

# The Witness Chair

Leading-edge Ideas for CPA Experts Providing Litigation and Dispute Resolution Services

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## Reasonable to Stickler: I Don't Need a Report, I Just Want a Number

by Charles Burak, CPA  
and Donald A. Glenn, CPA

Attorney Jim Reasonable needs a valuation of Concrete Co. for a settlement conference scheduled for next week. He calls Joe Stickler, a forensic CPA, who has been reading the new business valuation standards. We pick up the conversation when Reasonable casually requests a valuation number based on a couple of years of financials he just faxed:

**Stickler:** So, what kind of engagement would you like?

**Reasonable:** I just want a number.

**Stickler:** OK, but will it be a "valuation engagement" leading to a "conclusion of value" or a "calculation engagement" leading to a "calculated value"?

**Reasonable:** Which is better?

**Stickler:** The valuation engagement is more comprehensive.

**Reasonable:** I'll take that.

**Stickler:** Good. We'll evaluate various aspects of the company. The financials you sent look good. If you could send over another three years of financials and six years of general ledgers, then we can start. We'll need a couple days to research the company. Then I'll talk to the owner so we can set up our site visit ...

**Reasonable:** You don't understand. I just need an estimate so we can settle. Our settlement conference is next week.

**Stickler:** Impossible.

**Reasonable:** Last year, another CPA, Ms. Broadbrush, gave me a number the same day. Nothing special. All I need is one page with an estimate. It can even be a range.

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*We have new standards this year. All CPAs must now follow Statement on Standards for Valuation Services No. 1 effective Jan. 1, 2008. A one-page report without thorough analysis was risky before, but now it's not allowed under the new standards.*

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**Stickler:** Well, we have new standards this year. All CPAs must now follow the *Statement on Standards for Valuation Services No. 1* effective Jan. 1, 2008. A one-page report without thorough analysis was risky before, but now it's not allowed under the new standards.

**Reasonable:** Does everyone follow these standards?

**Stickler:** All AICPA members. The California Board of Accountancy routinely adopts AICPA's standards

in its regulations, so all California CPAs fall under the new standards. NACVA has also implemented similar standards.

**Reasonable:** The parties want a CPA to sign off on the number.

**Stickler:** The other option is to step down to a "calculation engagement." It is a lesser service, but will give us some flexibility.

**Reasonable:** OK, what does that mean?

**Stickler:** I'll still do quite a bit of work, but there are steps that we can agree will be limited or excluded. We will have to agree on a list of limitations that we call "assumptions and limiting conditions."

**Reasonable:** What will be in this list?

**Stickler:** Any documents I haven't seen, people I did not interview, offices I didn't visit, a list of the accepted methods of value that I did not apply, etc.

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## Section ACTION

### Business Valuation

by Cindy Craig, CPA

As noted by Shannon Pratt, “the value of an interest in a business depends on the future benefits that will accrue to the owner.”

While fundamental in concept, determining expected future benefits is where the rubber meets the road. In general, future benefits are measured by cash flow available after accounting for ordinary and necessary business expenses and expected cash flow demands.

In many valuations, particularly those for divorce, future benefits are typically measured via an analysis of historical operations. Reported income is examined and adjusted to eliminate discretionary expenses and non-recurring items.

In addition, compensation paid to the owner is examined to ascertain if it is comparable to what a new owner would expect to pay someone to do the same job. As with beauty, what is “reasonable compensation” is often in the eyes of which spouse’s attorney is looking at the analysis.

Given the significant impact a compensation adjustment can have on value and that attorneys frequently challenge this adjustment, it is critical for valuation analysts to gain additional skills and tools in this area. One resource that will provide such an opportunity is the May 28 California CPA Education Foundation Business Valuation Conference in Los Angeles.

Planned by CalCPA’s Business Valuation Section, the all-day, single-topic conference will address fundamental to advanced compensation topics and provide valuation analysts with additional training.

Presentations include “Adjusting Compensation: Fundamentals and Beyond,” “How to Statistically Analyze a Survey,” “Compensation Issues

in Marital Dissolutions,” “Adjusting Compensation for Business Valuation,” “Cross Examining the Expert” and “Determining Compensation Using Public Company Data.”

To view the full schedule and speakers, and to register, visit [www.educationfoundation.org/courses/detail.asp?Par\\_EventID=58145001&Par\\_EventYr=08](http://www.educationfoundation.org/courses/detail.asp?Par_EventID=58145001&Par_EventYr=08).

Cindy Craig, CPA, ABV is Business Valuation Section chair and a partner at Andersen & Company LLP in Santa Rosa.

