

Expert Witness Qualifications and Selection

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INTRODUCTION

This article discusses the criteria and qualifications that should guide the selection of a forensic accounting expert witness. Our discussion draws distinctions between the different skill sets that exist within forensic accounting and how those skill sets drive the selection of forensic accounting experts. We use these distinctions and classifications as a gauge for identifying appropriate experts in a variety of situations.

SCOPE OF ARTICLE

This article is not intended as a treatise or “how-to” manual on the selection of an expert; rather, it is intended to provide the reader with information regarding the criteria that should be considered and weighed in selecting a forensic accounting expert. While the article is intended for a wide audience, it addresses issues pertinent to attorneys evaluating experts; practitioners seeking to enhance their viability as an expert; and those in academia, including forensic accounting instructors and students.

AREAS OF EXPERTISE WITHIN FORENSIC ACCOUNTING

The term “forensic accounting” has come to represent a fairly broad range of services that can be classified into several distinct skill sets. Each skill set represents an area of specialization within forensic accounting that requires additional expertise and training. This added expertise and training is distinguished by separate qualifications and certifications.

We have categorized the types of forensic accounting skill sets into the following three categories:

1. Investigative accounting
2. Economic loss calculation, and
3. Business and intangible asset valuation.

INVESTIGATIVE ACCOUNTING

Investigative accounting refers to the process employed to trace funds or to reconstruct accounting information. This task has traditionally been undertaken by accountants because of their detailed

understanding of the financial accounting process and because they are more aptly trained to trace specific accounting transactions and to identify potential financial statement manipulation.

Investigative accounting may be useful in any situation where doubt exists as to the integrity of accounting data. Investigative accounting may be applied in the following types of cases:

1. Fraud detection, documentation, and prosecution/defense in criminal litigation
2. Shareholder disputes
3. Officers' and directors' litigation
4. Asset and income searches
5. Reconstruction of accounting records because of natural disasters, such as floods, fires and earthquakes
6. Marital dissolution, and
7. Insolvency and bankruptcy.

ECONOMIC LOSS CALCULATION

Economic loss calculation refers to the determination of potential lost profit due to the occurrence of a particular event or series of events. Typically these calculations evaluate damages suffered relative to the past, present, and future performance of companies and individuals under varying assumptions and scenarios.

Both economists and forensic accountants traditionally undertake these calculations. Forensic accountants are particularly effective at economic loss calculations because, unlike economists, they can interpret and assess lost revenue and determine the associated fixed and variable expenses.

Economic loss calculations may be useful in any situation where an economic loss may have occurred. Economic loss calculations may be performed in the following types of cases:

1. Business interruption
2. Lost profits/earnings
3. Wrongful discharge/death
4. Personal injury
5. Breach of contract
6. Loss of goodwill
7. Price erosion
8. Unjust enrichment
9. Prejudgment interest
10. Opportunity loss costs
11. Intellectual property infringement
12. Construction defects and delays

13. Anti-trust, and
14. Lender liability.

BUSINESS AND INTANGIBLE ASSET VALUATION

Business valuation refers to the appraisal of an equity interest or other interests in a business entity. Intangible asset valuation refers to the appraisal of intangible assets, such as licenses and patents, which may or may not be valued within the context of a business valuation. Generally, both business valuations and intangible asset valuations are conducted by business appraisers. For purposes of this article, the terms “business valuation” and “intangible asset valuation” are considered synonymous.

Business valuations or appraisals are often used to provide independent opinions on business value, or the diminution in business value, based upon generally accepted valuation theory and an understanding of business value as it pertains to the past, present, and future.

Business appraisers, who usually have formal training in finance, have traditionally undertaken business valuations. More recently, forensic accountants have also joined the business appraisal profession. Given the diverse backgrounds of contemporary business appraisers, it is generally observed that those who have a finance background are more effective at evaluating the financial risks and returns inherent in the appraised business or intangible asset; while those who have an accounting background are more effective at analyzing the historical and projected financial statements of the appraised business. The effective business appraiser is typically proficient at both.

