriate Criminal Investigation field office.

It was reported that the governor's attempts to layer and structure his transactions led to the filing of a suspicious activity report ("SAR") by a financial institution, whose identity may never be revealed. When someone makes multiple transactions totaling more than \$10,000 he violates Title 31 of the United States Code by structuring payments or withdrawals to conceal total deposits. Structuring activity must be reported to the IRS in the form of a SAR from the financial institution. SARs also are filed when someone is creating multiple transactions that could indicate money laundering.

While Holtz Rubenstein Reminick's Business Fraud and Investigative Services Unit was not involved in this case, we certainly have the experience. We have assisted in the investigation of individuals who attempted to hide funds, as well as in the defense of allegations stemming from government financial investigations. Our background permits us to provide forensic accounting analyses and to conduct computer and electronic discovery. Indeed, members of our forensic unit have conducted many federal, state, and local financial investigations.

For more information, contact Brian Brennan, manager of Business Fraud and Investigations who is himself a former IRS Criminal Investigation special agent, at (212) 697-6900, BBrennan@hrrllp.com.

In This Issue...

[Fraud in NFP Organizations](#)

[Adventures in E-Discovery](#)

[Are You Up-to-Date on the AICPA's New Valuation Standards?](#)

[Formula for Failure?](#)

From Marty...

When I walk down Broadway to my office and pass the NASDAQ I look up to make sure no one is jumping, with the wide swings and another crash of the tech stocks.

Market swings like this are the backdrop that appraisers have to consider in valuations. Recall the wisdom of the writers of Revenue Ruling 59-60 when they said "the fair market value of specific shares of stock will vary as general economic conditions change from 'normal' to 'boom' or 'depression.'" Bear Stearns' stock went from \$115 per share in 2007 to \$2 in 2008. Where is our economy going? What will give us a more accurate reading – the Federal Reserve Bulletin, the taxi driver, or the activity in Saks?

Now that it is spring and we wait for the trees to bloom in Central Park, my son (ex-chef and now a wine

(continued on page 3)

An independent member firm of



**HOLTZ
RUBENSTEIN
REMINICK**

CERTIFIED PUBLIC ACCOUNTANTS. BUSINESS ADVISERS.

Superior Thinking.
Unmatched Integrity.

LITIGATION & VALUATION ADVISER

Litigation, Fraud, and Valuation Services

With a large staff dedicated solely to litigation, fraud, and valuation consulting, our partners and managers have given expert witness testimony in hundreds of cases.

We deliver competent, credible service to businesses, municipalities, not-for-profits, and high net worth individuals. We are respected by both the plaintiff and defendant bar, and prosecutors at the state and federal levels.

Our Business Fraud and Investigative Services Group is staffed with career law enforcement professionals from federal, state, and local government, including the FBI, Office of Inspector General, and the Internal Revenue Service. Combined with a team of forensic accountants, certified fraud examiners, and CPAs, this makes us one of New York's premier fraud investigatory teams.

A partnership with Stroz Friedberg LLC gives us the capability to further assist our clients in digital forensics, e-discovery, and corporate investigations.

When we need intelligence gathered at a local, national, or global level, we engage firms like Corporate Risk International to assist our forensic accountants. Both Stroz Friedberg and Corporate Risk International are headed up by former FBI and law enforcement professionals.

Sample Our Services

FRAUD

- Financial fraud
- Civil and criminal tax fraud
- White-collar criminal defense
- Reconstruction of business records
- Municipal and public fraud

PERSONAL – EMPLOYMENT

- Wrongful death / injury
- Employment / discrimination
- Wrongful termination

BUSINESS VALUATIONS

- Shareholder dissolution
- Matrimonial dissolution
- Acquisitions
- Report review
- Estate and gift

ECONOMIC DAMAGES

- Breach of contract
- Lost profit
- Business interruption
- Construction claims
- Real estate claims

Contact Us...

For information on how we can help you build a better case:

PARTNER-IN-CHARGE:
Martin Randisi, CPA, ASA
212-697-6900
MRandisi@hrrllp.com

Joel Podgor, CPA, CFE
212-697-6900
Podgor@hrrllp.com

Philip Kanyuk, CPA, ASA
631-719-3456
PKanyuk@hrrllp.com

Giving Can Really Hurt:

The vast majority of Not-For-Profits (“NFP”) are wonderful organizations, staffed with wonderful folks, and doing wonderful things for people and communities. One might think that in an environment of such all-encompassing “goodness,” they would be immune to the problems of the world. Alas, they are not, and that can present a myriad of problems: financial loss, damage to reputation, impact on donations, intervention by authorities and regulators, and embarrassment for the often-prominent persons associated with the NFP.

