

# PART ONE

## **Dispute Resolution and the Financial Expert**

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# 1

## CHAPTER ONE

# Value of the Financial Expert in Litigation and Dispute Resolution

## WHY BE A FINANCIAL EXPERT WITNESS?

Before reading any further in this book, you must be able to answer this question: Why do I want to be a financial expert witness? For those of you who do not aspire to be a testifying expert witness, this is still the ultimate question as you will likely be supporting someone who will be serving as a financial expert witness. Serving as a financial expert witness, or as a consultant assisting one, is a stressful, challenging, and tough business.

The financial expert witness will be in the public eye, with his or her personal and professional life exposed for the world to see. Personal opinions will be used to assist a trier of fact to decide important disputes. In some cases, those decisions impact the survival of an enterprise, future rights, or the livelihood of others. Let's not forget grueling deadlines, incomplete data sets, and irrational adversarial disputing parties.

The quality of the financial expert witness's work product is paramount, as it will be critiqued by opposing experts and attorneys who will be dedicated to finding ways to exclude your opinions. If successful, it could adversely impact the financial expert's ability to get engaged as an expert witness in the future, depending on the reasons the testimony was deemed inadmissible. The cherry

on top—the financial expert witness is often the last witness to testify at the end of an arduous trial.

But, for the financial expert witness such great responsibilities come with great rewards. Serving as an expert witness is an important role in our society. Expert witnesses are specifically provided for by federal civil litigation rules. Expert witnesses provide necessary assistance to triers of fact to allow them to make well-informed determinations outside their own personal expertise and experience. That is critical for the disputing parties to have a fair trial.

Serving as a financial expert witness also recognizes personal professional expertise. Being qualified as an expert by the court is official recognition of your professional skills, knowledge, education, experience, and training in your field. It is an affirmation that you possess superior expertise compared to the average citizen in your chosen profession. This may enhance your ability to be retained in the future and is a justification to charge premium rates for financial expert witness services.

## VALUE OF THE FINANCIAL EXPERT WITNESS UNDER FEDERAL RULES

Fortunately for all expert witnesses, including financial expert witnesses, the Federal Rules of Evidence (FRE) and Federal Rules of Civil Procedure (FRCP) describe the value of an expert witness in a federal case.<sup>1</sup> The FRE and FRCP are the official guidance for civil litigation proceedings adopted by the federal courts and numerous state jurisdictions. Among other matters, the federal rules govern expert witness testimony and admissibility. The financial expert witness should be familiar with the FRE and FRCP when performing dispute resolution services in a federal setting.

Under the FRE, Rule 702, Testimony by Expert Witnesses, a qualified expert must have “scientific, technical, or other specialized knowledge” obtained “by knowledge, skill, experience, training, or education” that will “help the trier of fact to understand the evidence or to determine a fact in issue.” Based on this rule, the federal courts are instructed to value the qualifications of financial expert witnesses because they possess technical and specialized knowledge that may be helpful to the trier of fact when making decisions about disputed issues. For financial expert witnesses, that means undergraduate and advanced degrees in accounting, finance, economics, and other areas have value. In addition, professional credentials, like Certified Public Accountant or Chartered

Financial Analyst, are valuable, together with the continuing education these designations typically require. Last, but certainly not least, the courts recognize the value of financial expert witnesses' experience serving clients, the profession, and the community.

### Examples of Valued Financial Expert Credentials

- Advanced education degrees
- American Academy of Financial Management:
  - Chartered Wealth Manager (CWM)
  - Chartered Asset Manager (CAM)
  - Chartered Trust and Estate Planner (CTEP)
  - Chartered Portfolio Manager (CPM)
- American Institute of Certified Public Accountants:
  - Certified Public Accountant (CPA)
  - Certified in Financial Forensics (CFF)
  - Accredited in Business Valuation (ABV)
- American Society of Appraisers:
  - Accredited Senior Appraiser (ASA)
- Appraisal Institute:
  - Member Appraisal Institute (MAI)
- Association of Anti-Money-Laundering Specialists:
  - Certified Anti-Money-Laundering Specialist (CAMS)
- Association of Certified Fraud Examiners:
  - Certified Fraud Examiner (CFE)
- Association of Insolvency and Restructuring Advisors:
  - Certified Insolvency and Restructuring Advisor (CIRA)
- Certified Financial Planner Board of Standards:
  - Certified Financial Planner (CFP)
- Chartered Financial Analysts Institute:
  - Chartered Financial Analyst (CFA)
- Institute of Internal Auditors:
  - Certified Internal Auditor (CIA)
- Institute of Management Accountants:
  - Certified Management Accountant (CMA)
- Information Systems Audit and Control Association:
  - Certified Information Systems Auditor (CISA)
- National Association of Certified Valuators and Analysts:
  - Accredited Valuation Analyst (AVA)
  - Certified Valuation Analyst (CVA)

