THE WitnessChair

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

SUMMER 2017 California Society of Certified Public Accountants ISSUE 70

Valuing Derivative Claims

by Claudia Stern, CPA

Business valuators may find themselves in the awkward position of valuing derivative claims. In this context, a derivative claim results from a lawsuit brought by a business owner on behalf of the business. This article discusses how this issue arises, offers suggestions on how to value claims or avoid valuing claims and provides explanatory language for a valuation report.

When business owners disagree about how a business should be run, the California Corporations Code allows an owner or group of owners to file for dissolution (the "moving" owner). Specific sections of the code cover different types of entities and the language varies. However, the provisions all allow the non-moving owner to stay the dissolution while three appraisers determine the value of the moving owner's interest.

After the valuation, the court determines the value of the moving owner's interest. The owner who filed to stay the dissolution either buys out the moving owner at the price set by the court or the business is dissolved.

This buy-out, or dissolution, happens in a special, summary procedure—no trial, no depositions. The applicable language in the code, as well as case law, shapes the appraisers' assignment.

The case that discusses derivative claims is *Cotton v. Expo Power Systems, Inc.* (2009), 170 Cal.App.4th 1371. In this case, the court concluded that derivative actions are property rights of the corporation and a corporate dissolution appraisal report is incomplete unless it incorporates their value in the value conclusion:

"We conclude the order cannot be affirmed in any respect because the appraisal did not take into account the effect of the derivative action and was therefore incomplete as a matter of law, and the trial court's attempt to remedy this defect through a deferral of the buyout date until after the entry of judgment in the derivative action was contrary to the summary nature of the buyout proceeding."

To be clear, this decision considered a corporate dissolution proceeding. There is no case law (yet) that suggests derivative actions are or are not property rights of partnerships or LLCs. However, in our engagements for valuing partnerships and LLCs, we have included the value of derivative claims.

What are these derivative actions? We view them as potential or actual claims that the company has against parties. Typically, the control owner has paid themselves or a related party excess compensation (i.e., amounts over fair market value) and is generally the root of the disagreement between owners.

In some dissolution proceedings, the court hears and decides on derivative claims and orders the dissolution. The business owner who did not file for dissolution then invokes his or her right to avoid dissolution and the business is valued for buy-out purposes.

However, in some dissolution proceedings, derivative claims are not heard and it falls upon business valuators to value the claims. In other words, the business owner who did not file for dissolution invokes their right to avoid dissolution early in the process.

If there are derivative claims involved in the valuation, the first step may be to get the attorneys or the court to stipulate or decide upon both the issues of liability and value. Sometimes the derivative claims are not economically material, but are brought to force the buy-out.

In this instance, the attorneys may stipulate to the claims having no value. As discussed below, even if the claims have some value, there may be reasons why the claims have less value when you consider other factors. If material, asking the court for a decision or having the parties mediate or arbitrate may be possible. This way, the court, the attorneys and the valuators are all on the same page before the business valuation process is finalized.

If none of these alternatives is possible, then it falls to the valuators to value claims and, more problematically, to make an assumption about liability. The valuator should first consider whether they have the necessary skill and ability to accept the engagement.

Another option is seeking a court order stating that the valuators will value the claim and determine liability. This may allow the valuator to seek quasi-judicial immunity in their engagement letter. The valuator may issue a separate engagement letter covering the valuation of the derivative claims including assessing liability.

If the valuator is valuing the claims, one of the first issues is their duration. Usually we ask the attorneys to address the statute of limitations and issues in a position paper and hope that they agree on at least the time

continued on page 6

Inthisissue

Section Action

Business Valuation

by Thomas D. Collins, CPA

Past earnings and earnings projections are often the most important factor in valuing a company. Financial projections are most important when future earnings are expected to be different from historical earnings. Often companies are overly optimistic about their future earnings prospects. The following items should be considered when evaluating financial projections:

1. **Was the Projection Prepared by a Party with an Interest in the Outcome?** This is common when business projections are prepared for a business that is for sale. The projections may not reflect the company's historical rates of revenue growth or earnings growth. Additionally, the projections may not fully reflect the increased labor, supply and capital investment costs associated with a high revenue growth rate.
2. **Projections Need to be Accompanied by a List of Assumptions**. For example, what future revenue growth is expected from existing revenues and what revenue growth is expected from future acquisitions? Are the projected expenses based on historical experience or expected to change over time?
3. **Projection of Revenues and Expenses Without Balance Sheets**. Projecting balance sheets may indicate additional funding in the form of cash or new debt is needed to finance future revenue growth. Additional funding may not be available to support rapid revenue growth and therefore the projected revenue and earnings growth rates should be reduced.
4. **Projection Assumes the Company will Grow Rapidly for a Long Period of Time**. This is probably the most common mistake. Some companies can grow rapidly for a few years or maybe several years, but at some point their growth rate will decline as more competitors enter the industry. More reliable projections may show a high growth rate for a few years, a medium growth rate for a few years, then a lower long-term growth rate.
5. **Projections are More Reliable if they Represent the Average of the Likely Outcomes**. Projections should represent the possibility of a range of events from the best, most likely and worst case scenarios. By using projections that reflect a range of potential outcomes, management can gain insight into the company's performance in different economic environments.

Thomas D. Collins, CPA, ABV, CFA *is Business Valuation Section vice chair and owner of Collins Forensic and Valuation Services in Sacramento.*

Economic Damages

by Travis Armstrong, CPA

In a recent issue of the *Journal of Forensic and Investigative Accounting,* published by NACVA and LSU's Department of Accounting, research was presented from a study that evaluated the perceived value of forensic accounting certifications. (See *web.nacva.com/JFIA/Issues/JFIA-2017-No1-5.pdf*.)

The study surveyed attorneys and academics regarding the importance of nine characteristics associated with forensic accounting certifications. The characteristics with the highest weighting of importance were (in no particular order): whether the certification requires applicants to be a CPA; whether applicants must pass an exam to obtain the certification; and if applicants are required to have certain levels of education or prior work experience.

The results were then applied to 16 forensic accounting-related certifications to rank the certifications based on the perceived value of the nine characteristics.

The top five certifications were as follows (in descending order): Certified in Financial Forensics (CFF), Certified Forensic Accountant (CrFAC), Accredited in Business Valuation (ABV), Certified Financial Planner (CFP), and Certified Fraud Examiner (CFE).

This research is helpful, but it does have its limitations and shortcomings. Included in these shortcomings are the small sample size of inquiries (seven lawyers and five academics) and the pre-defined characteristics were general and did not take into account technical characteristics that would be important to different types of engagements (i.e., testifying to economic damages, conducting investigation into alleged financial fraud, etc.)

However, the research can be helpful to professionals as they think about obtaining certifications, as it provides relevant criteria that should be contemplated about not only the certification itself, but the organization issuing the certification

Travis Armstrong, CPA, CFF, CFE *is Economic Damages Section chair and a partner with Hemming Morse, LLP in San Francisco.*

Family Law

by Charles A. Burak, CPA

People are told not to let material objects define who they are. That is, of course, until divorce. Then parties are encouraged to describe, in detail, why each of their luxuries are necessary for their continued survival. Their ability to define themselves by objects will potentially dictate their future income.

As a CPA, I find it can be challenging to participate in this evaluation of one's Marital Standard of Living (MSOL). The difficulty stems from both the fuzzy nature of its definition as well as the subjective nature of how its results may be considered.

Family Code Sec. 4320 describes MSOL as only one of 13 factors that must be considered by a court when determining support. Specifically, Code Sec. 4320(d) states, "The needs of each party based on the standard of living established during the marriage." The description is vague and leaves courts to determine how one's "standard of living" should be quantified.

One opinion in regard to the quantification of MSOL came from Justice King in *Re Marriage of Smith* (1990) 225 Cal.App. 3d 469, where he stated, "The Legislature did not intend it to be a precise mathematical calculation, but rather a general reference point for the trial court in deciding this issue."

Words like these encourage caution before the CPA applies a detailed spending analysis when the issue may be approached and resolved more effectively from other angles.

Determining the CPA's role in an MSOL should be a coordinated effort between the CPA, the attorney and the client. It may be decided the CPA's role will simply be to demonstrate how much income was received by the parties after the payment of tax.

Alternatively, the CPA may be asked to provide a detailed analysis of how the parties spent, or saved, their funds during the marriage. Between these extremes are infinite variations of detail and presentation that may be assigned to the CPA.

The challenge is how does one determine in advance the detail required to tell the story of who the parties are and how they lived during marriage? How detailed of an analysis of the parties' marital spending is necessary to crystalize the view of who these people are, or were?

Sec. 4320 also requires an analysis of current needs. At what point should the financial focus be on parties' future instead of their past?