It is estimated there are over a million NFPs in the United States alone. Having such a large presence unfortunately ensures they will have their share of the same issues faced by other organizations – public, private, and governmental.

Occupational fraud is defined as the use of one’s position to defraud an organization one works for or is affiliated with. The 38,000-member Association of Certified Fraud Examiners (“ACFE”) is the oldest, largest, and most-respected group in the world devoted to the detection, investigation and prevention of occupational fraud. In its most recent Report To The Nation (2006, and available free on-line), ACFE estimates that occupational fraud in the United States costs the average organization 5% of revenue each year, or a total of \$638 billion. To put that figure in perspective, the value of all of Major League Baseball is estimated at \$4 billion, and the entire U.S. fast food industry is estimated at \$200 billion. Occupational fraud is big business!

Unfortunately, NFPs represent a sizeable share of these losses. To be precise, the 2006 report indicates that NFPs account for 13.9% of all occupational frauds, with a median loss of about \$100,000. Interestingly, these figures have remained fairly constant since the first ACFE report was published in 1996. And the true number of such losses must be much higher, since the incidents cited in the report had to be a) discovered; b) investigated; and c) reported.

Given that fraud is a reality, even for NFPs, let’s examine the incidents in more detail. The findings may shock you, for this is a type of crime that is committed by an uncommon type of criminal:

“Typical” Age. Their age is most commonly 40-60; significant majorities have college degrees; they have been associated with or employed by the organization for 10-15 years; only 8% have any prior criminal record; and they divide almost evenly between men and women. They are successful, if not prominent, in their communities (otherwise they would not have been selected for involvement with the NFP). The better educated they are and the higher their salary and

Fraud in NFP Organizations

position, the larger the loss if they go bad. Someone at a manager level steals an amount four times as much as an employee, and an executive steals four times as much as a manager. Why? They have more authority; more access, more stature, and are subject to less supervision or review.

“Typical” Crime. The crime itself is also interesting. Per the report, the most frequent types of fraud found in NFPs are: corruption (kick-backs, conflicts of interest, etc.), billing schemes, expense abuse, check tampering, skimming, and theft of cash. But it doesn't stop there: inflating the number of persons served to increase governmental payments; using the tax-exempt status of the NFP for personal or business purchases; selling receipts for donations that do not exist or are over-stated; receiving something of value – such as the use of a hall for a wedding reception – and claiming the full value of the “donation.”

“Typical” Duration. The typical fraud lasts for 18 months before being discovered. It almost always grows in size over time and is most frequently discovered by a tip or by accident. Why do these frauds last so long? Usually, on the surface, fraud looks like many other things: carelessness, inattention due to time constraints, lack of training, laziness, or just “informal” ways of doing business. NFPs tend to bring together people of like backgrounds and, with frequent meetings and social events, can develop a social atmosphere in which “awkward” questions are difficult to ask. Also, persons associated with a NFP may be highly regarded in their field or profession, but have limited competence or time to deal with the financial operations of a sometimes-sizeable organization.

So pressing has this issue become in one kind of NFP – churches – that at least

three universities (Duquesne, Villanova, and Boston College) now offer Bachelor's or Masters' level courses in the management of church finances and personnel. Charles Zech, the director of Villanova's Center for the Study of Church Management, has reported that more than 60 Catholic dioceses that responded to a survey indicated they had experienced a fraud incident in the past five years, and six of them reported thefts in excess of \$500,000. Likewise, an Associated Press survey in 2007 reported more than 20 churches in 17 states dealing with embezzlement issues.

Given these sobering figures, what are the officers and directors of a NFP – and their professional advisers – to do? A few suggestions:

- Perform some level of due diligence on persons being placed in positions of authority, whether they are paid or volunteer. “This is the guy I mentioned, Charlie. Known him for eight years. Great guy, and he would like to get involved.” isn't much due diligence. Consider an application form.