Business valuations may be useful in any situation where the value of a business may be in question. Business valuation methodologies may be employed in the following types of cases:

1. Diminution or destruction of business value
2. Buy-sell agreements
3. ESOP plans
4. Mergers and acquisitions
5. Marital dissolutions
6. Stockholder disputes
7. Bankruptcy adversarial proceedings
8. Intellectual property disputes
9. Estate and gift tax plans
10. Partnership disputes
11. Financing, and
12. Cases involving governmental regulatory agencies.

THE EXPERT WITNESS

As defined by FindLaw¹, an expert witness is “[a specialist] who by virtue of special knowledge, skill, training, or experience is qualified to provide testimony to aid the factfinder in matters that exceed the common knowledge of ordinary people.”

An effective forensic accounting expert can have a significant impact on the trier of fact². Significant complexities may arise in any forensic accounting work performed during the course of an engagement; if an expert is unable to successfully defend and explain this work and its inferences to a judge or jury, the expert’s work may be for naught.

QUALIFICATIONS OF AN EXPERT WITNESS

An expert can only be as effective as academic education, professional training, years of experience, and charisma will allow. Given the large pool of potential experts, it can be difficult to differentiate between them.

Although many variables must be considered in the selection of an expert, we posit that, in almost all cases, selection should be driven by the nature of the assignment. In this section, we discuss the various qualifications that should be evaluated in the selection process.

ACADEMIC

It’s safe to say that the majority of potential forensic accounting experts possess a significant amount of formal training. Typically, a forensic accountant will have an undergraduate degree, as well as an advanced or post-graduate degree. While academic training provides a forensic accountant with solid foundational skills, such training should be considered only as an entry point for further credentialing.

ACCREDITATIONS

The most applicable accreditations are dependent upon the type of engagement for which the expert is being retained. Although certain accreditations hold universal appeal, some are more specifically targeted to particular types of cases.

¹ <http://dictionary.lp.findlaw.com/>

² The judge in a bench trial or jury in a jury trial that carries the responsibility of determining the issues of fact in a case

Investigative Accounting

In analyzing financial records to determine whether they have been manipulated, investigative accountants draw heavily on an understanding of the accounting process and procedures used to account for funds, particularly cash. For this reason, most investigative accountants are Certified Public Accountants (CPAs)³ and/or Certified Fraud Examiners (CFEs)⁴. In specific instances, particularly cases involving bankruptcy or troubled business, investigative accountants with the Certified Insolvency and Restructuring Advisor (CIRA)⁵ designation may also prove extremely helpful. The CIRA designation denotes that the holder has demonstrated a high degree of specialized, professional, financial, and operational expertise in the area of underperforming and insolvent businesses.

Economic Loss Calculation

In determining economic damages, the forensic accountant relies upon expertise in accounting as well as on an understanding of the economic basis of a loss claim. For this reason, most economic damages experts are CPAs or have a background in economics. Since most of the principles of economic loss calculation deal with academic theories of economic reality, many economic loss experts are accounting, economic or finance professors and practitioners.

Business Valuation

Business valuation experts also draw upon forensic accounting because many of the financial details used and relied upon in the valuation process often need to be reconstructed or thoroughly analyzed. An important, but often overlooked, fact is that there are differences between the *objectives of an audit* in compliance with GAAP and a *forensic accounting reconstruction* of accounting records. The latter often attempts to reconstruct financial statements from an economic perspective.

Business valuation experts typically have the Accredited Senior Appraiser (ASA) designation⁶, in addition to other designations such as Certified Business Appraiser (CBA)⁷, Accredited in Business Valuation (ABV)⁸, and Certified Valuation Analyst (CVA)⁹.

The requirements for obtaining these designations vary significantly. The ASA designation is the most difficult to obtain, because of its education, proficiency, and five year experience requirement, and is consequently considered by most practitioners to be the most prestigious.

³ This designation is administered by the American Institute of Certified Public Accountants.

⁴ This designation is administered by the Association of Certified Fraud Examiners.