We have scheduled a group discussion of the MSOL at our Aug. 18 Family Law Section meeting in Oakland. We recently solicited input from members of our Section regarding how they handle the MSOL and will be providing a summary of the group's responses, as well as samples of workpapers from members who have shared their work, at the meeting.

Charles A. Burak, CPA, ABV, CFF, CFE, CVA *is Family Law Section chair and principal with Burak & Associates CPAs in Walnut Creek.*

MessageFromtheChair

by B. Marie Ebersbacher, CPA

CalCPA's Leadership Institute has graduated more than 200 leaders over the past 12 years. The program has been described as challenging and inspiring, thought-provoking and motivating. It emphasizes leadership qualities, such as communication; mentor and mentee development; the ability to manage change; and accountability.

Your Forensic Services Steering Committee recently began discussing a similar program, but one directed toward future leaders in forensic accounting. Our concept is something of a combination between leadership and expert witness training. Leadership in forensics typically requires success with both skills. We will include many of the same concepts as CalCPA's Leadership Institute, and add aspects of expert and consulting witness engagements. We plan to include tips on landing your first testimony assignment and how to work with difficult attorneys and clients.

There will be an application process that will require at least two recommendations, and the cost will be subsidized in some part by the Forensic Services Section Steering Committee. Tentatively, the program would be six days over the course of three months. We have discussed one Friday/Saturday combination each month. Combining a weekday and weekend day will require a commitment by the individual and their firm. Successful leaders need a successful support structure. At a minimum, success can be hindered without one.

The question we are considering is what level the program should be geared toward: Is this a boot camp for those with less than five years experience, or a "future partner" training for those with more than five years experience? (As I write that, I wonder why it can't be both, depending on the progress of one's career.) Comments and suggestions regarding the program or content are welcome and will be shared with the task force spearheading the idea. We will also be looking for volunteers to lead the classes next year, so please reach out if you are interested.

— **B. Marie Ebersbacher, CPA, ABV, CFF, CFE** *is Forensic & Financial Services National Practice Leader and Senior Managing Director for the Southern California offices of CBIZ MHM.*

Fraud and Financial Investigations

by David Callaghan, CPA

The standard mission of the Committee of Sponsoring Organizations of the Treadway Commission (COSO) is to provide thought leadership through the development of comprehensive frameworks and guidance on enterprise risk management, internal control and fraud deterrence designed to improve organizational performance and governance and to reduce the extent of fraud in organizations.

COSO is a joint initiative of the American Accounting Association, the AICPA, the Financial Executives International, the Association of Accountants and Financial Professionals in Business and the Institute of Internal Auditors.

At our last section meeting, Toby Bishop, a past president of the Association of Certified Fraud Examiners, introduced the new *Fraud Risk Management Guide* commissioned by COSO. The guide is composed of five chapters and a number of appendices.

Chapter 1, Fraud Risk Governance: Discusses how an entity's governance and internal control environment impact the organization's ability to manage fraud risks. The guide states it is important to assign overall responsibility for fraud risk management to a single senior executive.

Chapter 2, Fraud Risk Assessment: Identifies internal and external fraud risks faced by organizations, including risks related to financial reporting, asset misappropriation, illegal acts and corruption. The guide offers various examples illustrating how to effectively assess these risks.

Chapter 3, Fraud Control Activities: Describes the design and implementation of policies and procedures, including data analytics, that prevent or detect fraudulent activities.

Chapter 4, Fraud Investigations and Corrective Action: Explains topics such as advance preparation for addressing issues, evaluating allegations, performing investigations, maintaining confidentiality and how to take corrective action.

Chapter 5, Fraud Risk Management Monitoring Activities: Describes how ongoing and periodic evaluations are used to monitor fraud and support the improvement of an entity's fraud risk management.

In addition to the best practices included in these chapters, the appendices to the guide include reference material, example policies, scorecards and information on data analytics.

David Callaghan, CPA, CFF *is Fraud and Financial Investigations Section chair and a partner in the Fraud and Financial Consulting Services Group at Hemming Morse, LLP, based in Los Angeles.*

Keepin' It **Legal**

Causation and the Role of the Damages Expert

by Peter Rybolt

Editor's Note: The following is abridged and adapted from a chapter titled "Proving Loss Causation," by Stephen Boyles, Everett Harry and Peter Rybolt, in the forthcoming book, "Lost Profits Damages," edited by Everett Harry and Jeffrey Kinrich.

***

A plaintiff seeking recovery of lost profits must persuade the trier of fact that defendant's actions were the proximate cause of the losses it claims. Proximate cause, however, is not always the direct, immediate or factual cause of a plaintiff's loss, but a legal construct defined—sometimes ambiguously—by statute and legal precedent.

