

The CPA as Financial Expert: Accounting & Practice Issues

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SEMINAR OBJECTIVES

A discussion of:

- 1) Professional Standards applicable to CPAs working in the Litigation environment
- 2) The dynamics of the litigation environment
- 3) Practical Considerations for CPAs when working in the Litigation Support Role.

WHEN ARE CPA EXPERTS NEEDED?

- **Litigation**

- IRS Related Matters

- Peer Review

Practice Considerations

- Tips on responding to a subpoena for the production of records and/or Testimony:

Best Practices:

- Consult your own Legal Counsel right away
- If you are going to testify at a deposition make sure that you are represented by your own Counsel at the deposition

Confidentiality (Also See AICPA Rule 301)

- **The 2007 Florida Statutes** **Title XXXII** REGULATION OF PROFESSIONS AND OCCUPATIONS
 - **Chapter 473** PUBLIC ACCOUNTANCY **473.316** **Communications between the accountant and client privileged.**–
- (1) For purposes of this section:
- (a) An "accountant" is a certified public accountant.
 - (b) A "client" is any person, public officer, corporation, association, or other organization or entity, either public or private, who consults an accountant with the purpose of obtaining accounting services.
 - (c) A communication between an accountant and her or his client is "confidential" if it is not intended to be disclosed to third persons other than:
 - 1. Those to whom disclosure is in furtherance of the rendition of accounting services to the client.
 - 2. Those reasonably necessary for the transmission of the communication.
 - (d) A "quality review" is a study, appraisal, or review of one or more aspects of the professional work of a licensee in the practice of public accountancy which is conducted by a professional organization for the purpose of evaluating quality assurance required by professional standards, including a quality assurance or peer review.
 - (e) A "review committee" is any person or persons who are not owners or employees of a licensee that is the subject of a quality review and who carry out, administer, or oversee a quality review.
- (2) A client has a privilege to refuse to disclose, and to prevent any other person from disclosing, the contents of confidential communications with an accountant when such other person learned of the communications because they were made in the rendition of accounting services to the client. This privilege includes other confidential information obtained by the accountant from the client for the purpose of rendering accounting advice.

Confidentiality

- **The 2007 Florida Statutes** **Title XXXII** REGULATION OF PROFESSIONS AND OCCUPATIONS
- **Chapter 473** PUBLIC ACCOUNTANCY **473.316 Communications between the accountant and client privileged.**– (Continued)
- (3) The privilege may be claimed by:
 - (a) The client.
 - (b) A guardian or conservator of the client.
 - (c) The personal representative of a deceased client.
 - (d) A successor, assignee, trustee in dissolution, or any similar representative of an organization, corporation, or association or other entity, either public or private, whether or not in existence.
 - (e) The accountant, but only on behalf of the client. The accountant's authority to claim the privilege is presumed in the absence of contrary evidence.
- (4) There is no accountant-client privilege under this section when:
 - (a) The services of the accountant were sought or obtained to enable or aid anyone to commit or plan to commit what the client knew or should have known was a crime or fraud.
 - (b) A communication is relevant to an issue of breach of duty by the accountant to her or his client or by the client to her or his accountant.
 - (c) A communication is relevant to a matter of common interest between two or more clients, if the communication was made by any of them to an accountant retained or consulted in common when offered in a civil action between the clients.

Confidentiality

- The 2007 Florida Statutes **Title XXXII** REGULATION OF PROFESSIONS AND OCCUPATIONS
- **Chapter 473** PUBLIC ACCOUNTANCY
- **473.316 Communications between the accountant and client privileged.--** (Continued)
- (5) Communications are not privileged from disclosure in any disciplinary investigation or proceeding conducted pursuant to this act by the department or before the board or in any judicial review of such a proceeding. In any such proceeding, a certified public accountant or public accountant, without the consent of her or his client, may testify with respect to any communication between the accountant and the accountant's client or be compelled, pursuant to a subpoena of the department or the board, to testify or produce records, books, or papers. Such a communication disclosed to the board and records of the board relating to the communication shall for all other purposes and proceedings be a privileged communication in all of the courts of this state.
- (6) The proceedings, records, and workpapers of a review committee are privileged and are not subject to discovery, subpoena, or other means of legal process or to introduction into evidence in a civil action or arbitration, administrative proceeding, or state accountancy board proceeding. A member of a review committee or person who was involved in a quality review may not testify in a civil action or arbitration, administrative proceeding, or state accountancy board proceeding as to any matter produced or disclosed during the quality review or as to any findings, recommendations, evaluations, opinions, or other actions of the review committee or any members thereof. Public records and materials prepared for a particular engagement are not privileged merely because they were presented during the quality review. This privilege does not apply to disputes between a review committee and a person subject to a quality review.
- **History.--**ss. 15, 25, ch. 79-202; ss. 2, 3, ch. 81-318; ss. 10, 11, ch. 85-9; s. 1, ch. 91-63; s. 26, ch. 91-140; s. 4, ch. 91-429; s. 350, ch. 97-103.

