

Accounting Expertise in Litigation and Dispute Resolution

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Abstract

This paper looks at the role of experts from both a United Kingdom and North America perspective. The paper starts by pointing out the important role of expert evidence in assisting the tier of fact. The distinction between accountants as fact witnesses and as expert witnesses is identified. The expert's primary obligation is to the court not the hiring party. Expert evidence is not a substitute for the exercise of the court's own judgement. The qualities of expert evidence are discussed, as are the significance of the necessary qualities of such expert evidence. A lack of these qualities increases the likelihood that civil liability will be imposed on expert witnesses. The paper outlines the steps to be taken in engaging expert accountants.

This paper examines the role of expert witnesses generally, and specifically the role of accounting experts. The discussion is informed by UK common law, supplemented by references to cases and court rules from North America. The qualities of expert evidence, and civil liabilities applying to expert witnesses, are outlined. Cases (both those that go to court, and pre-trial proceedings) can benefit from accounting experts in a variety of ways which are summarized. Somewhat different professional standards apply to expert witnesses, compared with those applicable to other types of accounting assignments. The process of selecting and engaging accounting experts, including the matters to be included in engagement letters, is considered. The paper concludes with a discussion of accountants' fees in forensic accounting assignments.

ROLE OF EXPERT WITNESSES

An expert witness is one whose opinion a court or other tribunal is prepared to admit as evidence for the purpose of assisting in the resolution of a dispute or in arriving at the truth, and whose opinion is based on the application of particular expertise and knowledge to the relevant facts.

However, the courts have made it clear that expert evidence is never a substitute for the exercise by a court of its own judgment. Expert evidence is regarded as an ingredient (often a very important one) of the case to be used by the court to assist in arriving at a decision, but a court cannot abdicate its function in favour of an expert. A classic statement of the role of expert evidence is to be found in Beven (1908) on Negligence (p. 131) which states:

“To justify the admission of expert testimony two elements must co-exist:

- (1) The subject matter of the inquiry must be such that ordinary people are unlikely to form a correct judgment about it, if unassisted by persons with special knowledge.
- (2) The witness offering expert evidence must have gained his special knowledge by a course of study or previous habit which secures his habitual familiarity with the matter in hand”.

Courts are increasingly codifying rules to create express duties on experts to be impartial. While an expert needs to reconcile these rules with his or her duty to act in their instructing party's best interests, the court's intention is that the duty to the client is secondary to the higher duty to the court. The function of an expert witness is to assist the court in arriving at the truth by providing a skilled expert assessment of matters requiring a specialised appreciation of the particular problem at issue.

Role of experts in the UK

Under Civil Procedure Rule 35.1 expert evidence shall be restricted to that which is reasonably required to resolve the proceedings. Under rule 35.4 no party may call an expert or put in evidence an expert's report without the court's permission. The position has always been that the expert's duty is to the court and not the side employing them. This position has been reinforced in England and Wales under the Civil Procedure Rules. Rule 35.3 states:

- “(1) It is the duty of an expert to help the court on the matters within his expertise
- (2) This duty overrides any obligation to the person from whom he has received instructions or by whom he is paid.”

The fact that the expert's first duty is to the court is further emphasised by the court's right under rule 35.7. When two or more parties wish to submit expert evidence on a particular issue, the court can direct that one expert only give the evidence.

The practice of the courts is to permit expert evidence where there is a material matter at issue between the parties the understanding or explanation of which would fall outside the general level of knowledge and expertise normal in society. In court proceedings, an expert's opinion will, in general, be admissible unless the subject matter does not require specialist knowledge. Expert evidence, however, is not conclusive. The judge is the sole and final arbiter. Both the value of expert accounting evidence, and the limits on the extent to which courts will defer to an expert accountant's opinion, were explained by Pennycuik V. C. in *Odeon Associated Theatres Ltd v. Jones*:

"In order to ascertain what are the correct principles [of the prevailing system of commercial accountancy] it has recourse to the evidence of accountants. That evidence is conclusive on the practice of accountants in the sense of principles on which accountants act in practice. That is a question of pure fact, but the court itself has to make a final decision as to whether that practice corresponds to the correct principles of commercial accountancy. No doubt in the vast proportion of cases the court will agree with the accountants but it will not necessarily do so ... At the end of the day the court must determine what is the correct principle to be applied."²

Only expert witnesses may provide expert opinions. In the legal environment, expert testimony is rendered by a person who is qualified to speak authoritatively by reason of special training, skill, study, experience observation, practice or familiarity with the subject matter under consideration.

