THE Witness Chair

Leading-edge Ideas for CPAs Providing Litigation and Dispute Resolution Services

WINTER 2010 California Society of Certified Public Accountants ISSUE 51

Open(ing) Kimono

by Everett P. Harry, CPA

Have you been the subject of a motion in limine? Did the court restrict your testimony in full or in part?

When you testify for defendants, don't you often discount future damages at double-digit rates?

Did you copy any portions of this expert report from a report prepared for a prior engagement?

Opposing counsel may ask such questions at a deposition or at trial. Is the attorney just fishing for information or prepared to contrast your response to some very specific information from or about an earlier engagement? For a well-prepared examiner, the latter explanation may be correct.

A number of companies sell information related to an expert's prior engagement history. Using the internet and searching an expert's name through one of these websites may locate a number of documents related to a named expert, including deposition transcripts, written reports, trial court orders, trial motions, verdict and settlement summaries, appellate briefs and court decisions. The cost to access these documents is not insignificant, but may be reasonable for opposing counsel seeking any possible advantage for his or her client.

Available Information

I examined the information available from one commercial provider, Westlaw, using myself as the test case. Although I provided my first expert testimony in the early 1980s, I have averaged about a dozen testimony or court appearances per year over the last decade. In addition, I prepare several written expert reports each year, primarily since the advent of the Federal Rule 26 reporting requirements (which I also follow for certain non-federal cases).

- The search provided 40 documents referencing my name, however, the documents related to no more than 24 engagements.
- The oldest document was from 1997, but the document dates were concentrated in the last five years. The most recent document was a deposition transcript less than 6 months old.
- I understand that the documents are obtained from court filings and then electronically captured by scanning or optical character reading. At least for my available deposition transcripts and expert reports, OCR appears to have been employed.

Observations About Available Documents

I reviewed the available documents that included my name and have several observations:

1) I anticipate the volume of available documents by expert will grow significantly in the future.

As noted above, more recent documents dominate what is available about me, so I expect the commercial providers of this information will focus on relatively recent and future court filings compared to older historical archives, which may be less subject to remote electronic access.

2) A few documents related to matters for which I have no knowledge or recollection.

For example, one trial verdict statement listed me as an expert but I recall no, if any, substantive involvement in the case. Apparently, I was a designated expert in court-filed papers, but did not perform any work or testify at trial. In another instance, I was the subject of a motion in limine that was not brought to my attention, even though the court rejected the motion.

3) For the three motions in limine cited for me, the court-written decisions are also available. Two cases involved challenges to my professional experience, which were soundly rejected by the courts. The other matter did not involve my credentials, but challenged the credibility of client information relied upon by me. Again, the court rejected the arguments of opposing counsel.

4) About a dozen verdict and settlement summaries are available.

At first glance, I was the named expert for the designated prevailing party about half of the time. Even if an opposing attorney was allowed to refer to the reported results, the relationship to my work is not readily obvious. Judges and juries often reach verdicts on bases that have little to do with a particular expert's testimony about damages.

For example, if the trier of fact determines that the defendant has no legal liability toward plaintiff, then it matters little what the economic experts for either the plaintiff or defendant opine.

For at least two matters for which I was a defense witness, the verdict summaries reported plaintiff awards, but these cases involved admitted defendant liability, so some award amounts were givens. For at least one of these cases, both plaintiff's expert and I agreed on the damages amount.

Finally, one verdict summary showed a plaintiff award with me as the named defense expert. The subject plaintiff was also my client as a defendant in a consolidation

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Section Action

Business Valuation

by Scott T. Dye, CPA

How many times do we read cases relating to family limited partnerships (FLP) that portend to be valuation cases, when in fact they have little to do with valuation and everything to do with drafting of the partnership documents or the ultimate handling of the operations of the partnership? These are often referred to as "Bad Facts Cases."

As business appraisers, we are either brought in on the formation of FLPs to value the entity or some of the limited partnership interests for gifting, or we might be valuing an FLP after it has been formed and in existence for a while. One issue that faces the valuation analyst is what to do if you believe it is a defective FLP.