Litigation Environment

Accounting & Finance are inexact disciplines.

Therefore, variances in assumptions, methodologies, calculations and procedures are commonplace.

The CPA Expert should assess the probability of how his/her critiques and comments will be impacting a trier of fact, and this probability should be communicated to the engaging attorney.

The CPA Expert must remember his, or her, role in litigation.

Besides rendering an expert opinion, he, or she, often provides supporting information concerning economic issues to the engaging attorney.

Litigation Environment (Continued)

- In a litigation engagement, practitioners are often the only professionals capable of quantifying the impact of the events that led to the dispute.
- Their work product is therefore important in the litigation process. Each party to the proceedings may retain professionals to quantify and analyze the economic impact of events.
- Practitioners need to be able to evaluate and challenge the assumptions and calculations of other professionals as well as defend their own assumptions and calculations under rigorous cross-examination.

Milestones in The Litigation Process

- Early on, You must establish your role:
Consultant or
Designated Expert
- The Importance of your Engagement Memo
- You must consider Information produced during the Discovery Process

Litigation Landmines for the CPA Expert

- Know the Difference between an “Expert Opinion” and An “Audit Opinion”

Litigation Services Handbook –
Chapter 1 Section 1.6 (b): Opinion
Testimony:

- “The opposing lawyer may try to confuse the trier of fact by muddling audit opinions with expert opinions. The lawyer might ask whether the CPA performed an audit and can render an audit opinion. When the CPA answers “no,” the attorney might suggest incorrectly that a CPA with no audit opinion can have no expert opinion.”

CPA as Expert Versus Auditor

- Expert Opinion

- Audit Opinion

Litigation Landmines for the CPA Expert (Continued)

- Know how to credibly present the methodology used to form the basis for the opinion offered
- Know the Applicable Professional Standards
- Know how to deal with Compensation Issues

Client & Counsel's Expectations

- Impeach Opposing Expert.
- Assist attorney in evaluating the case.
- Preparing your report if you are a testifying witness.
- Preparing the attorney for deposition and/or cross examination.
- Be ready to provide rebuttal testimony.

Litigation Considerations

- In most instances, you will be deposed by opposing counsel shortly after you are named as an expert in the case
- You must be ready to stand the pressure brought upon you during deposition and possibly during trial
- Make sure that you have carefully researched all of your arguments and you must be able to articulate them effectively and credibly.

FEDERAL RULES OF EVIDENCE

ARTICLE VII.

OPINIONS AND EXPERT TESTIMONY

- **Rule 702. Testimony by Experts**

- If scientific, technical, or other specialized knowledge will assist the trier of fact to understand the evidence or to determine a fact in issue, a witness qualified as an expert by knowledge, skill, experience, training, or education, may testify thereto in the form of an opinion or otherwise, if (1) the testimony is based upon sufficient facts or data, (2) the testimony is the product of reliable principles and methods, and (3) the witness has applied the principles and methods reliably to the facts of the case.

- **Rule 703. Bases of Opinion Testimony by Experts**

- The facts or data in the particular case upon which an expert bases an opinion or inference may be those perceived by or made known to the expert at or before the hearing. If of a type reasonably relied upon by experts in the particular field in forming opinions or inferences upon the subject, the facts or data need not be admissible in evidence in order for the opinion or inference to be admitted. Facts or data that are otherwise inadmissible shall not be disclosed to the jury by the proponent of the opinion or inference unless the court determines that their probative value in assisting the jury to evaluate the expert's opinion substantially outweighs their prejudicial effect.