- Pay attention to sound business practices, such as competitive bids on large expenditures, proper documentation of business operations, and dual signatures on checks above a certain amount.

- Segregate duties. Is the person who receives donations also the person who deposits them, writes checks to vendors, and reconciles the monthly bank statement? That is an awful lot of responsibility in one position.

- Perform a vulnerability assessment. This is best done by professionals with deep experience in financial controls and the

From Marty

(continued from page 1)

purveyor) has pointed out the new great openings on the Upper West Side. Just when we thought the only great new restaurant to come to the UWS was Telepan, some new restaurants have bloomed with well seasoned chefs. Daniel Boulud has opened Bar Boulud; try the pâté bar. At Eighty One by the Museum, executive Chef Ed Brown has some great private label golden ostetra. Perhaps the best find is Dovetail, where John Fraser from the French Laundry recently opened. He has over 25 sherries to choose from and some legendary wines such as a '95 Romanée-Conti (\$3,700 per bottle) and a '98 Lá Tache, a wonderful burgundy.

After dinner take a stroll and arouse your sweet tooth by picking up some fine baked temptations at the new Magnolia Bakery on 72nd Street.

Bon Appétit!

Martin P. Sanvidge

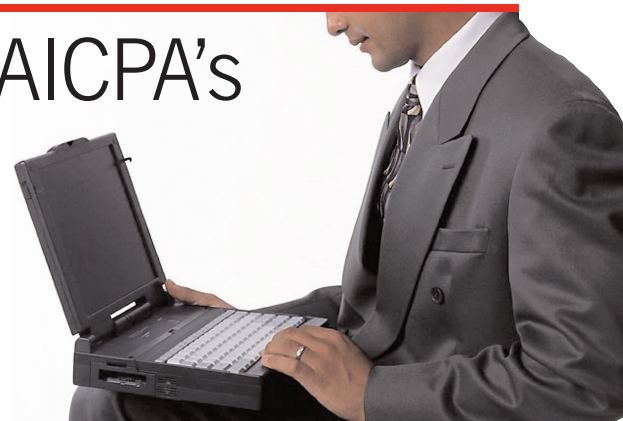
detection of fraud. A less effective measure is to engage in a form of peer review, by asking experienced members of another NFP to review the operations of yours and, perhaps, return the favor.

These are unpleasant things to think about in an environment of “goodness,” but prudence and experience indicate they may well be necessary. **h**

For more information, contact Brian Sanvidge, CFE, Director of Business Fraud and Investigations, at (212) 697-6900, BSanvidge@hrrllp.com.

The firm's newly-expanded Business Fraud and Investigations Unit, answers the concerns of clients about fraudulent activity related to the finances of a business.

Are You Up-to Date on the AICPA's New Valuation Standards?



Last summer, the American Institute of Certified Public Accountants (AICPA) finalized Statement on Standards for Valuation Services (SSVS) No. 1, which applies to CPAs who perform business valuations in engagements accepted on or after Jan. 1, 2008.

Become familiar with these and other standards so that you can evaluate your valuation experts' work product and ensure that it's not vulnerable to attack on cross-examination — or to find grounds for attacking the opposition's expert.

What engagement types are covered?

Generally, SSVS No. 1 applies to any engagement in which a CPA estimates business value or the value of a business interest, a security or an intangible asset. But the statement doesn't apply when:

- A client or a third party provides the subject interest's value and the CPA doesn't apply valuation approaches and methods or report on the subject interest's value,
- The CPA estimates value as part of an audit, review or compilation engagement,
- The valuation is an internal-use assignment from an employer to a CPA-employee who doesn't practice public accounting,
- The engagement is exclusively for the purpose of determining lost profits or other economic damages — as opposed to determining lost value,
- The engagement involves mechanical computations that do not

rise to the level of a valuation (in other words, the CPA doesn't apply valuation approaches and methods and use professional judgment),

- The CPA can't practically and reasonably obtain or use relevant information — thus, the CPA is unable to apply valuation approaches and methods, or
- The standards differ from published governmental, judicial or accounting authorities.

SSVS No. 1 contemplates two types of engagements: valuation engagements and calculation engagements. In a valuation engagement, the valuator is free to apply the valuation approaches and methods he or she deems appropriate under the circumstances.