⁵ This designation is administered by the Association of Insolvency and Restructuring Advisors.

⁶ This designation is administered by the American Society of Appraisers.

⁷ This designation is administered by the Institute of Business Appraisers.

⁸ This designation is administered by the American Institute of Certified Public Accountants.

⁹ This designation is administered by the National Association of Certified Valuation Analysts.

EXPERIENCE

Perhaps the most important characteristic of an effective expert is the extent of prior experience in forensic accounting cases. The effective application of forensic accounting derives from a wealth of knowledge accumulated over years of working on similar cases.

Experience in depositions and with courtroom testimony is also critical. It is important that forensic accountants who wish to serve as experts are comfortable and familiar with the litigation process and courtroom procedure.

SELECTION OF AN EXPERT WITNESS

The selection of an expert is a process dependent upon on a number of factors, including prior interactions with a particular expert and the type of engagement for which the expert is being retained.

The type and nature of an assignment should be the main determinant in the selection of an expert, primarily because this ensures that the approaches employed to complete the engagement will be 1) conducted in conformance with the relevant authorities and 2) constructed in a supportable manner.

Those responsible for selecting an expert should assess their case and determine the requisite core skills and experience that are relevant to the case at hand. In reality, attorneys often select experts with whom they have past dealings and established relationships. This often becomes a concern when the case for which the expert is being retained contains issues outside the skill set or experience of that individual. Although many forensic accounting experts can be proficient in most cases involving investigative accounting, there are a number of instances where investigative accounting is only one of several skill sets required to address the complex issues inherent in a particular case.

MATCHING THE EXPERT TO THE ENGAGEMENT

To provide a greater understanding of the nuances of expert selection, we have provided six examples. Each example highlights the interplay between education, training, and experience as they apply to different types of forensic accounting assignments.

Misappropriation of Funds Case

A typical investigative accounting case involves the assertion that an employee has misappropriated funds. In most cases where these charges have merit, thefts often are facilitated because of a deficiency in the segregation of responsibilities within the organization.

In these types of cases, any university-trained accountant may qualify as an expert. However, the CPA and CFE designation would enhance the credibility of a potential expert. These designations show the judge and jury that the expert has training and expertise beyond what is provided via a university education. This can assist in qualifying someone as an expert witness and helps distinguish an expert from the opposing expert witness. In addition, specific prior experience involving similar engagements would prove beneficial.

Business Interruption Case

Another type of economic loss calculation that draws on forensic accounting is the calculation of economic damages due to the interruption of a business' operations. For example, a forensic accounting expert may be retained to offer an opinion as to the loss of future income resulting from an accident that impacts the performance of a business. In an instance such as this, a forensic accounting expert might review historical financial records to quantify the economic impact of the business interruption.

In this particular type of case, an economist, a CPA or a CFE with specific prior experience could serve well as an expert. They have the requisite credentials to qualify as an expert and the requirements of the assignment do not go beyond their expertise.

Valuation of a Business Interest

The business valuation process is fairly dependent on the accuracy of underlying financial records. Although business appraisers are not required to review or even compile corporate financial records in compliance with GAAP, many engagements require that a certain amount of forensic accounting be employed, particularly when the source documents used in the valuation present inconsistencies or lead to questions regarding validity.

In this particular type of case, a CPA with additional expertise and experience in business valuation would serve well as an expert; however, the CPA designation does not provide evidence, on its own, that an individual is adequately prepared to act as a business appraiser. For this reason, additional credentials such as the ASA and the ABV would strengthen the testimony of the expert and also increase the likelihood that the expert will adhere to generally accepted valuation theory and practice. These designations require that candidates exhibit knowledge, training, and expertise through testing and experience requirements.

In order to obtain the ASA designation, an applicant must demonstrate up to five years of full time business valuation experience. Therefore, the ASA designation also ensures that the holder has attained a certain level of prior experience.

Construction Contract Damage Case

Another scenario involves cases wherein both fraud and economic damages are claimed. One example of this type of case might be found in litigation over a construction contract whereby the contractor is accused of falsifying billings and not performing in accordance with the contract.