How the Daubert “list of four” (potential factors) apply to Report Writing:

1. Whether the appraisal theory used can be or has been tested
2. Whether the appraisal theory or technique utilized has been subjected to peer review or publication
3. Consideration of a known or potential rate of error of that particular appraisal technique and the existence and maintenance of standards controlling the technique’s operation
4. Consideration of general acceptance of the appraisal methodology utilized within the professional appraisal community.

Note: The Daubert Factors have now been incorporated into the Federal Rules of Evidence.

CPA reporting considerations in litigation engagements.

- ✓ The type of court proceeding, e.g. U.S. Tax Court, Federal District Court or State District Court.
- ✓ The level of understanding of financial reporting concepts of the engaging attorney and the trier of fact.
- ✓ Economic risks in the subject litigation.
- ✓ Using the CPA's expert report (or critique) to assist an engaging attorney during deposition examination and with trial direct examination, cross-examination and rebuttal examination.

In litigation, written reports & critiques of an opposing experts' work product can be in many forms, including the following:

1. A Formal CPA Expert Report compliant with AICPA Standards

2. A letter format.

Typically, the letter discusses the overall quality of the business appraisal report and highlights areas of concern. Often, this format is used in circumstances in which the appraisal report is appropriate, and file documentation is important.

3. An outline format.

Typically, this format examines the entire business valuation report, and highlights controversial, or weak areas. In addition, the effects of inappropriate assumptions, methodologies, calculations and procedures is quantified.

4. Trial examination question format.

Often, this format is discouraged. However, in certain circumstances, e.g. complex litigation inexperienced attorneys etc, this format becomes appropriate by default. If this format is utilized, the engaging attorney should be encouraged to modify the format as desired.

COMPONENTS TO INCLUDE

- Introduction – Appropriateness or inappropriateness of the opposing expert's report.
- Point by point consideration of the subject report (numerical order).
- Particular attention on weak assumptions, weak methodologies, faulty calculations that have a *material effect* on the opinion of value.

IGNORE THE SMALL STUFF

- If you criticize the unimportant, people will ignore the important stuff on which you really want them to focus!

NATURE OF METHODOLOGY USED IN YOUR REPORT

- Is there sufficient information on which to form a basis for an opinion?
- Is the information and methodology Relevant?
Your analysis needs to be **probative** of your opined conclusion.
- Are the Methods Reliable?
Your analysis must rely on the same “tools of the trade” relied upon by other experts in your field
- Does the methodology reference the recognized body of knowledge?
Your methods must be those used by other experts when dealing with similar fact patterns and circumstances

ASSUMPTIONS AND LIMITING CONDITIONS

- Disclose and clearly explain any *special limiting conditions* or *hypothetical assumptions* included in the methodology utilized
- Consider presenting Different Scenarios

Credible Presentation of your Methodology

- A Real Life Example

Credible Presentation of your Methodology

Sourced from http://www.daubertexpert.com/recent_beating.html

- One of our recent cases illustrates. An accountant was prepared to testify as to damages but his testimony was opposed by a motion in limine that argued that the accountant's testimony did not meet the Daubert criteria.
- The motion articulated Daubert's factors 1-4 and explained how the accountant's testimony failed on all four of them, dooming it to the realm of junk science and rendering the testimony inadmissible.
- The attorney who had hired the expert called us, basically admitting defeat: No, he said, the expert's methods had not been tested; no, they could not find any peer reviewed study that used the method; no, the expert did not know the error rates; no, there was no evidence that the method was generally accepted; and yes, the expert had created his method just for this litigation.
- We showed that testing and error rate analysis were scientific criteria not applicable to this expert's methods, which were learned but not scientific. And we showed that what he had done was a simple textbook example of accounting principles straight out of a popular university intermediate accounting text, so that his testimony was not only based upon peer reviewed principles, it looked like it was generally accepted as well. We mixed in some references to meeting GAAP and FASB standards to bolster our claims of general acceptance. The testimony came in virtually in its entirety, much to the pleasure of the attorney who had called us believing that his expert was sure to be excluded.

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CRITICAL IMPORTANCE OF

Professional Standards Applicable to Litigation Support Engagements

Response:

- Adherence to AICPA professional standards, related interpretations, quoting published experts in the field on positions presented at conferences and other environments subject to peer review and utilizing published practice aids goes a long way to adhere to the requirement that the methodology used must generally accepted by experts in the

AICPA PROFESSIONAL STANDARDS APPLICABLE TO LITIGATION SERVICES

- Litigation services are consulting services provided by CPAs and their employees, and, therefore, adherence to the Statement on Standards for Consulting Services (SSCS) is required.
- The CPA engaged in litigation services must also comply with the general standards of the accounting profession contained in the American Institute of Certified Public Accountants (AICPA) Code of Professional Conduct, as well as relevant standards established by the state boards of accountancy or other licensing agencies and by other professional organizations to which the practitioner may belong.

