

The Role of the Accountant as Expert

By Mark G. Filler, CPA/ABV, CBA, AM, CVA

In the last decade the need for the certified public accountant (CPA) to act as an expert witness and consultant to litigating attorneys has grown even more than litigation itself. Ten years ago, few CPAs offered litigation-related services; now, a large number devote much of their practice to this area.

Why a CPA? Lawyers use CPAs in litigation for the same reasons that businesses retain CPAs as advisors. Lawyers need quality advice when litigating, and CPAs offer this service because they give advice in the real world to real companies with real problems. Juries seem to understand and respect this practical experience. Because accounting is the language of business, accountants can often clarify business transactions and explain the records reflecting them to lawyers, judges, and the jury. Because CPAs generally have quantitative skills, they often undertake and perform the quantitative analyses necessary to develop the technical evidence required in complex commercial cases.

CPAs often compute the plaintiff's monetary loss resulting from the defendant's legal wrong. In addition, CPAs sometimes address the business issues in a case. CPAs with suitable experience often consult or testify on issues involving marketing, economics, and industry practices.

A typical role that a CPA plays is as an expert witness. The CPA's expert opinion usually relates to business issues with which the CPA is familiar because of special education, training, or work experience. The opinion of the CPA expert will assist the trier of fact, who does not possess this knowledge or expertise, in reaching a decision.

Once the CPA is identified to the opposing party, all work the CPA performs related to the litigation potentially is discoverable. The CPA should conduct the engagement from the outset assuming that the opposing party will discover all of the CPA's work.

Another role is that of consultant. The attorney hires the CPA as consultant strictly to advise about the facts, issues, and strategy of the case. The consultant does not testify at trial nor render an expert opinion. The work of the CPA generally will be protected from discovery by the attorney work-product privilege.

The work of a consultant will often include analyzing the opposing expert's work and providing arguments on how best to discredit the other expert's work. The work may also include investigations into the strengths and weaknesses of the consultant's client's case and how best to represent these facts at trial.

Services that CPAs perform in litigation are discussed below.

Discovery Assistance

Business litigation often depends on documents to prove or disprove an issue at trial. Business records of a financial nature are crucial to a number of issues in most cases. CPAs can assist in finding, understanding and explaining the information from these documents.

The knowledge of the types of documents that normally exist in managing a business is important so that lawyers can formulate precise requests for documents. This knowledge also helps the lawyer to assess the responsiveness of particular productions and to understand what other documents might exist.

Depositions of financial and management people often relate to technical business issues. Attorneys need help in understanding the real issues and in formulating effective questions. Because technical people will often answer questions in jargon and in terms of art, the attorney may need assistance in understanding the answers and developing follow-up questions. CPAs can assist in this area.

Information about the opposing experts is essential for effective cross-examination and rebuttal of the opposing expert's opinion. When the expertise involves business, CPAs can assist lawyers in analyzing the expert's work and the strengths and the weaknesses of its support.

Proof of Business Facts

Evidence to support a position taken at trial must be based on facts. In commercial litigation, these facts generally must come from the business records of the companies involved. In addition, information may also come from industry and market sources. CPAs are familiar with these sources of information and can assist lawyers in obtaining, authenticating, organizing, and explaining this information.

Experts can base opinion testimony on either facts or assumptions. Assumptions are usually based on facts or presumptions from facts. In either case, the expert must lay a proper foundation as to the source of the information. CPAs can help to develop these facts by collecting the relevant business or industry data to support various experts' opinions.

Computation of Damages

CPAs often calculate damages in commercial litigation.

There are a number of types of damages - such as actual losses and expected, but lost, profits - and methods to compute them. The type of damages to be computed is a fact question; but the law may restrict or limit recovery of certain types of damages. In addition, the causes of action in the pleadings may limit the type of recovery permitted.

The CPA should communicate with the attorney so that both understand the type of damages the CPA attempts to calculate and the method the CPA uses to make the computation. Otherwise, a calculation of damages may be inadmissible for some factual or legal reason.

One type of damage recovery is the actual losses incurred. This form of restitution applies in fraud cases. A common method used to calculate actual losses is the out-of-pocket measure of damages computed as the difference between what the plaintiff paid for something and the actual value received.

Another common type of recovery is the expected profits from a proposed contract or deal. This is often called the "benefit-of-the-bargain" approach of computing damages in contract disputes. Plaintiffs often claim lost profits in business litigation. These can be measured by the amount the plaintiff's actual earnings fall short of the earnings that would have occurred "but for" the illegal actions of the defendant. This can be computed as the difference between "but for" profits and actual profits.

Most damage analysis requires the use of assumptions and projections about what would have happened if certain behavior of the defendant had been different.

Development of Strategy

CPA litigation consultants can suggest approaches to the business issues in the case. The best trial lawyers do not necessarily have the business experience and insights that CPAs have learned from their business consulting.

The lawyer needs independent analysis of the positions he believes he must prove in order to win the case. The CPA can help the lawyer spot errors and devise different approaches, perhaps using different facts. Although the CPA hired as a consultant is an advocate, he should remain objective and independent. These qualities are most useful to his client.

GAAP/GAAS Rules and Compliance

Only CPAs are qualified to render opinions as to generally accepted accounting principles (GAAP) and generally accepted auditing standards (GAAS). Such issues arise when a party questions the accuracy of financial statements.

GAAP and GAAS come up when a plaintiff sues an accounting firm for violating these standards, alleging harm because it relied on the accuracy of the financial statements.

GAAP issues also arise when litigation relates to the purchase or sale of a business and one party questions the accuracy of the prior financial statements. GAAP issues may also arise in any damages computations that rely on financial statements.

CPAs are experts on accounting matters and may, depending on training and experience, be expert in the application of economic, financial, statistical, or econometric techniques. A CPA may, based on work in that industry, be expert on the practices of a particular industry.

Skills commonly required of CPAs and exhibited in performance of the service outlined above are discussed in the following paragraphs.

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| Auditing | Litigation services engagements frequently use the investigative skills required by the audit function. Examples include investigation of fraudulent transactions, reconstruction of financial statements, and development of cash-flow statements. |
| Financial Analysis | <p>Development and analysis of financial ratios often aid in understanding the causes of business problems a litigant experiences. Ratio analysis may also be modified to derive the assumptions, as to what would have happened but for the alleged legal violation.</p> <p>CPAs in litigation often carry out present value analyses, capital market theory applications, and business valuations.</p> |
| Economic Analysis | CPAs trained in economics may perform both macro- and microeconomic analyses in a litigation services engagement. |
| Marketing Analysis | Much marketing analysis is based on the collection of quantitative data. CPAs can help collect and assess the required data. Examples might include the number of competitors, in a particular market or computation of the market share of each participant based on sales. |

Statistics

Some CPAs are familiar with statistical techniques--sampling and regression analysis--as a result of their auditing and consulting backgrounds. Litigation services engagements can require these same tools. Sampling is done when analysis of an entire population is too time consuming or expensive for the case. Regression analysis helps to project sales, establish cost relationships, or analyze other co-related factors.

Cost Accounting

The calculation of damages sometimes requires cost accounting skills. Cases where the plaintiff is a multi-line product manufacturer or service provider require allocating common costs to each product line affected by the defendant's actions.

This article provides an overview of the litigation process and terminology the CPA faces when acting as an expert witness or consultant in a litigation. The rules and procedures both of the CPA's profession and of the legal process govern the work and approach the CPA follows. Preparing a complex commercial litigation for trial requires accomplishing many tasks. The CPA can bring training and expertise to an adversarial proceeding where his or her conclusions will be challenged closely.

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