### Economic Damages

by Colin A. Johns, CPA

Since *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.* [511 U.S. 164 (1994)], which held that there was no private cause of action for aiding and abetting a Sec. 10(b) violation, plaintiffs have pursued claims against third parties under a theory of scheme liability. Under this theory it is argued that a party that does not make a public statement or violate a duty to disclose can be liable if it participates in a scheme to violate Sec. 10(b).

In *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc., et al*, the U.S. Supreme Court recently affirmed the dismissal of claims of scheme liability by the Eighth Circuit Court of Appeals.

This case involved allegations that Scientific-Atlanta (S-A) and Motorola, Inc. participated in a scheme with Charter Communications, Inc., whereby Charter overpaid S-A and Motorola \$20 per digital converter box, in return for S-A and Motorola purchasing more advertising from Charter. By capitalizing the overpayments and recognizing the increased revenue, Charter met its financial targets for 2000.

The Court held that, following the *Central Bank* decision, the conduct of a secondary actor must satisfy all of the elements or preconditions for liability under Sec. 10(b). In *Stoneridge* it reasoned that the “respondents’ deceptive acts, which were not disclosed to the investing

public, are too remote to satisfy the requirement of reliance.”

While this may be good news for vendors, the Court did state that “(a)ll secondary actors ... are not necessarily immune from private suit. The securities statutes provide an express private right of action against accountants and underwriters in certain circumstances, and the implied right of action in Sec. 10(b) continues to cover secondary actors who commit primary violations.”

Colin A. Johns, CPA, CFE, CA is Economic Damages Section chair and a director in the litigation and forensic consulting practice of Hemming Morse, Inc. in San Francisco.

### Family Law

by Tracy Farryl Katz, CPA

Engagement letters is a subject that is near and dear to all practitioners’ hearts. In a recent unpublished opinion, the California Supreme Court upheld the Appellate Court’s October 2006 ruling favoring the enforcement of a provision in Gursey | Schneider LLP’s (Gursey) engagement letter, which was drafted to promote judicial economy and provide some measure of certainty to both the client and the firm should a fee dispute or a malpractice claim arise from their engagement.

The disputed provision in the Gursey engagement letter can be summarized as follows: “The plaintiff must raise any professional negligence claims as an affirmative defense in any fee related arbitration with Gursey. Any damages that the Plaintiff is entitled to recover for a claim of professional negligence are limited to an offset of their outstanding fee balance in the arbitration proceeding. Should the plaintiff feel entitled to recovery beyond the outstanding fee balance, a separate suit must be brought in a Court of Law.”

In the instant case, Plaintiff failed to raise such an affirmative offsetting claim in the arbitration with Gursey. At that arbitration, Gursey

was successful in recovering its unpaid fees. After losing the fee arbitration, Plaintiff filed suit in Superior Court alleging malpractice.

The trial court found that Plaintiff's action was barred by her failure to assert that claim in the arbitration. The Court of Appeal affirmed that ruling in a lengthy opinion, addressing each of the Plaintiff's allegations. The Plaintiff appealed to the Supreme Court, which granted *certiorari*. In January 2008, the Supreme Court affirmed the Appellate Court's ruling in an unpublished decision.

While this ruling is a "win" for Gursey, the Appellate Court's dissenting opinion raises issues that should be considered by practitioners drafting similar provisions for their engagement letters. On May 16, the Family Law Section is having Randall J. Dean, Esq., of Chapman, Glucksman, Dean, Roeb & Barger P.C., who represented Gursey in this matter, address this issue and provide practitioners with some guidance.

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*Tracy Farryl Katz, Esq., CPA is Family Law Section chair and a partner with Gursey | Schneider LLP in Los Angeles.*

## Fraud

*by B. Marie Ebersbacher, CPA*

Some fraud engagements start with a call from counsel or your new client with a specific incident or analysis in mind. The key to being a successful consultant or expert witness in the fraud arena is to ask questions early on and be prepared for the investigation to take on a much larger life.

For example, assume in a case of a small-business fraud, the bookkeeper is suspected of embezzling funds from a business run by a husband and wife. In your first meeting with the client ask if a police report has been filed. If it has, request a copy. Also ask if the bookkeeper has been interviewed. If so, make sure you know what that person said, as this can help you modify your analysis to help prosecutors do their job.