In a calculation engagement, the valuator and client agree on the valuation approaches and methods the valuator will use and the extent of procedures he or she will perform.

What do the standards require?

SSVS No. 1 is similar to the standards other professional organizations have in place. They all provide best practice guidelines for analyzing the subject interest, considering and applying appropriate valuation approaches and methods, and preparing and maintaining appropriate documentation.

In a valuation engagement, for example, SSVS No. 1 provides that the extent of the information needed to perform the analysis depends, at a minimum, on: the subject interest's

nature; the valuation engagement's scope; the valuation date; the valuation's intended use; the applicable standard and premise of value; any assumptions and limiting conditions; and any applicable governmental regulations or other professional standards.

SSVS No. 1 also notes that, while a rule of thumb is not an appropriate valuation method, it may be used as a reasonableness check against other methods.

What are the reporting requirements?

According to SSVS No. 1, reports may be written or oral. For a valuation engagement, the valuator may provide a detailed report or a summary report. For a calculation engagement, a calculation report is required. SSVS No. 1 lists a variety of required disclosures, depending on the type of report.

Valuations performed for a matter before a court, arbitrator, mediator or other facilitator, or a matter in a governmental or administrative proceeding, are exempt from SSVS No. 1's reporting provisions (a jurisdictional exception).

Raise your standards

Regardless of which standards apply to your valuation experts, you need to become familiar with them to ensure that your expert's methods and conclusions meet the requirements. You also may be able to use them to impeach the testimony of an opposing party's witness. **h**



Adventures in E-Discovery

New Rules, New Strategies

ESI they may use to support their claims or defenses. Disclosure means providing a copy of the information or describing its category and location.

The impact

Practically speaking, the recent rules require attorneys to become intimately familiar with clients' electronic data "architecture" as well as clients' policies and procedures for storing, archiving and destroying ESI.

The advent of computers has radically altered the business paradigm. Today's companies couldn't function without e-mail and other electronically stored information ("ESI"). To keep pace with the electronic transformation of business operations, recent e-discovery amendments to the Federal Rules of Civil Procedure (FRCP) are having a profound impact on discovery practices involving ESI.

The new rules impose additional responsibilities on counsel to oversee clients' document management and discovery activities. They also make it even more important to get experts involved early to help ensure that ESI is received in a usable format.

Highlights of the new rules

Rule 16. The amended rules emphasize the importance of addressing e-discovery issues early. Thus, Rule 16 now provides that a scheduling order may include "provisions for disclosure or discovery of ESI" and any agreements the parties reach on handling privileged materials or work product that attorneys inadvertently produce.

Rule 26. Parties must confer early in the litigation process to address e-discovery issues. These include how the discoverable information will be preserved, the form the ESI should take and any potential privilege claims.

The rule also requires parties not to wait for a discovery request to disclose

But a party doesn't need to produce the ESI — at least not right away — if the information isn't reasonably accessible. For example, obtaining "legacy" data or disaster-recovery backup tapes may impose an undue burden or expense.

In the event of a motion to compel, the respondent must show that the information isn't reasonably accessible. The court may still compel production for good cause, but it has some flexibility to place conditions and limits on the discovery.

Rule 26 also establishes procedures for dealing with inadvertent disclosure of allegedly privileged ESI.

Rule 33. A party may produce ESI in response to interrogatories provided the burden of doing so "is substantially the same for the party serving the interrogatory as for the party served."

Rule 34. This rule allows the requesting party to specify the ESI format it prefers. The rule also establishes procedures for resolving disputes over the form of ESI production. If no format is specified, the respondent can produce ESI in the form in which it's ordinarily maintained or in some other form that's "reasonably usable."

Rule 37. The amendments establish a safe harbor to protect parties against sanctions for failing to provide ESI "lost as a result of the routine, good-faith operation of an electronic information system."

Rule 37's safe harbor recognizes that ESI may be deleted through routine operation of a company's backup and document retention procedures. But the concept of "good faith" means this protection may be lost if a client allows ESI to be destroyed despite a duty to preserve information for pending or reasonably anticipated litigation.