At formation, although we are not attorneys and cannot give legal advice, our experience may recognize issues that could cause future problems. In such instances we should discuss the issues with the FLP's legal counsel to correct the matter and, if it is resolved to our satisfaction, we should be able to continue and value the entity. This is assuming the owners of the FLP will operate as planned and in accordance with the FLP agreement.

If the issues are not corrected, resulting in what we feel could present problems in the future, we might consider not performing the valuation.

If the FLP has been in existence for several years and we observe or discover that there are issues that we reasonably believe might cause the FLP to be disregarded by the IRS, we should probably not take the engagement. By taking the engagement we are only putting ourselves at risk of placing a value on an entity that may not have any legal standing and we will become part of the problem. This is true even though we had nothing to do with the creation or operations of the FLP.

It is an unfortunate situation, but appraisers should take a long, hard look at FLPs before accepting the valuation engagement so they don't become a part of a "Bad Facts Case."

Scott T. Dye, CPA, ABV, CVA *is Business Valuation Section chair and a shareholder of Stoughton Davidson Accountancy Corporation in Fresno.*

Economic Damages

by Christian D. Tregillis, CPA

In a ruling that strengthened the position of user-generated video internet sites such as YouTube and Veoh Networks, which have been sued by large media companies owning rights to copyrighted content, Judge Howard A. Matz of the Central District of California ruled in *Universal Music Group v. Veoh Networks* that Veoh qualifies for protection under the safe-harbor provision of the Digital Millennium Copyright Act (DMCA).

The ruling comes after his rejection of UMG's attempts to undermine Veoh's safe-harbor defense in 2008 and may have ramifications in a similar lawsuit filed by Viacom against YouTube.

Veoh is a user-generated video site that operates similarly to YouTube, albeit on a smaller scale. UMG sued Veoh over the presence of infringing videos on the site, accusing Veoh of "engaging in high-tech theft in the name of 'sharing,'" which UMG argued disqualified Veoh from protection under the DMCA due to the transcoding of videos on the Veoh site.

As the issue of the safe-harbor provision was heard, Judge Matz held a meeting in his chambers and noted that Veoh "expeditiously" took down infringing material once it was notified of its existence and employed filtering and fingerprinting software to prevent uploading of infringing clips.

"Veoh has provided substantial evidence that it fulfilled the requirements of section 512(c)(1)(A)," wrote Judge Matz. "UMG has provided no material evidence to the contrary."

He continued: "No doubt it is common knowledge that most websites that allow users to contribute material contain infringing items. If such general awareness were enough to raise a 'red flag,' the DMCA safe harbor would not serve its purpose of 'facilitat[ing] the robust development and world-wide expansion of electronic commerce, communications, research, development and education in the digital age,' and 'balanc[ing] the interests of content owners, online and other service providers, and information users in a way that will foster the continued development of electronic commerce and the growth of the Internet.'"

UMG said in a statement, "The ruling today is wrong because it runs counter to established precedent and legislative intent, and to the express language of the DMCA," and vowed to quickly appeal to the Ninth Circuit.

Many pundits believe the case is likely to impact a similar case that Viacom brought against YouTube, which is pending in New York. To the extent that YouTube is taking similar steps to those of Veoh to identify and take down infringing content, YouTube may be able to use the same safe-harbor protection from the DMCA.

Christian D. Tregillis, CPA, ABV, CLP *is Economic Damages Section chair and managing director of LECG in Los Angeles.*

Family Law

by Lionel T. Engleman, CPA

One of the most important things we can do for our clients is to help them understand our role in the engagement. We should clarify our role with the attorney and communicate it to the client. Clients may need assistance understanding issues like:

- The reasons a forensic accountant is needed;
- The specific areas for which the accountant will be responsible;
- Who will provide direction to the accountant;
- The estimated costs involved;
- The inability to set a fee limit;
- The responsibility of the accountant to establish their own separate opinion (i.e., the limitations of being the advocate for a professional opinion vs. an advocate for the client);
- The difficulties of matching the benefit of work performed directly to its underlying costs;

- The client's responsibility for the accountant's fees; and
- The limitations of the accountant's work as it relates to the attorney's function.