The FRE, Rule 702, allows expert witnesses to testify in trial only if their testimony is “based on sufficient facts or data” and “is the product of reliable principles and methods” that the financial expert witness “has reliably applied . . . to the facts of the case.” As such, the federal courts value financial expert witnesses’ abilities to understand and identify relevant case evidence, especially accounting, financial, and economic facts and data commonly dealt with by the financial expert. Also valued are reliable and generally accepted principles and methods used by financial expert witnesses to analyze relevant financial facts and data. Industry standards, such as generally accepted accounting principles, and audit and valuation standards, are frequently accepted by the courts as reliable principles and methods for use in trial. Furthermore, courts have acknowledged that many of the procedures used by financial expert witnesses in the normal course of business are reliable methods that can be used to review and analyze relevant facts and data in a case. Procedures commonly used by financial expert witnesses include, but are not limited to, the following:

- Analytical tests
- Budgeting
- Compliance and control tests
- Comparative financial and ratio analysis
- Corroboration
- Data analytics
- Examinations
- Financial modeling
- Forecasting
- Inspection
- Interviews
- Inquiries
- Observations
- Projections
- Recalculations
- Reconciliations
- Regression analysis
- Reperformance
- Research
- Statistics
- Substantive tests

Turning now to the FRCP, it is clear that the federal courts also value the communication talents of financial expert witnesses. Under FRCP, Rule 26(b)

(4)(A), financial expert witnesses are required to produce “a written report—prepared and signed by the expert.” After submission of the written expert report, an opposing party “may depose any person who has been identified as an expert whose opinions may be presented at trial.”<sup>2</sup> During the trial, financial expert witnesses are required to orally testify about their opinions and the bases for them if called to do so. Obviously, financial expert witnesses with effective written and oral communication skills will be more valuable to the trier of fact and the client.

## Professional Standards and Value

As professionals, financial expert witnesses hold themselves to a higher standard of behavior and performance than an amateur or average layperson. In many cases, through professional affiliation and membership, financial expert witnesses are bound to adhere to professional standards governing acceptable behavior and service delivery. For example, the American Institute of Certified Public Accountants, the largest industry membership organization for CPAs, promulgates professional standards of conduct through a codification of professional standards. Adherence to professional standards governing professional services is valuable to clients and triers of fact because it evidences conformance to generally accepted industry requirements for the standard of professional due care, quality, ethics, integrity, and objectivity, among other matters.

The courts recognize the importance of professional standards toward meeting the FRE, Rule 702, requirements related to expert testimony. Triers of fact may also find such standards compelling when assessing the qualifications and reliability of financial expert witness testimony. Clients understand this value and often seek to engage financial experts whose work will be performed in compliance with professional standards. For these reasons, the adherence to professional standards adds value to the work of financial expert witnesses.

## Value Perceptions and the Financial Expert Witness

The perceived value of financial expert witnesses’ technical, specialty, and communication skills was validated in a study entitled the *Characteristics and Skills of the Forensic Accountant* sponsored by the American Institute of Certified Public Accountants (AICPA).<sup>3</sup> Although this study was designed to solicit feedback related to CPAs serving as financial expert witnesses, it is instructive to others. In this study prepared by two professors at California State University and the Managing Partner of Ueltzen & Company, LLP, a public accounting firm, forensic accountants’<sup>4</sup> areas of specialty, traits, characteristics, and skills were assessed by three constituencies: (1) attorneys, (2) academics, and

(3) Certified Public Accountants (CPAs). A summary of the AICPA study can be found in Exhibit 1.1.

Related to areas of specialty, attorneys ranked “financial statement misrepresentations” as the number one specialty, followed by “economic damages calculations,” “fraud prevention, detection, and response,” and “valuation.” Academia ranked “fraud prevention, detection, and response” first, with “computer forensic analysis” second. “Economic damages calculations” and “valuation” were next in line. In line with academia, CPAs chose “fraud prevention, detection, and response,” “economic damages calculations,” and “valuation” as the top areas of specialty needed. CPAs selected “financial statement misrepresentations” as the fourth-ranked specialty. Using these results, it is clear that financial expert witnesses should pay attention to “financial statement misrepresentations,” “economic damages calculations,” “fraud prevention, detection, and response,” and “valuation” as areas of specialty driving the potential value of financial expert witnesses.

