

Attacking Financial Expert Testimony Part I

In litigation, experts must adhere to several rules of engagement. Often, financial experts hold other certifications in order to enhance their perceived subject matter expertise. For example, CPAs often become certified business appraisers, management accountants or divorce planners. Experts often overlook their professional reporting requirements in an effort to add credibility through credentialing. Credentialed members are subject to rules governing how engagements must be performed and reported upon.

Experts that do not know or have a good general understanding of the engagement and reporting requirements of his or her credentialing organization may be subject to effective cross-examination. This article explores the general engagement obligations of financial experts.

What are the obligations of financial experts in litigation engagements? Many financial organizations follow the general engagement requirements as set forth by the American Institute of Certified Public Accountants.

The Litigation Services and Applicable Professional Standards publication 03-1 by the AICPA outlines its expectations of professionals performing litigation services. Specifically, AICPA Publication identifies the following sections of the Code of Professional Conduct particularly applicable to members engaged in providing litigation services:

1. Rule 101, Independence (AICPA, Professional Standards, vol. 2, ET sec 101.01);
2. Rule 102, Integrity and Objectivity (AICPA, Professional Standards, vol. 2, ET sec. 102.01);
3. Rule 201, General Standards (AICPA, Professional Standards, vol. 2, ET sec. 201.01);
4. Rule 202, Compliance With Standards (AICPA, Professional Standards, vol. 2, ET sec. 202.01);
5. Rule 301, Confidential Client Information (AICPA, Professional Standards, vol. 2, ET sec. 301.01);
6. Rule 302, Contingent Fees (AICPA, Professional Standards, vol. 2, ET sec. 302.01); and,
7. Rule 501, Acts Discreditable (AICPA, Professional Standards, vol. 2, ET sec. 501.01).

Rule 101 states that CPAs should be independent in appearance and fact with respect to client attestation engagements such as an Audit. Auditors who testify about the financial well being of a company are generally considered fact witnesses. Independence however, is not required in litigation engagements. The AICPA considers litigation as a consulting service, not an attest engagement. Notwithstanding, a lack of independence can be and is frequently used to attack an expert's credibility and objectivity.

AICPA Code of Professional Conduct Rule 102-6 provides guidance on professional services involving client advocacy. Specifically, 102-6 "Requires (members to) maintain(ing) objectivity and integrity and prohibits subordination of judgment to others."¹ This is further discussed in the Litigation Services and Applicable Professional Standards publication 03-1 by the AICPA; "The expert does not serve as an advocate for the client's position and, therefore should not subordinate his or her judgment to the client."² "The expert's function is to assist the trier of fact in understanding complex or unfamiliar concepts after having applied reliable principles and methods to sufficient relevant data."³

Rule 201, General Standards, of the AICPA Code of Professional Conduct requires that engagements be conducted with "Due Professional Care" using "Sufficient Relevant Data." According to AICPA Publication 03-1, "Due care requires diligence and critical analysis of all work performed."⁴ Furthermore, the AICPA requires that the practitioner "Obtain relevant data that is sufficient to provide a reasonable basis for conclusions or recommendations for any professional services performed."⁵ "The practitioner should consider analyzing key assumptions to determine whether they are reasonable. In several recent cases, experts had their testimony excluded because their opinions were based on assumptions that were deemed not reasonable."⁶

¹ AICPA Code of Professional Conduct Rule 102-6, discussed in §102.7, Page 4444.

² Litigation Services and Applicable Professional Standards, American Institute of Certified Public Accountants, Inc., Rule 102, Integrity and Objectivity, Page 3, Paragraph 13.

³ Litigation Services and Applicable Professional Standards, American Institute of Certified Public Accountants, Inc., Rule 102, Integrity and Objectivity, Page 3, Paragraph 13.

⁴ Litigation Services and Applicable Professional Standards, American Institute of Certified Public Accountants, Inc., Rule 102, Integrity and Objectivity, Page 4, Paragraph 18.

⁵ AICPA Code of Professional Conduct, 2005 Rule 102, discussed in §201.06 D, Page 4561.

⁶ Litigation Services and Applicable Professional Standards, American Institute of Certified Public Accountants, Inc., Rule 102, Integrity and Objectivity, Page 5, Paragraph 24b.