We also need to understand the importance of communication with the client. This communication starts with establishing the scope of our engagement. If we leave this vague, the client will assume that we can solve all of the financial misunderstandings. The scope can always be expanded as the case proceeds. Direct communication can also help us determine our client's financial knowledge. Frequent communication may also provide the client with better knowledge of the processes and the work being performed.

We can set client meetings or discussions at various milestones throughout the assignment, during which we can advise the client of the framework and importance of the tasks on which we are working. The specifics should include where we are in the process of our assignment and an estimate of the time and cost necessary to complete or work.

These discussions also allow us to advise the client of difficulties we have encountered and what additional information or documents would be helpful. Often the expectations of the client need to be compared with the cost of obtaining or pursuing the solution to the specific financial questions.

We should also continue to provide cost estimates for the client. While cost estimation is not easy to do, we should make the attempt. Just be sure to include the caveat that the estimates may change based on the level of cooperation with discovery, type of litigation, trial process and, of course, the level of conflict between the parties.

Lionel T. Engleman, CPA *is Family Law Section chair and shareholder in Engleman Accountancy Corporation in San Mateo.*

MessagefromtheChair

by Ronald L. Durkin, CPA

A recent article by Janice Simmons in *Healthleaders Media* (Oct. 29, 2009) discussed the health care fraud problem in America. U.S. Sen. Patrick Leahy was quoted as stating, "The scale of healthcare fraud in America today is staggering." According to recent estimates provided in the article, "about 3 percent of the funds spent on health care are lost to fraud, more than $60 billion a year."

Some 10 or so years ago at the FBI academy, the special agent in charge of the health care fraud unit talked about health care fraud being a $10 billion problem. That was a pretty big number back then and I made a note to myself to start learning more about health care so that I could get a piece of the action.

Considering that health care fraud is on the rise, what should you do to expand your service offerings, learn more about this type of fraud or, in other words, meet the challenge?

Just consider the exponential increase in health care fraud in the last 10 years as mentioned above and you can see the opportunities created in the forensic accounting marketplace.

Forensic accountants can assist clients by helping them assess the risk of fraud and abuse within their facilities, as well as respond to allegations of wrongdoing. Forensic services could involve using data analytical tools to search for various attributes such as overbilling, double billing and other forms of false representations made to federal and state governmental agencies. Other areas of concern involve possible corruption where kickbacks may have been made from suppliers to purchasing managers or others who arrange for services, equipment purchases or rentals and pharmaceutical products. Another area of concern is related party transactions, which may be a means of diverting funds and opportunities.

I hope that we all consider learning more about this important area and try to find ways to help eradicate the waste, fraud and abuse in the health care industry.

— **Ronald L. Durkin, CPA, CFF, CFE, CIRA** *is senior managing director of Durkin Forensic, Inc. in Los Angeles.*

Fraud

by Jennifer Ziegler, CPA

Fraud has been a familiar headline in the last several years. Madoff, Enron and Stanford Financial Group have become recognized names as a result of the frequent reporting of shockingly large fraudulent schemes. But we rarely hear about the 7 percent of fraud losses by U.S. companies each year to asset misappropriation, corruption or fraudulent financial statements.

According to the 2008 Report to the Nation on Occupational Fraud and Abuse, the median loss attributed to fraud was $175,000, while 25 percent of instances resulted in companies' losses of greater than $1 million. The largest losses related to fraudulent financial statement reporting.

Small companies and organizations with fewer than 100 employees usually have limited resources to combat fraudulent activities and, consequently, may not have adequate controls in place to detect fraud in a timely manner.

These small companies and organizations were the victims of the most number of thefts. These thefts included billing schemes for invoices that were submitted for fictitious sales or personal purchases; skimming, which was cash stolen before it was recorded; stealing of company assets other than cash; and corruption schemes, in which employees use their influence in business transactions that violates their duty to their employer in order to enrich themselves.

CPAs must be prepared to help companies identify how the fraud occurred so that future frauds can be prevented. Prevention requires keeping current on industry trends and processes and using that knowledge to proactively monitor client companies for fraudulent activities.