If litigation is imminent, attorneys should work closely with clients to design and implement a "litigation hold" to preserve ESI that's likely to be discoverable and not available from other reasonably accessible sources. But determining the scope of a client's duty to preserve ESI can be a challenge. For instance, in a controversial ruling in *Columbia Pictures v. Bunnell*, the U.S. District Court for the Central District of California found that information in a server's random access memory (RAM) was ESI and ordered the defendant to start logging certain RAM content and producing the logs, rejecting the defendant's objection that this was tantamount to creating new documents solely for purposes of production.

The expert's role

Forensic experts can help attorneys understand and manage clients' e-discovery obligations. For the best results, it's helpful to involve financial or valuation experts early in the discovery process.

(continued on page 6)

Formula for Failure?

Valuation formulas (or rules of thumb) are simple and cheap, but like most things in life, you get what you pay for. A formula can provide a handy “cocktail-napkin” guesstimate of a business’s value, but relying on it to set the price in a buy-sell agreement is dangerous and can be in violation of the appraiser’s professional standards.

Book value, for example, usually underestimates value because 1) it doesn’t reflect the current fair market value of assets, and 2) it fails to consider earnings or goodwill. Many buy-sell agreements use formulas based on a multiple of earnings or cash flow, but these formulas are risky as well. That’s because multiples derived from industry averages may not accurately reflect the characteristics of the business being valued.

Consider this hypothetical: Dental Practice A and Dental Practice B each had \$1.5 million in sales in 2007. Under a common industry rule of thumb, the value of each dental practice is 70% of annual sales, or \$1,050,000.

But Dental Practice A is in a brand-new building in an upscale neighborhood. It has state of the art equipment, with digital imagery and on-site CAD manufacturing. It also will retain a talented employee that will provide for the smooth transition of the patient base. Further, their sales have been climbing steadily and are expected to reach \$1.8 million by 2009.

Dental Practice B is in an older, worn-out building in an economically disadvantaged neighborhood. The equipment is

also aged and nearly obsolete and no service-providing employees will remain with the practice after it is sold. Their sales have been declining for several years, and this trend is expected to continue.

Clearly, a knowledgeable buyer would not be willing to pay the same price for the two dental practices. The rule of thumb values them equally, which errs because it looks only at the current year’s sales and fails to account for other qualitative and quantitative factors that have a significant impact on value.

Another formula pricing disadvantage – even if it produces a reasonable valuation when the buy-sell agreement is signed, it won’t adapt to changing circumstances. Over time, fluctuations in the national and local economies, the industry and the company itself are likely to render the formula obsolete.

Rules of thumb are based on actual transactions. With advanced resources of today, the appraiser has the ability to research actual company sales transactions and more closely match the business being sold to actual transactions. **h**

For these reasons, an appraisal process performed by a qualified appraiser is the only effective way to ensure a fair buyout price. For more information, contact Partner Philip Kanyuk at (631) 719-3456, PKanyuk@hrrllp.com.



Adventures in E-Discovery *(continued from page 5)*

Experts typically need to review and analyze large amounts of data, and they can help draft discovery requests designed to obtain ESI in a usable, cost-effective format. Once the data is received in a particular format (hard copy, for example), it may be too late to request an alternative format, such as an Excel file.

In addition, confer with your experts about their own ESI. Can they overwrite electronic drafts of reports? Are electronic drafts discoverable? Does an expert have a duty to preserve them?

In *University of Pittsburgh v. Townsend*, the U.S. District Court for the Eastern District of Tennessee found that experts had no affirmative duty to preserve or disclose electronic draft reports. But if they received deposition subpoenas that clearly requested drafts, they were obligated to retain and produce them. The parties were not subject to sanctions, however, for draft reports destroyed before the subpoenas.

Be prepared

The recent e-discovery amendments to the FRCP help clarify that identifying ESI early in the case is key in preparing for e-discovery. It’s also important to determine the burden and expense of collecting and producing the ESI and to request it in a usable format.

