Show Me *the Money*

Which Financial Expert is Right for You?

By Henry J. Kahrs and Dan DeCarlo

It's all about the money…or most of the time anyway. From economic losses to contractual disputes to damage awards in a case, the majority of legal cases revolve around the financial implications. Which is why it's not surprising that the use of financial experts in litigation has steadily grown since 2000, as have challenges of expert testimony.

As every attorney knows, the damages assessment is about much more than a mathematical equation. Cases often require a range of financial analyses to arrive at a defensible position that will stand up to aggressive cross examination and judicial scrutiny. Recent case law and federal rule changes regarding financial experts could prove game changing for lawyers and the outcome of cases where some courts have found that "any step rendering the [expert's] analysis unreliable…renders the testimony inadmissible." Selecting the right financial expert to perform the needed analysis then becomes absolutely essential.

In 2012, *Daubert* challenges of financial expert testimony alone reached an all-time high of 192 challenges in one year, 86 of which were successful. In the grand scheme of things that may not sound like a lot, but pause and absorb what that means — *nearly 45 percent of official challenges of financial expert testimony were successful.* The trial courts are taking their role as gatekeeper very seriously, closely evaluating expert testimony for relevance and reasonableness to ensure that the court receives reliable and accurate financial and economic evidence and analysis.

So, among the alphabet soup of financial credentials, how do you honestly know which designation or expert is right? The range of financial disciplines are as varied as the practice areas in law, and the differences between financial experts can be just as vast. So how do you choose the *right* expert with the *right* background for your case?

The Financial Questions

The right expert depends on the financial questions that need to be answered. Some of the questions might include:

- What is the financial picture of the company?
- Are there macro or micro issues?
- Are we looking at global trends or minute details?
- Who is affected by the case?
- Who are the stakeholders?
- Are there others who have a vested interest in the outcome of the case?
- What is the regulatory environment and how does that impact the financial issues?
- What is the analysis or report needed?

All of these questions help define which type of financial expert is needed.

Who Are the Experts?

Whether hiring them or cross examining them, knowing the difference between the primary types of financial experts is crucial. Financial experts are not "Jacks and Jills of all trades." Each discipline has a niche where special-

ized training and skills are best suited. Further, some cases will necessitate hiring multiple experts.

There are five primary types of financial experts:

- Economists
- CPAs
- Statisticians
- Business Appraisers
- Forensic Accountants

Economists

An economist typically works with economic trends and issues. They focus on the global level, studying business cycles and business patterns to create forecasts. Economics classes and professors dissect the market from the top down, studying macroeconomics like gross domestic product, inflation and wages, and microeconomics such as price sensitivity, and supply and demand. In litigation, economists are most often seen in personal injury and employment law or cases involving stock issues, import/export and pricing — disputes affected by the overall market or economy. An economics background is useful for calculations involving wages, inflation and investment.

Economists generally are not trained in accounting. Therefore, they usually do not spend time digging through records, verifying financial assumptions or providing an in-depth financial statement analysis. They are good at looking at certain market-driven issues and the overall economic climate and fitting these into an analysis.

CPAs

The certified public account, or CPA, is the traditional numbers person. They typically gain certification through experience in either tax preparation or audits. CPAs are engaged in the financial accounting of a business and are versed in the day-to-day requirements under standard accounting principles. Audit partners are involved in the preparation of financial statements for larger companies and tax partners gain their expertise in the taxation of individuals, corporations and other entities. Unless they have carved out a niche, they probably do not have a lot of experience in damage analysis or testimony.

As experts, they are best suited to conflicts that have tax, audit or standard of care related issues or to ascertain errors in the books. They may also be the right expert when particular industry or company knowledge is vital to the case. The CPA is retrospective in their financial assessment, focusing on the records of the company and not economic trends.

Statisticians

Statisticians deal with large volumes of data to identify trends and relationships within the data. They calculate probability factors and perform other statistical analyses. Their expertise comes in handy when preparing long-range predictions or projecting data based on many variables. Like the economist, they are not typically trained in accounting. The statistician does not dig into the financial records or provide in-depth financial analysis.

