

Choosing the Financial Expert Witness

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Attorneys often have needs for financial expert witnesses: personal injury, damage awards, tax law, shareholder actions, divorce, and other litigation matters. These cases may involve forensic accounting, financial or economic analysis, business valuation services, tax analyses, and so forth. Choosing the right expert is often one of the most important decisions an attorney is faced with -- especially if the attorney is not experienced in choosing an expert. To succeed an expert must be credible. A credible expert will be knowledgeable, experienced, objective, and an effective communicator. Attorneys looking for an expert often ask other attorneys for a referral, but the process does not stop here. You must decide for yourself if you have found the right expert for your needs.

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Is your "expert" in fact an expert?

An expert must show that his testimony “rests on a reliable foundation and is relevant to the task at hand. Pertinent evidence based on scientifically valid principles will satisfy those demands.” This principle was set forth in a decision handed down by the Supreme Court of the United States in *William Daubert, et ux., etc., et al., v. Merrell Dow Pharmaceuticals, Inc.*, , No. 92-102. In response to Daubert (pronounced "Dawbert"), the Federal Rules of Evidence were amended. Prior to the change, FRE 702 stated that an expert who was qualified by "...by knowledge, skill, experience, training, or education may testify..." To this was added that an expert's testimony is admissible "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." While it is up to the trial judge to determine what expert testimony is acceptable; clearly for an expert's opinion to be accepted, the expert will have to show that he/she has complied with these criteria.

Many states follow the Federal rules and testifying experts are accustomed to explaining how their process and conclusions have been reached.

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Massachusetts has not formally adopted FRE 702; however the SJC adopted the Daubert decision in *Commonwealth v. Lanigan*, 419 Mass. 15, 24 - 27 (1994). As other states issue opinions regarding the acceptance of expert testimony, these opinions are being cited by the Massachusetts and other state courts in their opinions. For more on the ramifications of Daubert go to www.daubertontheweb.com.

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What constitutes knowledge, skill, experience, training or education?

The "expert" who has taken a four-hour course in business valuation, and uses a software program to compute the value and to create his report, may not be capable of explaining the basis for his report to a judge or jury. Will this expert be able to explain the principles and methods he used to reach a conclusion? Can he explain the underlying concepts and assumptions used to value a business? Can he explain not just what data was used, but also why it was used and that its use is consistent with the underlying principles?

Not every financial expert is competent in all types of cases. Some people mistakenly believe a CPA is qualified for any type of engagement. This may not be the case. Certain CPAs may specialize in income taxation or gift and estate planning. Individuals or firms may specialize only in a specific industry, such as medical practices or restaurants, and are known by their peers to be experts in their industry. Some have general practices and may only occasionally do a business valuation or work on a divorce case. Others specialize in litigation support or business valuation and are highly competent in a number of industries. It is important to understand what type of practice your expert has.

All experts should be involved in a regular program of continuing education. It also helps if your expert has been certified by a credible organization. These organizations have standards for ethical behavior, accepted practices, and the content of reports.

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Does your expert have integrity and objectivity?

A few years ago, a Massachusetts Judge discarded the testimony of and reprimanded a well-known expert for testimony that contradicted testimony he had made in previous court appearances. Not only did this expert discredit himself; he left the attorney who engaged him with a very angry client. An expert testifies to assist the court and to help the court understand complex issues -- *not to be an advocate for your client*. In *Wagner Construction, Inc. v. CIR*, T.C. Memo 2001-160, the Tax Court considered whether the compensation paid to Wagner Construction's two shareholders was deductible under IRC §162. Under §162 reasonable compensation is an allowed business deduction; however "excess compensation" is treated as a taxable dividend to the shareholder and is not deductible by the business. Both the IRS and the taxpayer presented two

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experts. The Court rejected the testimony of all four experts finding that the experts acted as advocates for their clients. The Court went further to state:

"An expert has a duty to the Court that exceeds his duty to his client; the expert is obligated to present data, analysis, and opinion with detached neutrality and without bias, regardless of the effect of such unbiased presentation on his client's case."

While it does not guarantee competence and objectivity, those who are certified by an accrediting organization are bound by the ethics and standards of their organization.

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How well does your expert communicate?

A good report will allow another person to replicate the process and conclusions of the writer. Check what societies the expert belongs to. Many have standards, especially in business valuation, governing the contents of reports. A good way to determine an expert's style and ability to communicate is to meet with them. See for yourself how they present themselves. Certainly, if you find them making you uncomfortable a judge or jury will also. Ask the expert for a sample written report -- business valuation report, forensic report, or such other report as may be relevant to your case. How well does the expert present him/herself in writing? An expert who communicates well can greatly facilitate the reaching of a settlement even before reaching the trial stage.

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How much experience should your expert have?

The courts have rejected the testimony of highly experienced and known experts. In the above Wagner Construction, Inc. v. CIR case, one of the experts was nationally known and published. Certain Massachusetts Family and Probate Court judges have told me they know what some experts are going to say before they even testify. An expert's credibility can be further eroded if they regularly appear as a specific attorney's expert or if they only represent one side of a case. For example, in divorce cases, do only attorneys representing wives engage the expert? An expert who meets the criteria set forth in Daubert*, has integrity and objectivity, and communicates well, will have credibility with the court.

* Please refer to the section ["Is your 'expert' in fact an expert?"](#) above.

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When should you engage an expert?

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Experts need time to gather data, do their analysis, and prepare their report. Even if you are not sure you want to use an expert; for example, you hope to settle the case, you should involve an expert early on. There is a limited window for discovery and too often attorneys involve experts too late for them to be as effective as they could be. Remember that the data collection part of the engagement can take a lot more time than anticipated if the other side is not forthcoming with information. Further, upon analysis of the underlying data, the expert may uncover information that influences settlement negotiations. For example, in a divorce, an expert may uncover additional assets or income that would have otherwise been left off the table.

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Do your homework.

You cannot effectively choose or use a financial expert if you do not know something about the type of services you are requesting. The *Litigation Services Handbook, The Role of the Financial Expert*, by Roman L. Weil (Editor), et al, John Wiley and Sons, is an excellent all around reference. There are a number of excellent general texts concerning business valuation including *Lawyers Business Valuation Handbook*, by Shannon Pratt, published by the American Bar Association and *The Business Appraiser and Litigation Support*, by Michele G. Miles, John Wiley and Sons. Do your homework with regard to knowing what positions your expert and the other side's expert have taken in the past. Use your expert to help you prepare. Nevertheless, remember that your expert is not your client's advocate and do not pressure him/her to take this role. In conclusion, know what you need and what to expect from your expert. Make sure that your expert is competent, objective, and an excellent communicator.

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