Jennifer Ziegler, CPA, CFF, CFE *is Fraud Section chair and a director at Hemming Morse, Inc., CPAs, Litigation & Forensic Consultants in Los Angeles.*

Keepin' It Legal

In re Marriage of Blazer: 'Take One Dip and End It'

by Mike Radakovich, CPA

The Blazers were part owners of a company called Blazer-Wilkinson LLC (BW), a brokerage company that bought and sold produce. The court valued BW at $5.6 million for purposes of the dissolution using the excess earnings approach. It was extremely profitable, enough to justify a temporary support for Wife at $57,224 per month, plus $8,000 of child support effective July 2002. However, permanent support was set at only $20,000 starting Jan. 1, 2006.

Apparently, the reduced support was predicated in part on Husband's argument that a portion of BW's income was not available to him; rather, it was needed by BW as capital to fundamentally change its business operations to keep it profitable.

In her appeal of the spousal support order, Wife argued that the trial court abused its discretion by excluding from Husband's income the portion of BW's profits set aside for a new business venture.

Husband cross-appealed, challenging that since BW was valued using the excess earnings method, Wife unfairly "double dips" into the same income stream from his business—once in the payment of goodwill and again for support.

Before I address the "double dip" (a term I inherently dislike), I would like to comment on what I believe is the important issue of this case: a fairly thorough discussion of available income and its relationship to support, both spousal and child.

Income Available for Spousal Support

On appeal, Wife took issue with certain expenditures that the lower court allowed in determining Husband's income available for support: ". . . wife argues that by excluding 'income that was used by [husband] to diversify into other areas of his business to establish a more vertically integrated business,' the court 'failed to use the total of [husband's] income in setting support which is an abuse of . . . discretion.' Wife challenges only the nature of these expenditures, not the amount."

The court acknowledges that there is no statutory definition of income for spousal support and that child support and spousal support serve a different purpose. The applicable time frames of spousal support and child support are fundamentally different. The purpose of child support reflects a child's right to be maintained in a lifestyle and condition consonant with their parents' position in society *after* the dissolution of the marriage, whereas spousal support orders require a consideration of the parties' standard of living *during* the marriage.

For purposes of income for spousal support, the court divided the net profits of BW into two types—income that is available to Husband and income that is required by the business. Income that the lower court deemed required by the business is not income available for support. Only income available to Husband was counted for spousal support. Accordingly, the amount of income needed to "vertically integrate" was not available for spousal support. It further went on to say that it would allow this required reserve to "vertically integrate" as an allowable deduction for child support purposes.

The reserve concept is not new, but there is new terminology—"income of the business" versus "income of the supporting spouse." However, the concept of a reserve for business restructuring or expansion is new. Furthermore, the discussion regarding the interaction of child versus spousal support is insightful.

Double Dip

Although for most of civilization the propriety of "double dipping" was settled in a "Seinfeld" episode (the punch line is quoted in the article title), but we in family law had to wait for this case.

This is an unpublished part of the opinion. However, I believe that this sheds light on eventual resolution of principal versus income in determining income available for support.

Our colleague, Don Miod, was quoted by the Court to summarize the double dip issue:

"In circumstances in which the property division includes a business to be valued, it will most likely include both tangible and intangible assets. If the value of an intangible asset, such as goodwill, is charged to one party, the income stream, which is being used for the calculation of income available for support, is most likely the same income stream that was used for the computation of goodwill. Hence, the double dip."

The court approaches the issue of buying out excess earnings twice, once as goodwill and a second time as spousal support with the pension analogy.

In *In re Marriage of White* [(1987) 192 Cal.App.3d 1022], Husband paid for the pension received in the property division agreement and when he began receiving distributions from the pension after separation, these distributions were considered income for purposes of support. Husband claimed this was "double dipping" on behalf of his ex-spouse.

The *White* court stated, "spousal support considerations are separate and distinct from property division concepts." They implicitly rejected the double-dipping theory.

