

# Dollars and Sense

## Working Effectively With Financial Experts

BY MELISSA IYER JULIAN

with contributions from financial expert JOSEPHINE GIORDANO



Lawyers stink at math. Don't get us wrong. We know there are a few unicorns out there. You *know* the ones—they have a math degree or a dual JD/CPA designation, and they give you a haughty scowl when you ask them what “EBITDA” means. Listen, unicorns, the three of you can skip right over this article and scamper off to your mythical forest where fairies are real and lawyers do math.

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## If you're a litigator, then you are in the money business, whether you like it or not. And, at some point in your career, you will need to hire a financial expert to help you.

For the rest of the esquires, however, numbers can be Kryptonite. How else can you explain your Excel-spreadsheet-induced hives? But if you're a litigator, then you *are* in the money business, whether you like it or not. And, at some point in your career, you will need to hire a financial expert to help you navigate through the money issues in your case.

What money issues, you say? Business litigators often need financial experts who specialize in multi-discipline areas such as valuing business assets, calculating and projecting lost profits, tracing money for purposes of examining allegations of fraud, and bankruptcy and insolvency advising. But they aren't the only ones. Financial experts are often crucial in divorce cases, where calculating income, tracing commingled or misappropriated community assets, and other business valuations provide the key evidence in determining how the community estate is divided as well as spousal or child support obligations. Financial experts provide economic testimony in personal injury cases where projections must be made regarding future lost wages and impaired earning capacity as well as projecting future medical expenses discounted to present-day values. Similar financial determinations arise in tax controversy cases, bankruptcy, and in white-collar criminal matters. Even the probate of a will cannot be completed without an accounting of the estate's assets and liabilities.

Hiring a "money guy" (or gal) may seem simple enough. Just find someone with the letters "CPA" after their name and call it a day, right?

Wrong. With the 2012 amendment to Rule 702 of the Arizona Rules of Evidence, the Arizona Supreme Court abandoned the more lenient "general acceptance" test rooted in *Frye*. In its place, the Court adopted the "reliability" test long used under the federal rules and essentially codifying the United States Supreme Court's holdings in *Daubert*<sup>1</sup> and *Kumho Tire*.<sup>2</sup> What that means is that *all* experts, including financial experts, must withstand more exacting scrutiny in Arizona state courts when a challenge to the admissibility of their testimony is raised. Indeed, according to a study conducted by PricewaterhouseCoopers, *Daubert* challenges to financial experts have steadily increased over the last 15 years.<sup>3</sup> Of the 230 challenges to financial experts reported in 2015, 102 (44 percent) resulted in either a partial or full exclusion of the challenged financial expert's testimony.<sup>4</sup>

Admissibility is only the first step in the effective use of a financial expert. The second and more important use for your financial expert is *persuasion*. Even admissible experts aren't credible or persuasive if their opinions lack a sound methodology or cannot be supported by sufficient data. What's more, even well-supported opinions are still useless if they are presented to a judge or jury with too much incomprehensible, technical gobbledegook. Financial experts are often the linchpin to establishing value and damages, an obviously critical component for every case, regardless of the type. Your judge and your jurors need to readily comprehend your expert's opinions to be persuaded.

This article aims to provide Arizona liti-

gators with practical advice for the effective retention and use of a financial expert to deal with the "money" issues in your case. Follow our advice and you may find that you are actually much better at math than you thought you were. Just kidding. You'll still stink at math, but it won't matter. Because when you find the right financial expert, they'll do the math for you.

### 1 One Size Does Not Fit All

This may seem fairly obvious, but not all Certified Public Accountants qualify as financial experts. The right kind of financial expert depends on the financial issue presented in your case. There is a difference between a tax accountant, a fraud examiner, an economist, and an appraiser. In addition to "CPA," some of the other credentials to look for in a financial expert include Accredited in Business Valuation (ABV), Accredited Senior Appraiser (ASA), Certified Business Appraiser (CBA), Chartered Financial Analyst (CFA), Certified Fraud Examiner (CFE), Certified in Financial Forensics (CFF), Certified Insolvency and Restructuring Advisor (CIRA), and Certified in Distressed Business Valuation (CDBV).

You also must look beyond your expert's credentials and ensure that her or his experience is commensurate with the issues presented in your particular case. Even an expert who is generally qualified in a field may be



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disqualified from testifying in a particular case because he or she lacks the requisite experience in the industry or issue presented. For example, in *MDG Int'l, Inc. v. Australian Gold, Inc.*,<sup>5</sup> the district court excluded a financial expert's opinions regarding the value of a closely held business. Although the expert was a professor of accounting and chair of an accredited MBA program, he admitted that his past experience was limited to the valuation of large public companies. Though acknowledging that the professor was "very well credentialed," the court excluded his testimony anyway. As the court explained, "[I]n the face of his statements that he lacks expertise and experience in the area of valuing closely held businesses, we cannot conclude with any confidence that he qualifies as an expert in that area under Daubert."