In one recent case a bookkeeper claimed she was having an affair with the husband, that the two of them had colluded to steal from the com-

# Message from the Chair

*by Mark Luttrell, CPA*

As I near the end of my term as chair of the Litigation Sections, I'm grateful for the opportunity to work with the exceptional leaders and other professionals involved with our Litigation Sections. These leaders, along with the outstanding CalCPA management team, have provided vital contributions to our members during their term.

Moving into 2008, the Section leaders have completed plans for an exciting future. Task forces have been established to address some of the most interesting and controversial issues within each practice area. The results of this work are of enormous benefit to CalCPA members, as well as to judges, attorneys and the profession as a whole. Active involvement in Section meetings is the best way for members to truly benefit from the activities of each Section.

CalCPA's annual CPA Day at the Capitol is May 13 in Sacramento. This is the most important event in recent memory and one that calls for the attendance of all practition-

ers in our state. California is behind the times on the issue of license mobility and interstate commerce. We practice in one of the few states that has unusual and restrictive practice privilege requirements, thereby creating a barrier for California CPAs to practice in other states.

ers in our state. California is behind the times on the issue of license mobility and interstate commerce. We practice in one of the few states that has unusual and restrictive practice privilege requirements, thereby creating a barrier for California CPAs to practice in other states.

As CPAs, we are frequently required to endure significant and unnecessary administrative problems when attempting to conduct even casual practice in another state. This creates problems whether we are sole proprietors or members of large firms. More importantly, it impairs our ability to serve clients in a global economy. This issue must be resolved.

I look forward to a wonderful 2008 and CalCPA's Litigation Sections' continued leadership in the litigation services field. I also look forward to seeing you all in Sacramento May 13!

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*Mark Luttrell, CPA, ABV is the managing director of CBIZ & Mayer Hoffman McCann's Southern California offices.*

pany without the wife's knowledge, and that she gave all of the money to the husband. While this sounds like a "he said/she said" scenario, forensic accounting was able to provide some real evidence. An analysis of the bookkeeper's expenditures clearly showed that she had spent all of the money that she had obtained through the phony vendor scheme.

Assume your client is a company with tens of millions of dollars in revenue and suspects a high level and valued executive of committing fraud in the form of expense-account abuse. In this case, the client isn't looking to prosecute or terminate the employee, but is looking to quantify the amount

of abuse for purposes of negotiation. Be careful that this assignment does not limit the scope of your analysis to the point where you miss a larger fraud.

In a recent case, an engagement that started in this way ended with the terminations of the executive and two managers in his department. Someone who is willing to fudge an expense report is often willing to do more, and an analysis of the funds within that person's control should be included in the scope of the analysis.

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*B. Marie Ebersbacher, CPA, ABV, CFE is Fraud Section chair and a shareholder with CBIZ & Mayer Hoffman McCann P.C. in Bakersfield.*



## The Proper Standard of Value Used in a Family Law Appraisal

by Stephen James Wagner, Esq.

The following legal principles establish which standard of value to use in appraising a business or professional practice (hereinafter “business”) in a dissolution proceeding. Generally, the fundamentals of a business appraisal are universally accepted. However, when the business is being appraised in a marital dissolution, the fundamentals must be altered to fit California family law.

### The Right Standard

As detailed in Gray & Wagner's *Complex Issues in California Family Law—Volume G, Family Law Business Valuations: The Fundamentals of Business Valuation for Family Law Practitioners and Forensic Experts*, the attorney is responsible for the soundness of the standard of value used in the appraisal because the proper standard of value is a legal issue, not an appraisal issue. However, the appraiser should be aware of the law relating to the proper standard of value to assist the attorney in selecting the proper standard. If the wrong standard is used, the appraiser's testimony may be inadmissible.

Business appraisers often apply the wrong standard of value in dissolution proceedings because the attorney has not instructed the appraiser on which standard to use and the

appraiser misunderstands the applicable law.

### 'Fair Value' vs. 'Investment Value'

Appraisers commonly, though incorrectly, use the “fair value” or “marital value” standard. The “fair market value” standard is properly used where the business being valued is truly marketable. If the business is not truly marketable, then an alternative approach must be used, normally the “investment value” standard.

In *Marriage of Cream* [(1993) 13 CA4th 81, 87, 91, 16 CR2d 575], the court stated the proper standard of value when a business is marketable:

“... the fair market value of a marketable asset in marital dissolution cases is the highest price on the date of valuation that would be agreed to by a seller, being willing to sell, but under no obligation or urgent necessity to do so, and a buyer, being ready, willing and able to buy, but under no particular necessity for so doing. *We restrict the use of this definition to marketable assets because some marital assets are not marketable, but nonetheless may have to be valued.*” (Emphasis added.)