In this type of case, an expert with a CPA, CFE, and experience in quantifying economic damages would be qualified to examine the contractor's accounting records to determine whether fraud had indeed been perpetrated. An example of potential fraud items that might be uncovered through a forensic audit include:

1. Billings for equipment that was either never used, had already been billed, was excessively billed (billed for greater than actual usage), or that was not otherwise billed in conformance with the contract
2. Excessive non-equipment billings, and
3. Payments made by or to the contractor that were not appropriately recorded or that were never recorded.

Furthermore, the economic loss component in this type of case might include direct and collateral economic damages due to delays that occur as a result of alleged actions of the contractor. An expert versed in economic loss methodology can determine, either independently or through reliance on the expert reports of others, what the actual costs of the contracted project were and what those costs would have been, but for the alleged actions of the contractor.

Marital Dissolution Case

When it comes to the successful use of both investigative accounting and business valuation, there may be no case more prevalent than litigation over marital dissolution. In addition to requiring an accurate marital asset schedule, many of these cases also involve a business interest or interests that must be valued *prior* to marital division. As with other litigated matters, at least one of the parties often asserts that the other is purposely hiding assets.

An expert that is a CPA, CFE, ABV, and/or ASA would have a definite advantage over an expert that did not hold all of these designations. In addition to the standing that it gives the expert in the eyes of the court, the rigorous requirements inherent in attaining these designations help verify that work performed by the expert will be able to withstand a *Daubert* challenge, as discussed in a later section of this article.

Breach of Contract Case

There are certain cases that will contain elements of investigative accounting, economic loss calculation, and business valuation. Although previously we have presented expert qualifications as they related to specific types of cases, it is almost universally accepted that forensic accounting experts who hold all of the designations discussed thus far will be much better suited to assist in a case involving all aspects of forensic accounting than, by way of example, would an expert who only held the CPA and/or CFE designation.

The best illustration of required skills is contained in a case whereby a breach of contract suit alleges fraud, lost profits, and diminution in business value. Assume that Party A sues Party B, claiming that Party B fraudulently misrepresented key financial data about itself to lure Party A into a contract (Assertion 1). Party A further asserts that its reliance on the financial data misrepresented by Party B caused Party A to suffer opportunity costs that resulted in both lost profits and diminution in the business value of Party A (Assertion 2). As cited, investigative accounting skills will be required to address Assertion 1, while economic loss calculation and business valuation skills will be required to address Assertion 2.

THE INFLUENCE OF DAUBERT AND KUMHO TIRE ON THE EXPERT SELECTION PROCESS

In the current state of the litigation support profession, no discussion of expert witnesses is complete without an acknowledgement of the impact of decisions made in *Daubert v. Merrell Dow Pharmaceuticals Inc.* and *Kumho Tire Company, Ltd. v. Patrick Carmichael*. Although these cases have been discussed at great length over the years, and even though experts will be familiar with the implications mandated by the rulings in each case, we believe that a brief overview is warranted.

The *Daubert* decision essentially gave trial judges the ability to exclude as “junk science” any expert witness testimony that was considered to be unreliable. Effectively, the trial judge was designated as a “gate keeper” in determining whether expert testimony had sufficient support to be instructive to a jury.

Since this decision, assertions by one party that an expert of the other party is submitting opinions based on junk science have come to be known as *Daubert* challenges. However, because judges have been empowered at the trial court level, admissibility under *Daubert* has been made with a great deal of latitude. In many cases, a successful *Daubert* challenge can be more accurately predicted by reviewing the decision history of a particular judge rather than by looking at the rulings made in similar cases within the state.

Although these challenges are referred to under the umbrella of *Daubert*, it was actually the *Kumho Tire* ruling that applied the trial judges' powers of exclusion to non-scientific testimony, such as that proffered by forensic accounting experts. Given the significant nuances of expert selection, it is important that those responsible for the selection of a forensic accounting expert ensure that potential experts be able to withstand a *Daubert* challenge. This determination is even more appropriate considering that a forensic accounting expert may likely be testifying to complex issues that encompass theories relating to investigative accounting, economic loss, and business valuation.