Role of experts in North America

Rule 702 of the US federal rules of evidence addresses the concept of testimony by experts. Rule 702 allows expert testimony whenever it will "assist" the trier of fact. The former rule was much more restrictive. It required that the expert testimony be "necessary" for the trier of fact to understand the issues in trial. This liberalisation of the rule allowing expert testimony has dramatically increased the use of experts. Rule 702 states:

"Testimony of experts. If scientific, technical or other specialised knowledge will assist the trier of fact to understand the evidence or to determine a fact in issue, a witness qualified as an expert by knowledge, skill, experience, training or education may testify thereto in the form of an opinion or otherwise."

The case of *Daubert v. Merrell Dow Pharmaceuticals, Inc*³ modified Rule 702 in the case of scientific evidence. The modification arises from concerns at juries' abilities to understand complex scientific data and concerns on the misuse of scientific evidence. Judges are now required first to assess the reliability of scientific evidence before such evidence is admissible.

² [1971] 2 All E.R. 407 at 414.

³ 113 S.Ct. 2786 (1993).

In *R. v. Mohan*⁴ the Canadian Supreme Court elaborated on this requirement. There, Sopinka J.J. stated that expert evidence must be both necessary in assisting the trier of fact and relevant. Under the heading of “necessity in assisting the trier of fact” the Court made it clear that expert evidence was not to be admitted if the subject of the testimony concerned an issue which was within the common knowledge of the trier of fact. In particular, Sopinka J.J. quoted approvingly from *R. v. Turner*⁵ in which Lawton, L.J. concluded:

“An expert’s opinion is admissible to furnish the court with scientific information which is likely to be outside the experience and knowledge of a judge or jury. If on the proven facts a judge or jury can form their own conclusions without help, then the opinion of an expert is unnecessary.”⁶

Similarly

“...the evidence must be necessary to enable the trier of fact to appreciate the matters in issue due to their technical nature.”⁷

Qualities of expert evidence

The courts have variously commented on the qualities required of expert evidence. The most important of these is that the evidence be unbiased and objective. In addition, relevance, reliability and cost effectiveness of expert evidence are also important considerations.

Unbiased, objective

Expert evidence should be objective and fair. Some experts will be inclined to tailor their evidence to their client’s requirements and pay insufficient attention to the need to be balanced and objective. This lack of objectivity, if not exposed by the opposing expert’s challenge to what they are saying, will usually be perceived readily by the trial judge in any event. In *National Justice Companion Naviera S.A. v. Prudential Assurance Co. Ltd* Cresswell J. stated:

“An expert witness should provide independent assistance to the Court by way of objective unbiased opinion in relation to matters within his expertise ... An expert witness in the High Court should never assume the role of an advocate.”⁸

In *Whitehouse v. Jordan* Lord Wilberforce said:

“Expert evidence presented to the court should be, and should be seen to be, the independent product of the expert uninfluenced as to form or content by the exigencies of litigation.”⁹

The role of the expert is to educate and inform decision-makers so that the truth is revealed. It can be argued that the process of obtaining written reports, and

⁴ [1994] 2 S.C.R. 9 at 23.

⁵ [1975] Q.B. 834 at 841.

⁶ [1994] 2 S.C.R. 9 at 24.

⁷ *ibid.* at 23.

⁸ [1993] 2 Lloyd’s Rep. 68 at 81.

⁹ [1981] 1 W.L.R. 246 at 256.

examination and cross-examination of opposing experts is more likely to reveal the truth than evidence from a single 'neutral' expert. In either case it is essential that expert evidence be given with independence and impartiality.

It can be argued that bias is self-policing, since an overtly biased expert will soon lose credibility within the professional community and not be called by other parties in future cases. But such an argument may be fragile since the reality is that parties may "shop around" for an expert who will best support their case. Furthermore, the expert's evidence may risk being coloured by a preexisting or continuing relationship which may exist between the expert and the lawyer or the litigant. Nevertheless, an expert is probably shortening his useful life significantly if he compromises his independence.