This opinion sets forth the legally correct standard of value of marketable assets and lays the foundation for a different standard where there is no market for the asset in question. This different standard most often is “investment value.”

Shannon Pratt, a pre-eminent business valuation author, distinguishes investment value from fair market value in *The Lawyer's Business Valuation Handbook*, ABA Family Law Section (2000), as follows:

“The primary distinguishing characteristic of investment value is that it denotes value to a particular owner or investor. This is in contrast to fair market value, which is a concept of value in exchange, assuming hypothetical, typically motivated buyers and sellers. In other words, investment value is the value to a particular individual or entity, considering that individual's or entity's situation, perceptions, and motivation, not necessarily value in the marketplace ... *Whether or not the*

*term investment value is actually used, the concept is found frequently in business valuations for marital dissolution. That is, the courts often focus on value to the spouse who operates the business as opposed to value that could be realized in the market.*” (Emphasis added.)

The distinction between fair market value and investment value was discussed in *Marriage of Hewitson* [(1983) 142 CA3d 874, 887, 191 CR 392]. In this case, the Second District held that the trial court inappropriately used the price-earnings ratio valuation method for stock in a *closely held business*, because such a method is not applicable to such businesses, at least to the extent it was the sole method used to determine the fair market value of the business.

It explained the methods typically used to value corporate stock and why such methods did not apply to *close corporations*, particularly in dissolution actions, and distinguished between fair market value and investment value:

“Husband further contends that section 4800, subdivision (a) of the Family Law Act (Civ. Code, Sec. 4800, subd. (a)) requires the trial court to determine the present *market value* of Ronan. Husband also argues that inherent in the concept of present market value is the requirement that a valuation be based on all cash transactions. *We cannot agree for the following reasons.*

“Neither of the two methods used to determine the hypothetical market value of closely held shares is available in this case. First, the evidence here does not show any recent sales of Ronan's stock. Second, the use of the price-earnings ratio approach as the sole method to determine the market value of Ronan is improper (as we have explained) and, hence, unavailable. *We hold, therefore, that the determination of the value of Ronan by its investment value, as distinguished from its market value, will satisfy the mandate of Civil Code section 4800, subdivision (a).*” (Citations omitted, emphasis added.)

It is critical for appraisers to make sure that their family law attorney is

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by Christian Tregillis, CPA

The new year brings a change in the name and acronym of the AICPA section dedicated to forensic accounting and business valuation: Business Valuation and Forensic & Litigation Services (BVFLS) is now Forensic and Valuation Services (FVS).

In addition, many resources to assist practitioners in a wide range of contexts and types of analysis are available on the FVS website, <http://fvs.aicpa.org>.

Resources available to members include practice aids, website-only articles and publications, back issues of articles and AICPA publications (e.g., *CPA Expert*, *The Practicing CPA*, *The Journal of Accountancy* and *FVS Focus*), process/information checklists, practice standards, legal parameters/

case law, special reports and links to external resources. The tools are grouped by practice or specialty area, including the following:

- Analytical Guidance
- Antifraud/Forensic Accounting
- Bankruptcy
- Business Valuation
- Document Retention and Electronic Discovery
- Economic Damages
- Fair Value for Financial Reporting
- Family Law
- Laws, Rules, Standards and Other Guidance
- Litigation Services
- Practice Aids and Special Reports
- Practice Management

In 2007 one noteworthy addition was *FVS Practice Aid 07-1: Forensic Accounting & Fraud Investigations*. This practice aid, which addresses fraud investigations performed as a management consulting service, discusses the CPA's responsibilities, opportunities and assignments in fraud related matters. Topics include:

- Investigating Suspected Fraud

- Investigating Assertions of Fraud
- Developing Fraud-Loss Estimates
- Scope of Practice
- Conflicts of Interest
- Engagement Acceptance Issues, Including Payment of Fees
- Oral or Written Understandings
- Staffing Engagements
- Engagement Performance Considerations (including Working with Client Records, Conducting Interviews, etc.)
- Communication of Findings
- Legal Bases for Fraud Allegations and Related CPA Services

The practice aid also provides samples describing the scope of work for fraud investigation, engagement letters, a list of circumstances that may imply fraud and descriptions of a sampling of fraud schemes.

So, don't overlook the FVS website when you're searching for litigation practice reference materials or guidance.