Business Appraisers

Business appraisers, otherwise known as valuation experts, tend to have a background in finance. Their expertise involves projecting operations into the future and determining the value of a business based on a variety of factors, including projected cash flows, the assets of the business and how the business compares to the market. Their services are often requested in a shareholder dispute when there is a question as to the value of the company or investment and if the offer is fair. Although some are also accountants, many are not and they may not dig into the books and records of the business when determining value.

Forensic Accountants

The forensic accountant is the investigator. They take little or nothing at face value, and their focus is oriented to the analysis of source documents and getting behind the numbers to find out the real story. They examine everything:

- Revenue and sales documents
- Expense documents
- Profit and loss statements
- Inventory reports
- Cash flow
- Business plans, budgets, forecasts and cycles

- Business type
- History, changes and milestone events for the company
- Business environment and community factors
- Market conditions
- Extenuating circumstances that affect the company's business cycle

The forensic accountant looks at the business from every angle and from all perspectives, combining accounting principles with economics and statistics. They look at the contextual setting of the financial data and what other factors are — or could be — affecting the business. They talk to the people involved and look at the business cycle and market conditions, then generate independent models and assumptions about value based on the original source data.

When things seem amiss in the finances, the forensic account is in their element. They are often hired when there is a problem that requires a more detailed analysis of specific areas than what an audit will provide.

The forensic accountant has crossover skills within the financial realm. They examine issues at both the micro and macro levels, are both forward looking and retrospective. They are often involved in the analysis and calculation of economic damages, and examine cause and effect to determine the loss and economic impact on a company. They also are handy when there are allegations of fraud or other types of mismanagement and the accuracy of the financial statements may be questioned. While trained, and often certified, as accountants, forensic accountants do not usually handle tax and audit work.

Why the Right Expert Matters

Why does having the right expert matter? With the increasing use of financial experts, the courts have increased their scrutiny of expert reports and testimony. For nearly two decades, trial court judges have acted as gatekeepers in relation to expert witness testimony. The U.S. Supreme Court decisions in *Daubert v. Merrell Dow Pharmaceuticals Inc.* and *Kumho Tire Co. v. Carmichael* both addressed the admissibility of expert testimony, clarifying Federal Rule of Evidence Rule 702. These cases gave the lower courts additional factors to consider when evaluating the relevance and reliability of scientific and technical testimony, including financial expert testimony.

In more recent cases, the courts have issued what may be game changing opinions related to the use of financial experts, going beyond an examination of credibility and acceptability to focus on the reasonableness of the conclusions reached by the experts. For example, the California Supreme Court recently held that California trial courts must follow the same rigorous gatekeeping standards that the Federal Courts observe with regard to financial experts in particular.

The impact of these standards has been felt across the U.S. as challenges of expert testimony continue to increase. Here are some highlights from PriceWaterhouseCoopers' 2013 "Daubert Challenges to Financial Experts" report:

- 7,756 *Daubert* challenges of expert witnesses in federal and state courts over 12 years
- 18 percent were challenges of financial expert witness testimony
- Nearly 45 percent of financial experts challenged in part or in whole in 2012 were successful

The data further showed that financial expert opinions were most often excluded on the basis of relevance and reliability, where the misapplication of generally accepted methodologies was the primary reason cited. Interestingly enough, economists and accountants were the most frequently challenged financial expert witnesses, and in 2012, appraisers were the most likely to survive a challenge while economists were the least likely to survive.

Not only are courts questioning financial expert methodology, but they're also focused on making sure the court is receiving sound financial and economic evidence and analyses. As a result, attorneys and their experts must be more stringent with preparation, identifying and addressing problems within damage testimony that may be potential grounds for challenge or exclusion.

With the courts taking a serious stance as gatekeeper, financial experts are going to be faced with the need to exercise reasonable due diligence and skepticism to ensure the reliability of the inputs underlying their calculations.

In selecting a financial expert, or cross examining one, knowing the difference between the types of experts gives you powerful information for your case.

Having the right expert really can make or break your case. LM

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