As for traits and characteristics, the AICPA Study reported that attorneys, academics, and CPAs all believed “analytical” was the number one trait and characteristic for a forensic accountant to have. Following this, attorneys responded the top traits to be “detail-oriented,” “ethical,” “responsive,” and “insightful.” Academics thought “ethical,” “skepticism,” “inquisitive,” and “persistent” were important beyond being “analytical.” CPAs placed “inquisitive,” detail-oriented,” “ethical,” and “persistent” after “analytical” in the rankings of traits and characteristics. Therefore, to create value, financial expert witnesses should at a minimum be analytical, ethical, and detail-oriented, traits and characteristics that attorneys, academics, and CPAs all agree are important.

The perception of core skills needed by the forensic accountant varied among attorneys, academics, and CPAs, except “critical/strategic thinker” and possessing “investigative ability,” which all constituents ranked in the top five. The number one skill attorneys want a forensic accountant to have is the ability to be an “effective oral communicator.” In addition, attorneys responded that they need the skills to “simplify the information” and “identify key issues” using “auditing skills.” Academia agrees that “auditing skills” are critical, but also thinks forensic accountants need to “synthesize results of discovery and analysis” and “think like the wrongdoer.” CPAs seemed a bit out of sync with attorneys and academics on this topic, selecting “effective written communication” and “investigative intuitiveness” as required core skills. Regardless, if financial expert witnesses are going to create value in the litigation and dispute resolution process, they must be critical/strategic thinkers with investigative



## Ranking of scores

Areas of specialty needed	Attorneys	Academics	CPAs
Financial statement misrepresentations?	1	1	4
Economic damages calculations	2	3	2
Fraud prevention, detection, and response	3	1	1
Valuation	4	4	3
Essential traits and characteristics	Attorneys	Academic	CPA
Analytical	1	1	1
Detail-oriented	2		3
Ethical	3	2	3
Responsive	4		
Insightful	5		
Inquisitive		4	2
Intuitive			5
Persistent		5	
Skeptical		3	4
Core skills	Attorneys	Academic	CPA
Effective oral communicator	1		3
Simplify the information	2		
Critical/strategic thinker	3	1	1
Identify key issues	4		
Auditing skills	5	2	
Investigative ability	5	3	4
Effective written communicator			2
Investigative intuitiveness			5
Synthesize results of discovery and analysis		4	
Think like the wrongdoer		5	
Enhanced skills	Attorneys	Academic	CPA
Analyze and interpret financial statements and information	1	3	1
Testifying	2		4
Knowledge of relevant professional standards	3	5	
Audit evidence	4		
Fraud detection	4	1	3
Asset tracing	5		
Electronic discovery		4	
General knowledge of rules of evidence and civil procedure		4	5
Interviewing skills		2	2

**EXHIBIT 1.1** AICPA Study

Source: Davis, Charles, Ramona Farrell, and Suzanne Ogilby. "Characteristics and Skills of the Forensic Accountant." AICPA FVS Section 2010, accessed January 3, 2014, [www.aicpa.org/InterestAreas/ForensicAndValuation/Resources/PractAidsGuidance/DownloadableDocuments/ForensicAccountingResearchWhitePaper.pdf](http://www.aicpa.org/InterestAreas/ForensicAndValuation/Resources/PractAidsGuidance/DownloadableDocuments/ForensicAccountingResearchWhitePaper.pdf).

abilities that can simplify information using effective communication, especially oral communication.

The AICPA Study also inquired about the enhanced skills necessary for the forensic accountant to possess. All constituents, attorneys, academics, and CPAs agreed that the forensic accountant must be able to “analyze and interpret financial statements and information” and assist with “fraud detection.” Attorneys also perceived the enhanced skills of “testifying,” “having knowledge of relevant professional standards,” the use of “audit evidence,” and “asset tracing” as important. Academics rated “testifying” and “audit evidence” lower than attorneys, leaning more toward “electronic discovery,” “general knowledge of rules of evidence and civil procedure,” and “interviewing skills” as critical for the forensic accountant. CPAs selected the same enhanced skills as attorneys and academics, but ranked them differently. CPAs ordered enhanced traits needed by the forensic accountant to be “analyze and interpret financial statements and information,” “interviewing skills,” “fraud detection,” “testifying,” and “general knowledge of rules of evidence and civil procedure.” In most cases, the enhanced skills needed from financial expert witnesses to provide value to the client and the trier of fact will align with the responses of CPAs in the AICPA Study.