SOURCES FOR THE SELECTION OF AN EXPERT WITNESS

Knowing what skill set you are looking for in a forensic accounting expert is only part of the selection process; perhaps even more difficult is sifting through the large number of potential experts to find the one that is perfect for the engagement at hand. Barring the consideration that an expert may be selected based on history, familiarity, or referral, what other options exist for the identification of forensic accounting experts?

In the information age, the selection of an expert witness has been greatly facilitated by resources available through the Internet. We forego discussion of the usual expert witness sources, such as locally and nationally distributed directories, in favor of listing quality expert witness databases that are available online¹⁰. These Internet expert witness databases are very beneficial because they generally have been corroborated or filtered, they provide more comprehensive information, than do printed directories, about each expert, and they also provide links to the expert's website so that further research can be performed. Furthermore, these databases are continuously updated to provide accurate information and it is fairly easy to compare and contrast experts from around the country, or the world if necessary.

The better-known expert witness databases that can be found online¹¹ include both ExpertWitness.com and JurisPro.com

THE BEAUTY CONTEST

Understanding and distinguishing between the different qualifications held by forensic accounting experts is helpful. Knowing how to match the appropriate expert to the skill set required in different engagements involving forensic accounting is even more useful. But what should be done when, given the growing number of forensic accounting practitioners, these experts have substantially similar qualifications and years of experience?

How about a beauty contest?

¹⁰ Please note that the authors have no reciprocal interest in any of the sources provided in this article.

¹¹ Our listing of these reference sources may not be construed as an endorsement.

At some point the selection of an expert will come down to a choice between two or more similarly qualified and experienced practitioners. The decision itself has broader implications since, once an expert is retained and has testified, the trier of fact will be required to weigh the differing opinions of two experts who may be equally qualified and experienced. By holding a beauty contest *before* selecting an expert, those responsible for the selection of an expert will be able to assess attributes that may not be readily apparent on paper.

In a perfect world the quality of an expert's work product should stand objectively on its own merits; however, the real world is more often affected by subjective considerations. In addition to having high quality work, an expert must also be persuasive; unfortunately, the most accurate work product is not always the opinion that prevails. The charisma of the expert is often more convincing than the quality of their work, which frequently leads to the success of a case hinging on the persuasiveness of its expert. If two experts are equally qualified and experienced, the expert who can more astutely explain the work without condescension may prove to be more valuable.

A beauty contest may not necessarily produce a single winner. A strategy that also works well involves retaining two forensic accounting practitioners as consultants at the outset and then eventually designating only one of the practitioners as the expert. This strategy comes with its own pros and cons.

On the positive side, two consultants can collaborate to strengthen the opinions that are eventually concluded. Furthermore, if two forensic accountants are retained as consultants — especially when the case at hand deals with complex or innovative theories — then the attorney has the option of selecting only one of the consultants to continue as an expert, usually the consultant who develops the most solid opinions given a preponderance of the evidence.

The potential downside to this strategy, however, is that retaining two consultants is expensive. Additionally, if both consultants are subsequently designated as experts, a separate problem may arise if the two experts independently develop different opinions. In such a case, the two experts could conceivably be used by the opposition to rebut the opinion of the other.

CONCLUSIONS / CHALLENGE

The objective of this article has been to identify issues that relate to the qualification and selection of forensic accounting experts. Our motive in composing this article, however, has been to challenge academia. The foundational skills of forensic accounting experts are directly related to the quality of education received in school. Currently, most training for forensic accountants occurs outside of the university environment. Although universities are beginning to recognize forensic accounting as an expertise separate and apart from auditing and tax, there is still a general lack of university-level courses on investigative accounting, economic loss/damage calculation, and business valuation.

We hope that this article promotes further discussion within academic circles on ways that the forensic accounting syllabus can be strengthened to prepare students to become effective forensic accounting experts.