

## Want to go to court?

### Know the risks of becoming an expert witness before you sign on

By William Barrett III, CPA,  
CVA, CTP, CCFM

"I've got some good news and some bad news," said the surgeon to the patient in the recovery room after a leg amputation. "Bad news first. We amputated the wrong leg. Now the good news — once we discovered the error we went back and amputated the correct leg." The astonished patient gasped, "I'm gonna sue you and your practice group for everything you're worth!"

"Forget it," said the surgeon, "you don't have a leg to stand on."

Unfortunately, CPAs acting as expert witnesses in federal and district courts are not as lucky as the surgeon above. Sued in increasing numbers, many expert witnesses are losing because they "don't have a leg to stand on."

CPAs can no longer be all things to their clients. Orthopedists do not take on patients with eye, ear, nose and throat ailments. Estate lawyers do not represent cat burglars — or even dog burglars. Yet more and more often, CPAs and their firms will represent clients in divorce or business breakup situations or accept strategic knowledge work like forensics and business valuations. Then, as a favor for the client, the firm or CPA will happily testify in court.

As recent court rulings demonstrate, CPAs who are not used to the expert witness role are getting in over their heads. Debunked in court by some lawyers for not being true litigation experts, some CPAs have lost cases for their clients. Unhappy clients are suing their CPAs for not receiving the consulting services they were promised.

How can you ensure that you provide appropriate services — and help, rather than hurt — your client's case? By understanding the current litigation climate, appropriate court cases and new rules from the federal government, you can make an informed decision when a client asks you to represent them in federal or district court.

#### Understanding precedents

Court cases from the last 10 years demonstrate the current litigation climate — and to what standards expert witnesses are now held.

Before the 1993 U.S. Supreme Court case *Daubert v. Merrell Dow Pharmaceuticals*, most courts adhered to the so-called Frye rule, which allowed evidence in court



that was generally accepted within the scientific community.

The *Daubert* case changed all that, allowing that scientific evidence would be admitted in court if supported by strong methodology, even if it hadn't achieved general acceptance. It became the responsibility of the sitting judge to act as the gatekeeper to keep out "unreliable" science. In certain cases, defense attorneys began to use *Daubert* to exclude causation experts unless they could really support their opinions by studies.

In 1999, the U.S. Supreme Court heard *Kumho Tire Company v. Carmichael* and determined that the expert witness reliability factors addressed in *Daubert* also applied to nonscientific experts. CPAs could now be held to the same high expert witness standards.

Additionally, in 2000 the U.S. Supreme Court implemented New Rules Amending the Federal Rules of Civil Procedure and Federal Rules of Evidence, which made important changes in regard to expert witnesses.

### Claims against accounting experts

Expert witnesses have historically assumed they could testify in court without fear of legal retaliation from parties who may disagree with their testimony. The common law doctrine of witness immunity has been the basis for this legal protection and was, until recently, followed in all states.

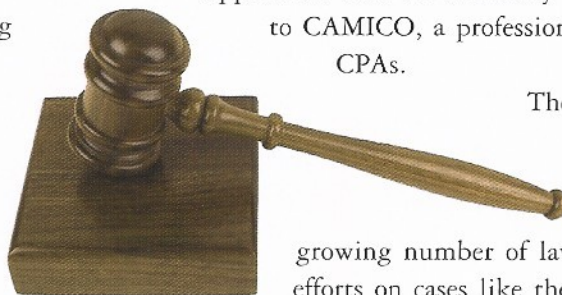
In 1994, the ruling in *Mattco Forge v. Arthur Young* held the accounting firm liable on two counts of fraud arising from litigation support. The jury awarded \$14.2 million in compensatory damages and \$27.8 million in punitive damages to the plaintiff. The jury also found a former managing partner liable for \$250,000 and a former employee liable for \$5,000.

While these rulings apply only to federal court cases, many states pattern their rules after federal guidelines. The environment for CPA expert witnesses in state courts is becoming just as difficult.

Last year I spoke with a divorce attorney who consistently uses the *Daubert* rule to challenge financial/accounting/valuation experts in divorce court. Often, the expert is dismissed by the judge and the expert's parties cannot plead or defend causation or damages.

To make matters even worse for those witnesses, claims against CPAs impeached as expert witnesses in

civil and financial crimes cases are rising because the opposition wins on summary judgment, according to CAMICO, a professional liability insurer for CPAs.



The current litigation environment escalates claims against CPAs. A growing number of lawyers focus litigation efforts on cases like the one above. The liberalization of court decisions, the widening applicability of civil liability, the federal government's efforts to widen the scope of the bases for litigation, and an overall increase in the public's tendency to opt for litigation as a means to solve civil liability disputes are all factors contributing to claims against CPAs.

### Ethics and codes of conduct

Accountants doing expert witness work should be educated about how the legal system views evidence, expert testimony, and negligence; and should always adhere to their professional responsibilities and ethical standards.

Accounting reform from places like the Public Company Accounting Oversight Board (PCAOB) not only impact audits of publicly traded companies, but also mandate changes to AICPA standards and rules of conduct.

CPA experts whose firms work with both public and private companies should be aware of 2003 changes and proposals:

1. Revised AICPA Code of Professional Conduct, Interpretation of Rule 101-3, *Independence* (ET sec. 101.01) — CPAs rendering consulting or non-attest services to non-public attest clients must document in writing that the client makes all management decisions, performs all management functions and designates a competent employee to oversee the non-attest service; that the client must evaluate the adequacy and results of the engagement and the related conclusions; and that the client accept responsibility for the non-attest work.
2. Reconsideration of Rule 102, *Integrity and Objectivity* (ET sec. 102.01) — CPAs offering litigation

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and dispute resolution services should determine how the client would comply with the requirements of interpretation of Rule 101-3, above.

3. Consulting Services Special Report 03-1, *Litigation Services and Applicable Professional Standards* — Provides additional guidance on the existing professional standards and the related responsibilities that affect the litigation services practitioner.
4. Proposed *Statement on Standards for Valuation Services: Valuation of a Business, an Interest in a Business, or an Intangible Asset* — Established standards during an engagement to develop and report on the valuation of a business.
5. New interpretation of *AICPA Statements of Standards for Tax Services* — How



CPAs practice ethically in tax return positions, administrative proceedings or court decisions would now become part of the AICPA Code of Professional Conduct (see above).

6. The AICPA Professional Ethics Executive Committee (PEEC) enacted new policies and processes to discipline AICPA members who violate professional standards of practice. Disciplinary actions include public admonishment by publishing in the *Wall Street Journal*, non-duplication of state board's investigation at the PEEC appeal level, automatic sanction transfer from approved government agencies (like the PCAOB) and disclosure of results of an investigation. Prior results were not made public, even to individuals who filed the complaints.

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### There's good news!

There will always be general CPA practitioners, and some will even specialize in the ever-expanding practice niches our clients ask us to provide. Like doctors, lawyers, architects and other professionals, CPAs will realize the value of referral and the clear consequences of non-referral.

Clients will be happier. CPAs who realize all the potential risks and consequences of serving as an expert in their clients' divorce, business dispute, forensic investigation, valuation or litigation will be the happiest and most successful of all.

*William C. Barrett III, CPA, CVA, CTP, CCFM, has more than 20 years of public accounting,*



*tax planning and compliance, operations management, and mergers and acquisitions serving clients in a wide variety of industries. He has investigated fraud and misfeasance in corporations, boards of directors and medical practices, and has directed teams investigating multi-defendant money laundering, illegal income, tax evasion and white-collar fraud. E-mail him at Bill.Barrett@BarrettPC.com.*