## The Financial Expert as Teacher

One of the best ways to add value in your role as an expert witness is to approach and deliver oral and written testimony as if you were an effective teacher. Each of us can recall a special teacher in our lives, one who made learning interesting, engaging, and memorable. The financial expert witness often tries to capture the magic between a great teacher and his or her class when testifying to a judge or jury.

Of course, great teachers share some common traits that can be studied and replicated by the expert witness. Personally, I have observed that effective teachers are prepared, dynamic, empathetic, positive, and energetic people who truly enjoy what they do. They have a knack for storytelling and use analogies and demonstratives to reinforce key concepts and make them memorable. In addition, effective teachers are students themselves, constantly seeking new information and ways to teach.

An effective teacher (i.e., the expert witness) knows the subject matter to be taught, together with the teaching techniques best suited for student (i.e., judge or jury) learning. The great teacher is ready, willing, and able to explain difficult and complex matters in a clear, concise, and easy-to-understand way,

often using stories, examples, analogies, visual aids, and anecdotes to make matters approachable and understandable. They also never forget what it is like to be a student learner (i.e., *juror*) and use this empathy to craft relevant teaching techniques and methods.

Learning objectives (i.e., what the financial expert witness wants the judge or jury to learn and remember) are made clear by the teacher and reinforced throughout the learning experience. At times, it may be necessary for the teacher to provide the learner with: (1) context by describing past, present, and expected future states; (2) contrast by introducing differing theories, or (3) comparison by showing concepts from related fields.

Effective teachers display true enjoyment about what they do. By their human nature, great teachers are dynamic and enthusiastic people who ooze self-confidence. To student learners, this positive and energetic way can act as a magnet for attention and a catalyst for memories. Like effective teachers, financial expert witnesses also must be passionate about their profession and assignments and be able to confidently and appropriately show that passion through their testimony.

An effective teacher (and testifying financial expert witness) is also a talented speaker who can tell when others are not following along or understanding the material. Concerned about the quality of instruction, an effective teacher stimulates the audience using variations in pace, gestures, and other communication methods. This means finding a way to connect with each juror or the judge during testimony. This can be accomplished by using appropriate eye contact, displaying a relaxed and open body frame, and responding to noticeable lapses in attention with changes in vocal pace and tone. Perhaps this concept is best expressed by this quote from Benjamin Franklin:

Tell me and I forget, teach me and I may remember, involve me and I learn.

—Benjamin Franklin

## The Seven Cs of Financial Expert Value

It may be helpful to remember the keys to a financial expert's value in litigation and dispute resolution by using the seven Cs, which consist of (1) competence, (2) credibility, (3) compliance, (4) creativity, (5) care, (6) confidence, and (7) convincing. Each of these words has deep and far-reaching meanings beyond the obvious.

**Competence** refers to the qualifications of the financial expert witness to accept and faithfully, professionally, and successfully complete litigation and

### The Seven Cs of Value

1. Competence
2. Credibility
3. Compliance
4. Creativity
5. Care
6. Confidence
7. Convincing

dispute resolution assignments. Competence relates to the financial expert witness's skills, knowledge, education, experience, and training, together with the personal talent and necessary resources required to responsibly do the work in a professional manner.

**Credibility** is earned by the financial expert witness. It requires the financial expert witness to be unbiased, objective, and intellectually independent, in fact and appearance. In addition, credibility refers to the character traits of personal integrity and trustworthiness. Credibility is also dependent on competence and due care.

**Compliance** with laws, rules, policies, and professional standards is critical for the financial expert witness's testimony to be deemed admissible. Therefore, it is essential that the financial expert witness be knowledgeable about relevant civil laws, rules, and regulations, and professional standards applicable to the financial expert witness. This includes an awareness of statutory requirements related to allowable civil claim relief and damages, which can vary based on the type of dispute and be influenced by case precedence. It is also important to understand and comply with local rules for jurisdictional and courtroom processes and the individual preferences of each presiding judge.

**Creativity** recognizes that the financial expert witness has been engaged to do what the client cannot do himself or herself—provide out-of-the-box thinking on complex disputes. It requires sharing the financial expert witness's unique thought processes in the form of business advice, methods for effective communication (visual and oral), and solutions to issues and problems. Creativity can build value that sets the financial expert witness apart from others participating in litigation and dispute resolution.