The problem with the *White* case is that it was argued using the inflammatory "double dip" term. Husband's argument was that: "… the parties' property division agreement removed the pension from the trial court's jurisdiction. Otherwise, he urges, Bernice will twice receive the benefit of the pension, once upon dissolution and again for spousal support. This, according to Dewitt's reasoning, is 'double dipping.' Although Dewitt's argument may have a superficial appeal, it is inherently unsound."

The real issue in *White* was a "return of capital" or a basis issue. A return of capital is not income for purposes of spousal support. "Only investment income, *not investment principal*, should be available to pay spousal support … [*In re Marriage of Pearlstein* (2006) 137 Cal.App.4th 1361] [emphasis added].

In *White*, Husband was awarded the community pension at $97,000. This was his investment principal (basis). A portion of

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AICPA Alert

by D. Paul Regan, CPA

The AICPA has a variety of committees and task forces that are organized to assist its members who perform forensic and valuation services. As those services have become more complex, so have the AICPA's committees and task forces. For CalCPA members to understand that structure, and to know how to contact their CalCPA colleagues who are members of these committees and task forces, I prepared an organization chart that I can e-mail to you upon request at *reganp@hemming.com*.

For a complete list of the volunteer members and AICPA staff, go to *www.fvs.aicpa.org/Community/Business+Valuation+and+Forensic+and+Litigation+Services+Committees.htm*.

As an AICPA senior committee, the FVS Executive Committee is the only committee in the organizational structure of the AICPA's forensic and valuation community that has standard-setting authority and "speak out" authority for the AICPA.

During our most recent meeting in September, we established three task forces:

- Issues Task Force: Identify issues confronting practitioners and the pathway(s) for their resolution.
- Standards Task Force: Define the process of identifying and establishing standards for forensic and valuation services.
- Strategic Task Force: Provide input and advice to the FVS Executive Committee on strategic matters.

The standard setting authority is relatively new for the FVS Executive Committee. It is establishing a process to identify and prepare new standards in forensic and valuation services.

In the meantime, the CFF credential has been an astounding success. The CFF Committee has made great progress on the body of knowledge for the CFF, the related educational modules are being finalized and an examination provider will be selected in the near future. Then the examination questions will be created and reviewed, an examination will be piloted and refined and, finally, in late 2010, the examination will be in place.

All of this has been done in record time by a core group of talented and energetic volunteers and staff.

D. Paul Regan, CPA, CFE, CFF *is chairman of Hemming Morse, Inc., CPAs, Litigation & Forensic Consultants. He is a member of the AICPA's Forensic and Valuation Services Executive Committee.*

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of related cases, which was not immediately apparent.

Implications for the Work of an Expert

Expect opposing attorneys to search for material that can be used to indict your credibility or, at least, suggest that you will craft opinions to satisfy the latest client's desires. The expert cannot control many of the cross-examination tactics of opposing counsel, but can prepare for and mitigate such challenges by taking these steps:

- Strive with each engagement to adhere to applicable CPA professional standards, give appropriate consideration to the relevant professional literature and maintain intellectual consistency. The facts pertinent to cases are seldom if ever the same, so alleged inconsistencies between opinions presented for the current case compared to opinions rendered for selected earlier cases may not be discrepancies at all. For each engagement, for example, the expert should be objective and intellectually honest about the pertinent damages assessment principles and common considerations for a particular type of loss measurement, at least given the expert's contemporaneous state of knowledge.

> Expect opposing attorneys to search for material that can be used to indict your credibility.

- When a client presses for opinions that are inconsistent with your best impartial judgment and previous expressed opinions and, of course, not justified by a materially different fact set, tell the client it is not in either your or the client's best interests for you to testify.
- "I don't recall" and "Not to my knowledge" may be better answers than "No" to certain questions.
- Because attorney clients may file pre- or post-trial motions, including formal appeals, that include your name, request that they send you a copy or otherwise advise you of such filings.
- Consider accessing and reviewing available expert profile documents concerning your prior testimony and engagements. The exercise underscores the goal of providing intellectually honest opinions that minimize the risk of inconsistencies over time.
- Appreciate that an expert may not retain perfect knowledge of all past case facts, testimony or written assertions, yet the public record may offer certain details and specifics beyond the expert's recollection at the moment of questioning. If you are asked to explain an alleged discrepancy compared to a prior engagement opinion, limit your answer to matters of which you are certain.