When considering whether or not data is sufficient and relevant, accountants should consider whether by including or excluding the data a risk of material financial misstatement is likely. “The evidential matter obtained should be sufficient for the auditor to form conclusions concerning the validity of the individual assertions embodied in the components of financial statements.”⁷ If material facts are in dispute they should be identified as “Assumptions” within the body of the report.

Rule 301, Confidential Client Information may not be disclosed without the client’s consent. Although court orders trump the AICPA’s Code of Professional Conduct, prior experience and knowledge of clients and their trade secrets must be protected. Who qualifies as a client? “In determining conflicts and client interests, the litigant is generally deemed to be the client, although relationships with the attorneys for each party should be considered.”⁸

Rule 302, Contingent Fees prohibits expert witnesses from having a stake in the outcome of the case. Non testifying experts, however, are permitted a contingent fee relationship in litigation.

Rule 501-01, Acts Discreditable of the AICPA Code of Professional Conduct states that a, “Member shall not commit an act discreditable to the profession.”⁹ Rule 501-04 states that a member shall be considered to have committed an act discreditable to the profession when, by virtue of his or her negligence the member, “Signs, or permits or directs another to sign, a document containing materially false and misleading information.”¹⁰

Experts that do not know their engagement requirements subject themselves to a simple line of questioning. Consider the following excerpt:

Question (Q) by attorney in pre-trial deposition: “Sir, do you consider yourself a good expert?”

Answer (A) “Yes.”

(Q) “You are a CPA in good standing, is that correct?”

⁷ AICPA Professional Standards Volume 1, U.S. Auditing Standards, American Institute of Certified Public Accountants, Inc., 2002, discussed in §326.13, Page 447.

⁸ AICPA Statement on Standards for Consulting Services Rule 202, Compliance With Standards.

⁹ AICPA Code of Professional Conduct, 2005, Rule 501, discussed in §501.01, Page 4831.

¹⁰ AICPA Code of Professional Conduct, 2005 Rule 501, discussed in §501.04, Page 4832.

(A) "Yes."

(Q) "In this matter you have provided your findings in a written report which I will label as Exhibit A and show to you. Is that correct?"

(A) "Yes."

(Q) "And that report has been written to the best of your ability?"

(A) "Yes."

(Q) "Did you violate any ethical provisions of your profession in the preparation of your report?"

(A) "NO."

(Q) "Would you please tell me the general requirements of CPAs involved in litigation engagements?"

(A) "I am not sure I understand your question."

(Q) "Do you know whether or not the American Institute of CPAs has issued a set of requirements for CPAs to follow when performing a litigation engagement?"

(A) "Yes, I believe they have."

(Q) "Should CPAs follow the directives of the AICPA that pertain to litigation assignment?"

(A) "yes"

(Q) "Do you know what those requirements are?"

(A) "Not off the top of my head."

(Q) "Did you follow the AICPA's engagement requirements when you conducted your analysis in this matter?"

(A) "yes"

(Q) “Sir, would you please explain how you could have possibly complied with the AICPA’s litigation engagement requirements when you do not know what they are?”

(A) “I guess I should have reviewed those.”

(Q) “Sir, do you know whether or not you may have violated the AICPA Code of Professional Conduct when you performed your engagement?”

(Etcetera)

In the above example the financial expert would have served his client’s interest by being a better student of the rules for CPAs involved in litigation engagements. He has allowed his credibility to become an issue by simply not understanding the basic requirements of his profession. Surprisingly, many journeyman experts are often tripped by this simple line of questioning. Experts who do know the answers to these questions frequently have learned them after being subjected to such a line of questioning!

Why is this tactic harmful? Failing to understand the requirements may cause judges and juries to question the methodology used by the experts in the conduct of his engagements. Rehabilitation is not a straightforward proposition. If the requirements are not known by the expert, his counsel will not know them either. If the expert does not know the requirements to what extent can his findings be relied upon?

www.professional standards

Where are the professional rules listed? Professional rules can generally be found on the credentialing organization’s web site. If not, usually a simple Google search usually produces the requested text.

Future Issues

In future articles on the subject of attacking financial experts, we will review reporting and other requirements. These areas provide other opportunities for breaching an expert’s credibility.

Frank Wisehart CPA, ABV, CFE, CVA is President of Wisehart & Wisehart, Inc. a firm specializing in forensic accounting, fraud, business valuations, CPA due care, and expert testimony. Mr. Wisehart is a nationally recognized speaker on these topics and a MBA candidate at Cornell University.

www.wisohart-wisohart.com

(614) 791-2100