**Care** is a direct reference to the exercise of due professional care by the financial expert witness. It includes a dedication to quality and accuracy. It also encompasses confidentiality. A well-known legal treatise defines professional due care as:

Every man who offers his services to another and is employed assumes the duty to exercise in the employment such skill as he possesses with reasonable care and diligence. In all these employments where peculiar skill is requisite, if one offers his services, he is understood as holding himself out to the public as possessing the degree of skill commonly possessed by others in the same employment, and if his pretensions are unfounded, he commits a species of fraud upon every man who employs him in reliance on his public profession. But no man, whether skilled or unskilled, undertakes that the task he assumes shall be performed successfully, and without fault or error; he undertakes for good faith and integrity, but not for infallibility, and he is liable to his employer for negligence, bad faith, or dishonesty, but not for losses consequent upon pure errors of judgment.<sup>5</sup>

**Confidence** is to have a strong, assured belief in yourself and the certainty of your opinions. The financial expert witness must be an advocate for his or her opinions—not an advocate for the client or the client's positions. Confidence is markedly different from arrogance. One way to reinforce the difference between the two is to remember the following saying:

Confidence is believing you have something to teach. Arrogance is believing you have nothing to learn.<sup>6</sup>

To be **convincing** is to master the art of persuasive communication. The financial expert witness must be able to get others to believe that his or her opinions are true, right, and reliable. Of course, the financial expert witness is most convincing when he or she has followed the other six of the seven Cs.

## ENHANCING VALUE USING THE LITIGATION PROCESS

Clearly there are many ways financial experts can add value to the litigation and dispute resolution process. However, there are inefficiencies built into the process that may adversely impact the effectiveness of the financial expert.

The American Institute of Public Accountants (AICPA)<sup>7</sup> established a task force to study these issues. The AICPA Study revealed five recommendations to “maximize both the effectiveness of financial experts and efficiency of their use in the civil pretrial process”:<sup>8</sup>

1. Judges should implement early and consistent active case management;
2. Clients and attorneys should involve experts early in the process;
3. Attorneys should target, focus, and streamline expert depositions and discovery;
4. Attorney’s *Daubert*-like challenges should be appropriately targeted and acted on promptly by the court; and
5. Attorneys and the court should develop a process for the collaboration and cooperation of opposing experts where appropriate.

## COMING UP

Chapter 2 addresses important matters related to the retention of the financial expert.

## NOTES

1. Federal Rules of Evidence, December 1, 2013, available at [www.uscourts.gov/uscourts/rules/rules\\_evidence.pdf](http://www.uscourts.gov/uscourts/rules/rules_evidence.pdf) and Federal Rules of Civil Procedure, December 1, 2013, available at [www.uscourts.gov/uscourts/rules/civil-procedure.pdf](http://www.uscourts.gov/uscourts/rules/civil-procedure.pdf).
2. FRCP, Rule 26(b)(4)(A), TITLE V, DISCLOSURES AND DISCOVERY, Discovery Scope and Limits, Trial Preparation; Experts, Deposition of an Expert Who May Testify.
3. AICPA, *Characteristics and Skills of the Forensic Accountant* (2010), available at [www.aicpa.org/interestareas/forensicandvaluation/resources/practaidsguidance/downloadabledocuments/forensicaccountingresearchwhitepaper.pdf](http://www.aicpa.org/interestareas/forensicandvaluation/resources/practaidsguidance/downloadabledocuments/forensicaccountingresearchwhitepaper.pdf).
4. As used in this study, a “forensic accountant” is defined similarly to a financial expert witness as used in this text.
5. D. Haggard, *Cooley on Torts*, 4th ed. (1932), 472.
6. “True arrogance is the belief that you have nothing left to learn, while true confidence is the belief that you can help others to learn as you continue learning yourself.” Michael Haberman, *Arrogant versus Confident*, quoting Alan Weiss, available at <http://omegahrsolutions.com/2012/05/arrogant-versus-confident.html>.

7. The AICPA is “the world’s largest association representing the accounting profession.” AICPA, *Another Voice: Financial Experts on Reducing Client Costs in Civil Litigation* (2013), available at [www.aicpa.org/interestareas/forensican dvaluation/newsandpublications/advocacy/downloadabledocuments/financial-experts-on-reducing-client-costs%20in-civil-litigation.pdf](http://www.aicpa.org/interestareas/forensican dvaluation/newsandpublications/advocacy/downloadabledocuments/financial-experts-on-reducing-client-costs%20in-civil-litigation.pdf).
8. *Ibid.*

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