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*Christian Tregillis, CPA, ABV is managing director of Kroll Financial Advisory Services in Los Angeles.*

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## I Just Want a Number

*Continued from Page 1*

**Reasonable:** So you will list all omitted materials and methods?

**Stickler:** You got it. That's why many professionals believe it is too risky in litigation to use a "calculated value" rather than a "conclusion of value." Calculated values are not as persuasive, particularly if the other side prepares a conclusion of value.

**Reasonable:** So if you do all of this and we agree on a list of all the limiting conditions, then you'll give me a number?

**Stickler:** Then I can write a report.

**Reasonable:** I don't need a report; just get me a number. Isn't there an exemption for litigation?

**Stickler:** Yes, but it only applies to reports, not development, which includes our analysis and documentation. This means we have to do the work and document it in our file; we

just don't have to put it all in a formal report.

**Reasonable:** That's pointless. The other side will just demand to see your files and will get all your work anyway.

**Stickler:** That's right. We're documenting all the work already, so we might as well put it into a report and we can fully explain the results of our assignment.

**Reasonable:** Fine. So the report will have my number?

**Stickler:** Actually several. It is common that each method results in a different value.

**Reasonable:** Are these numbers going to be close?

**Stickler:** Hard to tell. Often there are large differences in the results of different methods.

**Reasonable:** So, after everything, you're going to give me a report that includes possibly significantly different results? This is supposed to help me bring the parties closer together

and settle their differences? All I want is a number.

**Stickler:** In a valuation engagement, I'll reconcile the results of the various methods so you understand why they are different. My report will also include a recommendation of value. Your number will be on Page 1 in the executive summary.

**Reasonable:** Finally a number! For settlement, it appears my client should go with a conclusion of value, not a calculated value. I'll continue my settlement conference to allow you time to complete a valuation engagement and provide a conclusion of value. So, how much is this going to cost?

**Stickler:** Well ...

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*Charlie Burak, CPA and Donald Glenn, CPA are members of Glenn & Dawson, LLP in Walnut Creek. They specialize in forensic cases, including business valuations.*

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# H A P P E N I N G S

## Litigation Sections Meetings

Business Valuation	Thursday, Aug. 21, LAX
Economic Damages	Wednesday, May 21, OAK Friday, Aug. 15, LAX
Family Law	Friday, May 16, OAK Friday, Aug. 22, LAX
Fraud	Tuesday, May 20, OAK Thursday, Aug. 14, LAX

Each section will send individual meeting notices.  
Download a copy at [www.calcpa.org/LIT](http://www.calcpa.org/LIT)  
or contact Bobbie Nochenson at (818) 546-3502.

## Education Foundation Course Offerings—(800) 922-5272 or [www.educationfoundation.org](http://www.educationfoundation.org)

Business Valuation Conference	Wednesday, May 28, LAX
Fraud in Audit, Accounting and Tax Conference	Thursday, June 19, BUR Friday, June 20, SF
Family Law Conference	Thursday, Oct. 23, SF Friday, Oct. 24, LAX

## Help Pass Mobility Bill AB 2473: Attend CPA Day at the Capitol May 13

CPAs Roger Niello and Fiona Ma, both CalCPA members, have introduced AB 2473, sponsored by the California Board of Accountancy, to help address CPA mobility issues.

CalCPA supports AB 2473 and encourages you to speak to your local legislators and educate them on the importance of this bill to you and the businesses and individuals with whom you work, including the difficulties you encounter when testifying in other states. Ten other states

have already enacted similar mobility provisions and 30 or more are pursuing changes this year.

For more information, including background information and links to your legislators, and to register for CPA Day at the Capitol May 13, visit [www.calcpa.org/mobility](http://www.calcpa.org/mobility).

Please copy CalCPA on communications with your legislators; e-mail [cpalobby@calcpa.org](mailto:cpalobby@calcpa.org), or fax to (916) 441-5354. If you have questions, call CalCPA's government relations department at (916) 441-5351.

## Renew Your CalCPA & Litigation Sections Membership Today!

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provide, such as education, representation and opportunities to network and grow. Renew your membership today.

## Keepin' it Legal

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familiar with the investment value approach. It is often the legally correct standard of value to use, *especially when a business is truly not marketable*. To use the fair market value standard when a business is not truly marketable can result in the opinion of value being inadmissible.

In some instances, the appraiser and attorney may use more than one standard, thus allowing the court to determine which one is permissible.

It is not the place of the appraiser to advise anyone on legal principles. Still, the appraiser should raise the issues addressed herein and discuss with the attorney whether or not the business is marketable and which standard of value to use.

*Stephen James Wagner is a Certified Family Law Specialist and partner in the Sacramento law firm of Dick & Wagner, specializing in complex family law matters.*

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