**Even free opinions should still be clearly articulated, explained by a sound methodology, and supported by sufficient data.**

A similar conclusion was reached in *Feduniak v. Old Republic Nat'l Title Co.*,<sup>6</sup> where the court excluded an expert's opinion on diminution of property value caused by undisclosed easement even though he was a CPA and Chartered Financial Analyst. Because the expert had no experience appraising real property, he was unqualified to render an opinion in that particular case.

The moral of these stories is clear: When looking for an expert, pay close attention to your expert's particular credentials as well as her or his experience to avoid a qualification challenge.

## 2 If You Have to Be Cheap, Be Careful

Some of your clients *are* experts. They built their businesses from the ground up, and some of them come to us as CPAs, MBAs, or Ph.D.'s. And who better to opine on the loss suffered by a business than its owner?

Clients love this option because it's free. The exciting news is that Arizona law actually does permit an owner to "estimate the value of his real or personal property whether he is qualified as an expert or not."<sup>7</sup> But, before you get *too* excited, remember that the admissibility of an opinion does not automatically mean that it is going to be *persuasive*. An owner who is also a party to the litigation and testifying to the value of his own property is inherently biased. Everybody knows it. And unless your client

looks like Brad Pitt and sounds like Sean Connery, that bias inevitably *will* impact his credibility.

A second concern is whether those unqualified owner opinions may be easily refuted. Because the owner/client may *not* actually be qualified, her opinions regarding value may not really be supported by an acceptable method and concrete data. That may be all well and fine *if* no one bothers to test it. But if your opponent hires a qualified expert, then those opinions will be worth precisely what you paid for them—absolutely nothing. Accordingly, when considering whether to forgo the retention of a profes-

sional expert in such cases, be very careful about being cheap—even free opinions should still be clearly articulated, explained by a sound methodology, and supported by sufficient data.

## 3 Don't Procrastinate

Litigators are genetically predisposed to procrastinate. Once you get your trusty scheduling order in place and calendar those all-important deadlines, you promptly forget all about them until that annoying Microsoft Outlook "reminder" box starts dinging incessantly on the computer screen one or two weeks before the report is due. In a panic, you call up your financial expert and ask for a last-minute appraisal, valuation, damages calculation, economic analysis—and the list goes on.

According to financial expert Josephine Giordano, this is almost guaranteed to increase your client's costs significantly for no good reason. Clients just love that, right? ("NOT!" said in my best nasally 90's kid voice). When Giordano gets a call for an expert opinion well in advance (at least 30 days *or more*) of the report deadline, she can more efficiently manage and minimize costs by assigning certain tasks to staff with lower hourly rates. On the other hand, when you call her the week before your report is due, you're going to get the "premium" rates caused by a week of sleepless nights crunching numbers and cranking out a thorough expert report for you on time. In short, getting your act together a little bit earlier can save your client money.

Better yet, consult a financial expert before you file. Often a client walks into a lawyer's office with lots of suspicions and some financial documents, but not much more. Our instinct is to listen, nod, take notes, and draft a complaint based on those suspicions.

## Retaining or consulting with a financial expert *before* initiating any type of proceeding can have a tremendous impact on the way the case is litigated.

We'll worry about understanding the financial data at some later point (like the week before our expert report is due).

In reality, retaining or consulting with a financial expert *before* initiating any type of proceeding can have a tremendous impact on the way the case is litigated and how quickly it is resolved. If the issue is financial fraud, a pre-litigation expert can help you gather sufficient evidence to meet the "particularity" pleading requirements. The expert can identify quickly what documents

must be gathered and whether a client's suspicions can be supported by what is available. An expert hired before litigation can provide a damages analysis that will enable a client to evaluate the potential upside of pursuing the litigation against the substantial costs that will be incurred and the risk of no recovery at all. Finally, expert reports also can facilitate settlement, particularly when engaged early on in the case and in advance of a mediation or settlement conference.

## 4 Make Them Show Their Work

There are two primary reasons a financial expert's opinions are either excluded or disregarded: (1) the opinion is not based upon an accepted methodology and (2) the opinion is not supported by sufficient facts or data.

In other words, even a "supremely qualified expert cannot waltz into the courtroom and render opinions unless those opinions are based on some recognized scientific method and are reliable and relevant under the test set forth by the Supreme Court in *Daubert*."<sup>8</sup> That may sound a little complicated, but it's really as simple as this: Anyone who took a math test in elementary school remembers the annoying teacher's

## Expert Witness in Malpractice Cases



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**Your expert must articulate a method that is generally accepted in the field, and his or her conclusions must be supported by independent facts and data.**

mantra, “The right answer isn’t good enough; you MUST show your work!” Experts must heed the same advice, and it’s our responsibility to make sure they do.