Conclusion

Commercial enterprises apparently aided by technological advances are offering a growing library of past engagement information about expert witnesses. I trust that the courts will strive to permit introduction of such information if it is relevant and not used in a purely dramatic, theatrical fashion. If used properly, this information has the potential to improve the litigation process through a real or perceived deterrent to experts simply molding opinions for the desires of each client.

Everett P. Harry, CPA, CFF *of Harry • Torchiana in San Francisco, is a past chair of the Litigations Sections.*

HAPPENINGS

LITIGATION SECTIONS MEETINGS

Business Valuation	Thurs., Feb. 4	LAX
Economic Damages	Tues., Feb. 9	LAX
Family Law	Fri., Feb. 5	LAX
Fraud	Wed., Feb.10	LAX

Each section will send individual meeting notices.
Download a copy at www.calcpa.org/LIT
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EDUCATION FOUNDATION COURSE OFFERINGS

(800) 922-5272 or www.educationfoundation.org

Fighting Fraud Using Data Analysis	Thur., Jan. 7	SFO
Financial Fraud Investigation Methodology	Wed., Jan. 6	SFO

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each payment should have been allocated in some manner to his $97,000 of basis. A simple analogy would be if he had been awarded a $97,000 savings account from which he began making withdrawals, the principal would not be included in income.

After the *White* analogy, the Court in *Blazer* continued for six pages with a second anti-double dip argument. The Court basically says if the goodwill is based on future earnings, then, yes, it is double dipping.

The Court states, "Husband's challenge to the spousal support order is premised on the factual assertion that the court's earlier valuation of BW was based on husband's post-separation efforts."

Husband had apparently argued that the goodwill of BW used in the property division was necessarily determined by reference to post-separation earnings. He argued that the excess earnings method *"is in essence a way of talking about expected future earnings. To argue otherwise is splitting hairs."*

The written decision of the lower Court even makes reference to Husband's post separation, future earnings: "Interest in Blazer-Wilkinson LLC may be considered in setting spousal support, notwithstanding [his] $2.8 million buy-out of [wife's] community *interest in capitalized future earnings* of the business as part of the division of community assets."

However, the Appellate Court emphasized the prohibition on using future earnings to compute goodwill for family law purposes and pointed out that Husband's experts both testified as to this prohibition. The Court found that BW was not valued using post separation earnings; therefore there was no double dip.

In concluding, the Court quotes the New York State case *Grunfeld v. Grunfeld*, supra, 94 N.Y.2d at p. 707, that prohibits double dipping: "There is no double counting to the extent that maintenance is based upon spousal income which is not [sic] capitalized and then converted into and distributed as marital property."

Since one definition of goodwill is the "expectation of future patronage," does it not appear that it is the expectation of future income that is being capitalized? Can this be argued as a return of capital issue?

What is needed is some method to allocate the "goodwill" purchased. One simple method would be to follow income tax law and amortize the purchase price of goodwill over 15 years. If the business is non-transferrable, such as a highly skilled professional, then the amortization period could be the remaining worklife of the in-spouse.

More learned persons than I have spent considerable time on this subject and have proposed working solutions. I refer to Don Miod's article "The Double Dip in Valuing Goodwill in Divorce" (*www.expertlaw.com/library/family_law/double-dip.html*) or various articles by Mr. Blazer's expert, Steve Popell.

A final thought: the Court may be solving this problem with its trend of assigning either no goodwill or a nominal amount as found in the string of recent cases, including *In re Marriage of Iredale & Cates* [(2004) 121 Cal.App.4th 321], *In re Marriage of McTiernan & Dubrow* [(2005) 133 Cal.App.4th 1090] and *In re Marriage of Ackerman* [(2006) 146 Cal.App.4th 191]. No goodwill. No capitalized earnings to allocate. All income is fair game.

These are interesting times for those of us who practice in family law, so stay tuned.

Mike Radakovich, CPA *is founding member of Radakovich, Shaw & Blythe LLP in San Luis Obispo.*

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