Moreover, the standards by which proximate cause is adjudicated may differ according to the specific cause of action asserted by plaintiff, as well as applicable law.

The purpose of this article is to introduce some basic concepts related to causation, discuss how and when causation may fall within the purview of the damages expert, and identify a few causation-related pitfalls in lost-profits analysis.

Proximate Cause vs. Cause-in-Fact

The proximate cause of a plaintiff's harm is that cause that is legally sufficient to establish defendant's liability: "[Proximate cause is] an act or omission that is considered in law to result in a consequence, so that liability can be imposed on the actor." (Bryan A. Garner, *Black's Law Dictionary*, Fourth Pocket Edition (2011), p. 101). It need not be the cause-in-fact of plaintiff's harm, however. A classic example from criminal law helps illustrate the distinction:

- A shoots B; B dies. A shooting B is both the cause-in-fact and the proximate cause of B's death.
- A shoots at B, but misses; B runs, trips and later dies of injuries sustained in the fall. While A

shooting at B is not the cause-in-fact of B's death, A's actions may nonetheless be held to be the proximate cause.

The same kinds of questions may distinguish proximate cause and factual cause in business litigation. For example:

- Company A sells a fire suppression system to Company B. An arsonist sets fire to Company B's factory, the fire suppression system fails, and Company B incurs a loss.

The factual cause of Company B's losses is the fire, and the arsonist would presumably be charged with a crime. In addition, however, Company B may have a claim against Company A for negligence or other wrongful conduct. As before, whether the failure of the fire suppression equipment constitutes the proximate cause of Company B's losses is a question of fact, and whether Company A faces liability for those losses is a question of law.

Tests of Causation

Causation is most clearly and consistently tested through application of the "but-for" rule: That but for the act or omission of the defendant, no injury to plaintiff would have occurred.

Yet the but-for test is not without its conceptual weaknesses. One can imagine an almost limitless array of facts or events but for which plaintiff's losses might not have occurred. Some jurisdictions, including California, have therefore dropped the but-for test in favor of other standards.

California relies on the "substantial factor" test: "A substantial factor in causing harm is a factor that a reasonable person would consider to have contributed to the harm. It does not have to be the only cause of the harm." (CACI No. 430.)

Background notes for this instruction explain the rationale:

"The substantial factor standard . . . has been embraced as a clearer rule of causation—one which subsumes the 'but-for' test while reaching beyond it to satisfactorily address other situations, such as those involving independent or concurrent causes in fact." (CACI No. 430.)

Seeking further clarity, some legal scholars have argued that a cause is legally sufficient if it was a necessary element of a set of conditions that were jointly sufficient for the observed result. This test, known as the Necessary Element of a Sufficient Set (NESS) test, has gained momentum in recent years as a preferred method of evaluating causation in cases involving multiple causes.

Role of Damages Expert

While it is unquestionably plaintiff's burden to demonstrate that the defendant's actions were the proximate cause of its losses, the plaintiff may or may not enlist the damages expert in support of that effort.

The causal issues may lie beyond the expertise of the damages expert. In our example of the flawed fire suppression system, the failure of the device and physics of fires are beyond the expertise of most damages experts.

When the subject turns to lost profits, however, causation will typically fall front and center before the damages expert.

Typically, lost profits analyses require the expert to model the cash flows plaintiff would have enjoyed in the absence of defendant's wrongful conduct. Such efforts may call upon the expert not only to estimate the effect of defendant's actions on plaintiff's business, but also to account for industry and economic factors that may have affected (or may yet affect) plaintiff's business. Because most damages experts have backgrounds in accounting, finance or economics, such analyses generally lie within their expertise.

Indeed, the role of plaintiff's damages expert is often not to establish causation per se, but to refute or dismiss other factors that may explain plaintiff's losses. Defense counsel and opposing experts will try to undermine the credibility of a plaintiff's expert who willfully ignores alternative explanations for plaintiff's losses. Well-prepared experts will have considered other causes and adjusted their analyses accordingly.

Common Errors in Causation Analysis

To strengthen the causal link between the

continued on page 5

AICPA Alert

by Travis Armstrong, CPA

During the first quarter of 2017, the FVS committees (FVS Executive, FLS, BV, and CFF and ABV Credential) embarked on strategic planning designed to align our committees' goals and develop cross-functional teams to meet the ever-changing needs of our practitioners. Although the strategic initiatives resulting from the planning have not yet been rolled out to the public, there is a lot of work being done behind the scenes, so stay tuned for updates.