An expert report should contain a description of the data relied upon and the source of that data. Moreover, the expert should identify the ways in which she independently verified the accuracy of the data relied on. Simply assuming that what a client or lawyer has told an expert regarding the facts or financials at issue will not be sufficient. For example, in *Grabois v. BMO Harris Bank, No. 1*,<sup>9</sup> the plaintiff “tendered” two different expert opinions to support claimed lost profits, but the trial court granted judgment as a matter of law to the defense so that the issue of lost profits never reached the jury. The plaintiff appealed that ruling and lost again. Why? Because the mere presentation of the experts’ opinions did not suffice to get the issue of lost profits to the jury. Instead, the Arizona Court of Appeals emphasized that both the plaintiff’s experts lacked sufficient *independent* data to support their opinions: “[T]he experts in this case largely relied upon Grabois’ statements as to costs and values that, from the record, were not properly supported.”

Lastly, in applying a methodology, a financial expert should be able to point to generally accepted guidelines that support the methods used. Indeed, one readily available resource for generally accepted methods can be found by reference to the American Institute of CPAs (“AICPA”). The AICPA has developed “practice aids” specifically tailored to govern the involvement of CPAs in litigation including the provision of technical guidance on valuations, damages calculations in personal injury cases, bankruptcy and re-

organization, and fraud investigations, among others. Reference to specific AICPA standards can sometimes be determinative of whether an expert’s methodology is determined to be sound. By way of example, in *Mortensen v. Mortensen*,<sup>10</sup> the trial court rejected the expert’s valuation opinions in a divorce case in part because “he ‘did not provide sufficient reference to AICPA ... Standards for Valuation Service.’”

Put simply, your expert must articulate a method that is generally accepted in the field, and his or her conclusions must be supported by independent facts and data, not merely what you or your clients relay.

## 5 Keep it Simple

Under Rule 702, Ariz. R. Evid., an expert’s testimony only comes into play to address issues that are inherently difficult to understand. The point is not to impress the judge or the jury with an expert’s vast knowledge of multi-syllabic technical jargon. The expert’s purpose is to simplify those difficult concepts so the fact-finder understands them. Even highly intelligent judges may not have a background in complex financial issues, and you can certainly expect an average juror to fall into a boredom-induced coma at the mere mention of an “overly aggressive discount rate.” So if you get your expert’s 100-page report and *you* can’t understand it without a dictionary and a bottle of tequila, then something has got to change. Go back to your expert and kindly ask them to dumb

it down. An impressive expert is utterly useless to you in trial if nobody (including you) understands what the heck he

or she is saying.

## Conclusion

Always remember that you don’t have to be able to balance a checkbook to be able to effectively use financial experts. But if you follow these rules and find the right financial expert, it won’t matter that you still think EBITDA is the name of that hot new rapper going on tour with Kanye next summer. No one except that dual JD/CPA sitting down the hall from you in the firm will know of your math deficits. And nobody believes in unicorns anyway. **AZ**

## endnotes

1. *Daubert v. Merrell Dow Pharmaceuticals*, 509 U.S. 579 (1993).
2. *Kumho Tire Co. v. Carmichael*, 526 U.S. 137 (1999).
3. *Daubert Challenges to Financial Experts: A Yearly Study of Trends and Outcomes 2000-2015*, PriceWatershouseCoopers (2016), available at [www.pwc.com/us/en/forensic-services/publications/assets/pwc-daubert-study-whitepaper.pdf](http://www.pwc.com/us/en/forensic-services/publications/assets/pwc-daubert-study-whitepaper.pdf)
4. *Id.*
5. No. 1:07-CV-1096-SEB-TAB, 2009 WL 1916728, at \*3 (S.D. Ind. June 29, 2009).
6. No. 13-CV-02060-BLF, 2015 WL 1969369, at \*2 (N.D. Cal. May 1, 2015).
7. *Atkinson v. Marquart*, 541 P.2d 556, 559 (Ariz. 1975).
8. *Clark v. Takata Corp.*, 192 F.3d 750, 759 n. 5 (7th Cir. 1999).
9. CA-CV 13-0164, 2015 WL 4040612, at \*9-11 (Ariz. Ct. App. June 30, 2015), *rev. denied* (Jan. 5, 2016).
10. No. 1 CA-CV 15-0097 FC, 2016 WL 3211196, at \*1 (Ariz. Ct. App. June 9, 2016).