The AICPA Code of Professional Conduct

- The AICPA *Code of Professional Conduct and Bylaws* applies to all services rendered by AICPA members. The following sections of the Code of Professional Conduct have particular applicability to the practice of litigation services:
- Rule 102, *Integrity and Objectivity*
(AICPA, *Professional Standards*, vol. 2, ET sec.102.01)
- Rule 201, *General Standards*
(AICPA, *Professional Standards*, vol. 2, ET sec. 201.01)
- Rule 202, *Compliance With Standards*
(AICPA, *Professional Standards*, vol. 2, ET sec. 202.01)
- Rule 301, *Confidential Client Information*
(AICPA, *Professional Standards*, vol. 2, ET sec. 301.01)

LITIGATION SERVICES AND APPLICABLE PROFESSIONAL STANDARDS

- Rule 302, *Contingent Fees*
(AICPA, *Professional Standards*, vol. 2, ET sec. 302.01)
- Rule 501, *Acts Discreditable*
(AICPA, *Professional Standards*, vol. 2, ET sec. 501.01)
- In some instances, the following also apply:
- Rule 101, *Independence*
(AICPA, *Professional Standards*, vol. 2, ET sec. 101.01)
- Rule 203, *Accounting Principles*
(AICPA, *Professional Standards*, vol. 2, ET sec.203.01)

Rule 102-2 on Conflicts of Interest states, in part, the following:

- "A conflict of interest may occur if a member performs a professional service for a client or employer and the member or his or her firm has a significant relationship with another person, entity, product, or service that could be viewed as impairing the member's objectivity. If this significant relationship is disclosed to and consent is obtained from such client, employer, or other appropriate parties, the rule shall not operate to prohibit the performance of the professional service..."
- AICPA independence standards relate only to the performance of attestation services; objectivity standards apply to all services.

Rule 201, *General Standards*

- Rule 201, *General Standards*, of the AICPA Code of Professional Conduct applies to litigation services as well as to all other services rendered by CPAs to their clients.
- The general standards cover professional competence, due professional care, planning and supervision, and sufficient relevant data.

LITIGATION SERVICES AND APPLICABLE PROFESSIONAL STANDARDS

- Professional competence includes, among other things, identifying client needs, applying an analytical approach, and being knowledgeable about the technical areas involved in the litigation engagement.
- As a result of *Daubert v. Merrill Dow Pharmaceuticals, Inc.*, 509 U.S. 579 (1993), and *Kumho Tire Company, Ltd. v. Patrick Carmichael*, 526 U.S. 137 (1999), the practitioner should consider that the **reliability and relevance** of the expected testimony is likely to be subjected to careful judicial scrutiny before it will be allowed to be presented at trial. When deciding whether to accept a litigation services engagement, the practitioner should consider whether it is likely that he or she has the knowledge and skills necessary to provide a reasonable basis to present relevant and reliable testimony on the issues to be presented in the particular case.

Professional Competence

- Practitioners should undertake only those litigation services that they reasonably can expect to complete with professional competence.
- Consequently, practitioners may be unprepared to meet client needs adequately in every area and in every phase of litigation engagements.
- To comply with this standard in providing litigation services, practitioners may need the assistance of other individuals with the required education and experience.

Primary sources of Information used in this presentation:

- Litigation Services Handbook. The Role of the Financial Expert
John Wiley & Sons 3rd Edition. Editors: Weil, Wagner, and Frank
- AICPA Consulting Services Special Report 03-1: Litigation Services and
Applicable Professional Standards

Some Useful Links:

AICPA Forensics and Valuation Services Center

- <http://fvs.aicpa.org/Resources/>

Federal Rules of Evidence

- http://www.law.cornell.edu/rules/fre/#article_vi

Listing of IRS Rulings:

- <http://www.taxlinks.com/rulings/findinglist/revrulmaster.htm>
- Online Dictionary & Thesaurus
- <http://www.websters-online-dictionary.org/>

**Thank You for your Attention
And Good Luck!!**

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