The second issue of the AICPA FVS *Eye on Fraud* was published in February, which discussed recent trends in elder financial abuse. It is a great resource for practitioners that can be shared with family and friends so they can recognize scams targeting seniors. Additionally, there are several practice aids in development, including Volume 2 of *Attaining Reasonable Certainty in Economic Damages Calculations, Communicating in Litigation Services and Dispute Resolution Engagements*, and updates to *Calculating Lost Profits and Calculating Intellectual Property Infringement Damages*. Be sure to visit the Online Professional Library to ensure you are using the latest educational resources offered at the AICPA FVS Library (*www.aicpa.org/InterestAreas/ForensicAndValuation/Resources/Pages/FVS_Online_Professional_Library.aspx*).

Speaking of education, the AICPA's annual FVS Conference will be at Caesars Palace in Las Vegas Nov. 13-15. The conference will have a continued focus on up and coming practitioners, while offering advanced topics for more seasoned practitioners, plus plenty of networking opportunities with your FVS peers and attorneys and judges from across the country.

Additionally, the AICPA's Expert Witness Skills Workshop will be held Sept. 13-16 in Maryland. It is a great opportunity for any first-time testifier to develop and hone their skills needed to be an expert witness and includes one-on-one guidance from lawyers, judges and experienced testifiers. For more information, see the AICPA Expert Witness Skills Workshop Info at *www.aicpastore.com/ForensicValuationandLitigationServices/aicpa-expert-witness-skills-workshop/PRDOVR~PC-EXPERT/PC-EXPERT.jsp*.

Consider nominating an up and comer in your firm or network for the AICPA's FVS Standing Ovation Award. Nominations are being accepted through Aug. 15. The program recognizes CPAs 40 years old and younger in forensic accounting or business valuation practices who exhibit exemplary professional achievement. The recipients are recognized in person at the national conference in November and in an AICPA press release.

Criteria for nominees and further details about the recognition received by recipients can be found on the AICPA's Nominations Page at *www.aicpa.org/InterestAreas/ForensicAndValuation/Pages/fvs-standing-ovation-application.aspx*.

Finally, the AICPA has launched the Certified in Entity and Intangible Valuations (CEIV) credential for practitioners who perform fair value engagements for financial statement reporting purposes. This credential is offered jointly by the AICPA, RICS and ASA in response to regulatory concern over the quality and supporting documentation surrounding fair value measurements. To learn more about the background and apply for the new credential, go to the CEIV Credential Landing Page at *www.aicpa.org/Membership/Join/Pages/credentials.aspx#tab-5*.

Travis Armstrong, CPA, CFF, CFE *serves on AICPA's FLS Committee and chairs its Litigation Process Task Force.*

---

continued from page 4
alleged wrongdoing and the diminished financial performance of the plaintiff, experts should avoid the following pitfalls:

Confusing Correlation with Causation

A simple negative correlation between plaintiff's sales and defendant's actions does not by itself establish that defendant's behavior was the cause of plaintiff's declining losses.

In many cases, it will be possible to test the significance of other explanatory variables and thereby demonstrate that other factors do not adequately explain the decline in sales.

Overreliance on Industry and Macroeconomic Data

An assumption that plaintiff's but-for sales will continue to mirror a given benchmark assumes, among other things, no change in the competitive landscape, no changes in consumers' buying preferences and no product obsolescence. Experts should test such assumptions where possible and be prepared to defend that such assumptions are reasonable.

Overreliance on Flawed or Limited Data

Experts are often forced to develop projections of but-for financial performance from relatively few years of financial data. Using the performance of comparably positioned companies, industry and macroeconomic data, and relevant testimony may help fill the gaps in the causation argument when the parties' data are limited.

Simple Extrapolation

Like simple correlation, simple extrapolation of pre-injury financial performance often lacks prima facie credibility. A more robust model will account for known factors that may have affected plaintiff's financial performance.

Model Specification Errors

Presented with many potential explanatory variables, the expert may be tempted to "overfit" the model, inadvertently creating the appearance of statistical significance (and a causal relationship) where none exists.

Conclusion

The principle that defendant's wrongdoing must be shown as the proximate cause of plaintiff's losses is well established, but the facts of the case may make the question complex. The well-prepared expert will be familiar with the nuances of causation analysis from a legal and economic perspective and, as a result, be better prepared to reach meaningful and well-supported conclusions.