There are still many unanswered questions about the parameters of e-discovery. The answers will come over time as courts grapple with these rapidly evolving legal and technical issues. **h**

Interesting & Helpful Statistics

Treasury yields¹

30 day: 2.27% | 5 year: 2.78% | 20 year: 4.49%

Prime lending rate²

52 Week High: 8.25% | 52 Week Low: 6.00%

Dow Jones 20 year bond yield⁴

5.33%

4th Quarter 2007 Returns by Sector³

Large-Cap Core: -3.06% Small-Cap Core: -5.69%

Mid-Cap Core: -3.63% Real Estate: -12.12%

International Large-Cap Core: -1.56%

Barron's intermediate grade bonds⁴

7.61%

High yield estimate⁴

Mean: 14.65% | Median: 14.15%

IBBOTSON: Total rate of return for years 1926–2006⁹

Small Cap: 12.7% | Large Cap: 10.4%

Average vacancy rates NYC⁸

Hotels: 11.0% this year | Office space: 14.9%

Dow Jones Industrials P/E Ratios²

On current earnings: 50.36

On 2007 earnings: 16.77

On 2008 earnings estimate: 12.62

S&P 500 Index P/E Ratios²

On trailing 12-month earnings: 19.05

On 2007 earnings: 16.63

U.S. Equity Indexes – YTD Returns⁵

S&P 500: 4.40%

NASDAQ Composite: 10.20%

Dow Jones Industrials: 7.30%

NYSE Composite: 7.90%

Dow Jones Transports: 2.20%

Wilshire 5000: 4.70%

Dow Jones Utilities: 16.50%

Long-term inflation estimate⁶

2.5%

Unemployment

US: 4.9%⁷ | NYC: 5.4%⁸

Top 5 Long Island Public Golf Courses¹⁰

1. Bethpage Black
2. Montauk Downs
3. Bethpage Red
4. Eisenhower Red
5. Tallgrass

1/Source: Federal Reserve Statistical Release; www.federalreserve.gov; February 2008 average

2/Source: Wall Street Journal Online, www.wsjonline.com, as of March 3, 2008 and March 17, 2008

3/Source: Barron's Online, January 8, 2008

4/Source: BV Resources.com; Business Valuation Update, Vol. 14, No. 3, March 2008

5/Source: The CPA Journal, January 2008; data as of November 30, 2007

6/Source: 10 year forecast; Federal Reserve Bank of Philadelphia, Livingston Survey, December 10, 2007

7/Source: United States Department of Labor; Statistics as of January 2008

8/Source: New York City Economic Development Corporation, A Summary of New York City's Economy; February 2008; rate as of December 2007

9/Source: Ibbotson, S&B Valuation Edition, 2007 Yearbook; Total returns for 1926–2006, Table 2-1, Geometric Mean

10/Source: www.ExploreLI.com



CERTIFIED PUBLIC ACCOUNTANTS. BUSINESS ADVISERS.

Superior Thinking.
Unmatched Integrity.

Holtz Rubenstein Reminick LLP • www.hrrllp.com

1430 Broadway
New York, NY 10018
212-697-6900

125 Baylis Road
Melville, NY 11747
631-719-3456

To change contact
information, please contact
MRandisi@hrrllp.com

This publication is intended to provide accurate and authoritative information on the subject matters covered. The articles do not render an opinion by Holtz Rubenstein Reminick LLP, its partners, or employees on any technical matter, but rather are of an educational nature. They should not be used in any litigated matter in which a representative of the firm acts as an expert witness. ARTICLES ARE NOT INTENDED OR WRITTEN TO BE USED, AND THEY CANNOT BE USED, BY ANY TAXPAYER FOR THE PURPOSE OF AVOIDING PENALTIES THAT MAY BE IMPOSED ON THE TAXPAYER.

©2008 Holtz Rubenstein Reminick LLP.

LITIGATION AND VALUATION
ADVISER

Holtz Rubenstein Reminick LLP
125 Baylis Road
Melville, NY 11747



HELPING
YOU BUILD
A BETTER CASE

This is what our Litigation & Valuation Consulting Group is all about.

With over 2,500 matters and hundreds of court appointments and appearances, we are one of the largest and most experienced forensic accounting groups in the New York metropolitan area.

Business Valuation
Economic Damages
Fraud & White Collar Crime
Personal Injury – Employment

SUPERIOR
THINKING.

UNMATCHED
INTEGRITY.

For more information, contact:
Martin P. Randisi, CPA, ASA
(631) 719-3456
MRandisi@hrrllp.com

Holtz Rubenstein Reminick LLP
125 Baylis Road, Melville, NY 11747
1430 Broadway, New York, NY 10018
www.hrrllp.com

 **HOLTZ
RUBENSTEIN
REMINICK**

CERTIFIED PUBLIC ACCOUNTANTS. BUSINESS ADVISERS.