Relevant

The significance of relevance can be seen from the following extract from *R v. Wilson*¹⁰:

"... lack of relevance can be used to exclude evidence not because it has absolutely no bearing upon the likelihood or unlikelihood of a fact in issue but because the connection is considered to be too remote. Once it is regarded as a matter of degree, competing policy considerations can be taken into account. These include the desirability of shortening trials, avoiding emotive distractions of marginal significance, protecting the reputations of those not represented before the Courts and respecting the feelings of a deceased's family. None of these matters would be determinative if the evidence in question were of significant probative value."

In *R. v. Mohan* the Court ruled that, prima facie, expert evidence was "relevant" if it was "...so related to a fact in issue that it tends to establish it." A more academic definition of relevance is provided by Stephen (1946, p. 4) who says that any two facts are relevant to each other if they are:

"...so related to each other that according to the common course of events one either taken by itself or in connection with other facts proves or renders probable the past, present, or future existence or non-existence of the other."

Reliable

Expert evidence should be able to withstand close scrutiny to determine whether it is "reliable".

"[E]xpert evidence which advances a novel scientific theory or technique is subjected to special scrutiny to determine whether it meets a basic threshold of reliability and whether it is essential in the sense that the trier of fact will be unable to come to a satisfactory conclusion without the assistance of the expert."¹¹

Cost effective

In the same case, the issue of cost-effectiveness of expert evidence was dealt with as follows:

¹⁰ [1991] 2 N.Z.L.R. 707 at 711 *per* Fisher J.

¹¹ *R. v. Mohan* [1994] 2 S.C.R. 9 at 25.

“Evidence that is otherwise logically relevant may be excluded ... if it involves an inordinate amount of time which is not commensurate with its value or if it is misleading in the sense that its effect on the trier of fact, particularly a jury, is out of proportion to its reliability.”¹²

Civil liability of expert witnesses

The previous section discussed the qualities of expert evidence. A lack of these qualities increases the likelihood that civil liability will be imposed on expert witnesses.

Expert witnesses have historically had significant protection from civil liability through a litigation privilege granted to witnesses. Communications between clients and their lawyers are privileged from production/discovery. Equally, communications between a lawyer and an expert which arise after litigation has been contemplated or commenced, and made with a view to such litigation, are privileged.

Two discrete concepts underlie this issue: immunity from suit from actions in negligence, and immunity from suit from actions in defamation. A claimant who alleges an expert has been negligent is obliged to demonstrate that fact. Immunity from suit from actions in defamation is designed to ensure candor in court and protects expert witnesses as witnesses of fact from exposure to defamation proceedings. In defamation proceedings, once it is established that the evidence was defamatory, the expert witness is *prima facie* liable and the burden falls on the expert to demonstrate that the evidence was justified.

In an Irish case, *M.P. v. A.P.*, Laffoy J. dealt with this immunity and went on to consider whether witness immunity arising from evidence given in a civil case in court extended to providing protection to the witness from professional disciplinary proceedings:

“There is ample authority to support the proposition advanced by counsel for the applicant that a witness is protected from civil proceedings, not merely an action for defamation, in respect of his evidence in the witness box and statements made in preparing evidence (*Watson v. M'Ewan*, *Watson v. Jones* [1905] A.C. 480; *Marrinan v. Vibart* [1963] 1 Q.B. 528). While no authority has been cited which supports the proposition that an expert witness is immune from disciplinary proceedings or investigation by a voluntary professional organisation to which he is affiliated in respect of evidence he has given or statements he has made with a view to their contents being adduced in evidence, having regard to the public policy considerations which underlie the immunity from civil proceedings - that witnesses should give their evidence fearlessly and that a multiplicity of actions in which the value or truth of their evidence would be tried over again should be avoided - in my view, such a witness or potential witness must be immune from such disciplinary proceedings or investigation.”¹³

Rule 35.3(1) of the UK Civil Procedure Rules provides that an expert witness owes an overriding duty to the court. The leading authority on this issue in the UK is the court of appeal decision in *Stanton v. Callaghan*. It was accepted that, without immunity, an expert, like any other witness, might be inhibited from giving fair and truthful

¹² *ibid.* at 21.

¹³ [1996] 1 I.R. 144, at 155 – 156.

evidence to the court. It was also decided that immunity is necessary for the orderly conduct of the court process. Thus, in the UK an expert witness is immune from suit in respect of anything he says in court, and this protection extends to the contents of the expert's report which is adopted or incorporated in his evidence. If the expert's report is for the purpose of a trial the expert is immune from suit, even if he does not give evidence in court. The law provides for absolute immunity from clients over expert evidence given to the court. In other words, experts have 'free reign' to make whatever statements they feel inclined to make.