Peter Rybolt, MBA *is a vice president at Analysis Group in Los Angeles.*

HAPPENINGS

FORENSIC SERVICES SECTION 2017-18 MEETING DATES

All Sections Joint Meeting	Oct. 12	LAX
Business Valuation	Aug. 17 Feb. 8, 2018	OAK South
Economic Damages	Feb. 22, 2018	South
Family Law	Aug. 18 Feb. 9, 2018	OAK South
Fraud and Financial Investigations	Feb. 23, 2018	South
CalCPA Education Foundation Family Law Conference	Oct. 26 Oct. 27	LAX and webcast East Bay

Register online: *www.calcpa.org/fss*. | For more information, call (818) 546-3502.

continued from page 1

period. It is also possible to compute the value of claims using different time periods and offer the information to the court for the ultimate determination.

Another odd aspect to these claims is that they are valued to the date of valuation. Typically the date of valuation is the date the moving owner filed an action to dissolve the company. It is assumed that the dissolution occurred on the valuation date and the claims are only valued to that date.

There is a further question of whether pre-judgment interest should be added to the claims. It should be clear to the reader of the valuation report what assumptions are made regarding this and other elements of the claims.

Finally, valuing claims must also consider whether the company would prevail if these claims went to trial and the risk associated with bearing the costs of litigation without prevailing. This risk typically lowers the value that a hypothetical buyer would pay for the claims.

If all of these issues were not sufficiently complicated, we must consider that to preserve the derivative claims, the buyer (in the hypothetical dissolution) would need to buy the stock of the company to preserve the claim, i.e., the sale of the company could not be an asset sale.

A stock sale typically lowers the value of the company as the purchaser takes on potential liabilities and does not get a step up in basis for the assets purchased. So the valuators need to weigh the value of the derivative claims against the discount a likely buyer would demand in a stock sale. Unless the derivative claims are sufficiently large, the claims may not meet this hurdle and end up having no value.

Below is a sample of the language we use to discuss the stock purchase issue as well as the company being a C corporation:

"For the reasons discussed throughout this report, we have assumed a stock sale transaction as opposed to an asset sale transaction. In order to induce a buyer to acquire the Company under this transaction structure, an adjustment is needed to account for assumed risk related to the adoption of an inefficient tax structure, a low carried tax basis in the underlying assets which precludes the buyer from depreciating/amortizing the assets acquired for the price paid, the need to hold such assets for a minimum of 10 years to avoid significant capital gains tax liabilities, the exposure to unknown liabilities of the corporation, and the requirement to successfully litigate the derivative claims involving the corporation. We have considered all of these risks and opined that a valuation discount of XX percent is required."

In our reports, we make clear any assumptions we make and advise the court that if our assumptions are incorrect, then the valuation would require revisions. Below, we provide a sample paragraph discussing derivative claims:

"The assessment of success or failure of pending litigation by definition calls for a legal conclusion and is beyond the expertise of a business appraiser to determine with precision. Nonetheless, we have been ordered by the Court to determine the value of the stock inclusive of these outstanding claims. To this end, we have read the briefs of the attorneys in this case, along with many other documents provided to us that were relevant to the claims. For the purpose of our valuation, we have assumed that the Plaintiff would prevail in the derivative claims, subject to an adjustment for risk and cost that a hypothetical buyer would assume in acquiring the claims in connection with his or her acquisition of the stock. If our assumptions are incorrect with regard to these claims, our valuation would likewise be incorrect and require revision."

It is difficult for business appraisers to value derivative claims, but they are assets of the company which may have value. As long as our assumptions are clear to the court, the court makes the decision whether we have properly assessed the claims. The court ultimately makes the decision on the value of the moving owner's shares.

Claudia Stern, CPA, ABV, CFF *is a principal at Hemming Morse, LLP in San Francisco.*

The Witness Chair is published three times a year by the Forensic Services Section of the California Society of Certified Public Accountants.

Editor
Susan Bleecker

Associate Editors
Leslie O. Dawson | Emily Ku

Section Chair
B. Marie Ebersbacher

Individual Section Chairs
Business Valuation — Lynda Schauer
Economic Damages — Travis Armstrong
Family Law — Charles Burak
Fraud and Financial Investigations — David Callaghan

Nonmember subscription rate is $75 for one year. To subscribe, call CalCPA at (818) 546-3502 or (800) 922-5272.

We welcome your letters, articles, comments and suggestions, which may be sent to the editors at *witnesschair@calcpa.org*.

www.calcpa.org/FSS