HEMMING MORSE, LLP
CERTIFIED PUBLIC ACCOUNTANTS,
FORENSIC AND FINANCIAL CONSULTANTS

How Can a CPA Help Litigators?

Jim Andersen, CPA/CFF/ABV, ASA

When litigation involves financial issues, it is widely recognized that a qualified certified public accountant (CPA) is the individual who should be engaged to provide expert consulting and testifying services. Surprisingly, it appears that in practice, there is wide disparity as to when this CPA expert is engaged.

Typically, one would not expect a CPA to be engaged during the latter stages of a trial to provide direct testimony. Yet, within the last year, my firm has received two such requests. In one instance we turned down the attorney's request. The client believed we could analyze financial data, prepare a damage model and provide expert testimony, all within the span of three days. In the other instance, plaintiff's counsel requested that we testify, on two days' notice, on the net worth of a defendant as a basis for possible punitive damages. This testimony would be the last evidence presented to the jury. Under some circumstances an expert might be able to provide such testimony. But in this instance, discovery relating to the defendant's net worth had not been properly handled and there was no financial information on which to base an expert opinion. Counsel did attempt to convince the trial judge to re-open discovery so that the appropriate financial information could be produced for the expert's use, but the judge refused to do so. As a result, plaintiff's counsel was precluded from pursuing his client's punitive damage claim. Had the expert been engaged earlier in the discovery process, the expert could have assisted the attorney in developing a discovery plan that would have yielded the information upon which an opinion could be rendered.

The foregoing are extreme examples of engaging an expert. What if the expert is engaged after the complaint is filed and discovery begun, but well before the time of deposition and trial? This may not be a problem if the expert is being engaged to provide rebuttal testimony. However, as in a recent case, if counsel waited until the latter stages of the discovery process, the experts would not have had sufficient time to analyze the relevant financial information and prepare an adequate rebuttal.

In this matter, the plaintiff was claiming substantial economic damages in the form of lost earnings, extraordinary out-of-pocket costs and decrease in the value of the business. The damages calculations were prepared by the entity's chief financial officer and were supported by numerous worksheets and analyses. As with most damages calculations, the assumptions on which the calculations were based were of the most significance. To evaluate the assumptions and to determine their reasonableness was a task that required intensive research and analyses over a four to five month period. Based on this work, it was determined that a number of the plaintiff's assumptions were unfounded and many discounts were improperly applied. Had the experts not been engaged in the early stages of this litigation, they could not have performed the research and analyses necessary to rebut the plaintiff's damage claims and provide their clients, the defendants, with a reasonable damages estimate upon which to base a settlement.

In most instances, it is unadvisable for a plaintiff to delay the engagement of its financial expert. Such a delay can have catastrophic consequences. A few years ago, a plaintiff prepared its own damage analysis and model. As the trial date neared, and before discovery closed, an expert was engaged to review the plaintiff's damages calculation. The expert in this case was an experienced CPA, who undertook a review of the key assumptions underlying the damages model. He found that the revenue and most of the cost and expense assumptions were reasonable. However, during his review he noted that the plaintiff was relying on a sole supplier for the key component of its product. The expert was told by the plaintiff that this supplier was the only one in the United States who had the capability of providing this component.

The expert then contacted the supplier to verify its ability to provide components to the plaintiff during the damages period. Based on the plaintiff's damages model, the business would need to sell 50 units a month to break even and it was forecasting that it would sell 200 to 250 units per month, which gave rise to the plaintiff's substantial lost earnings claim. The expert interviewed the sole supplier's owner and learned that: a) his company could make the component; b) special tooling would be needed to expand production of this component; and c) if he produced nothing but this component at his plant, he could make, at most, 25 units a month—half the number of units necessary to meet the break even point. At this point, the plaintiff's action died; but not before many tens of thousands of dollars had been expended. These dollars would not have been spent, had the expert been engaged upon completion of the original damages model.

My experience has shown that the most successful cases are those where the CPA expert is engaged at the inception of the litigation process. Plaintiffs should engage the expert before the action is filed; defendants should engage the expert upon notice of the action.

In most instances, a plaintiff and its counsel can be very confident as to the liability of a defendant. It is plaintiff's expert who can determine if a financial loss has occurred and if that loss is determinable. In a number of cases, we have informed counsel and the plaintiff that either there are no damages or, if there were damages, they could not be sufficiently determined. Some years ago, a number of plaintiffs put forth damages claims for losses suffered by their respective businesses due to an environmental

accident. Of the plaintiff group, only one had a history of successful business operations. All of the remaining plaintiffs' businesses had never shown a profit over the past three to five years. The defendant's expert immediately pointed out this fact to defendant's counsel. The plaintiffs' claims were quickly dismissed at very little cost to the defendant.

In another matter, a plaintiff and his counsel engaged a CPA to advise them as to whether they could provide a damage claim before they filed a complaint. The defendant's liability was very clear; however, how the plaintiff was damaged was not clear. Intuitively, the expert believed that there were economic damages suffered, but because the plaintiff's business continued its rapid growth and profitability, the expert concluded that the amount of the damages suffered was indeterminate. Accordingly, no action was taken against the defendant. The plaintiff incurred less than $5,000 in legal and expert fees, a huge savings from those fees that would have been incurred had a lawsuit been filed, discovery commenced, and then a determination made that the damages could not be determined.

In summary, the most successful and cost effective cases are those where the CPA expert is involved in the earliest stages of litigation and works with counsel as a partner in the process.