This immunity, however, does not extend to advice to a client on the merits of the case. A claim by a client in respect of advice given in the context of pending litigation may be successful.

The current trend in the US is to exclude negligence of friendly expert witnesses from the litigation privilege. A significant recent case is *Mattco Forge Inc. v. Arthur Young & Co.*¹⁴ In 1992, a California court of appeals decided that statutory litigation privilege that protects lawyers, judges, jurors, witnesses and other court personnel from liability arising from publications made during a judicial proceeding does not apply to claims of negligence of the expert by the party who hired the expert. The court ruled that an expert could not assert a statutory litigation privilege against his own client. The court reasoned that the litigation privilege applies to adverse witnesses but not to friendly witnesses. Thus, as a result of the above decision, in the US a client may sue a forensic accountant who provides expert witness services and the applicable professional standards of the accounting profession may determine the appropriate standards of care.

The case suggests that expert witnesses may be subject to civil liability. Careful attention to matters such as engagement letter preparation (see below) may be helpful in avoiding civil liability, controlling legal expense and reducing professional liability insurance costs.

ACCOUNTANTS AS EXPERT WITNESSES

Accountants may appear in court in one of two situations: when giving evidence of fact and when acting as expert witnesses in giving opinion evidence. This important distinction between the two situations is explained below.

Specialist as witness of fact

Forensic accountants can act as witnesses of fact where they can state as a fact, from their own knowledge and examination of a particular item, that a certain event or sequence of events occurred in a particular instance. Generally speaking, an ordinary witness providing testimony in court can only give evidence of fact, e.g. what they saw, heard, tasted, smelt, touched – facts collected by one of the five senses. Accountants acting as witnesses of fact should provide evidence in court based on what happened, not on supposition. They are not permitted to speculate or to give an opinion as to the circumstances leading up to an event they have witnessed.

¹⁴ 60 Cal. Rptr. 2d 780 (1997) (CA).

Specialist as expert witness who gives evidence of opinion

Forensic accountants also act as expert witnesses and in that role they can, from their own knowledge and experience, give an opinion as to why a certain event or sequence of events did or did not occur. The trial judge will decide when a witness is allowed to give expert opinion. Expert witnesses may be called upon to state their opinion on a matter within their specialised knowledge and skill where the court itself cannot form an opinion from the facts. Forensic accountants often present highly technical material to courts in terminology they can understand.

Discovery assistance

Litigation often depends on documents to prove or disprove issues at trial. An integral pre-trial procedure is discovery of documents, including financial records. Forensic accountants can assist and advise in finding, understanding and explaining information from such documentation. The knowledge of financial documents can assist the lawyers in formulating requests for discovery.

Document management

Forensic accountants can assist in organising and summarising large volumes of data. In addition they can provide expert advice on management systems, including computer systems.

Understanding the other side's case

Forensic accountants can assist the lawyers during a trial in framing questions to be asked in cross-examination. Aspects to consider are the opposing expert's report and its strength and weaknesses, information about the opposing side's forensic accountant and providing assistance in interpreting the opposing expert's responses in cross-examination.

Proof of financial facts

Experts can help develop proof of financial facts. These can be used in court to explain issues or transactions. In addition, they may be the basis for facts or assumptions included in the expert accountant's opinion.

Computation of damages

Forensic accountants often advise in the computation of damages such as actual losses incurred, expected future losses, business valuations etc.

PROFESSIONAL STANDARDS IN A LITIGATION ENVIRONMENT

In providing expert evidence, experts are expected to observe professional standards in the conduct of their work. Some of these have been discussed already – experts should be fair, unbiased and objective, and should present evidence that is relevant, reliable and cost effective.

Codes of professional conduct

A number of expert witness organisations have codes of practice governing the conduct of their members. A good example is the code of the British Academy of Experts (available at www.academy-experts.org). The National Association of Forensic Economists also provides interesting guidance on the ethical requirements applicable to experts (available at <http://nafe.net/communication/ethics.htm>).

Conflict of interest and expert accountants

Ethical considerations impose on experts an obligation to disclose to their instructing lawyer in advance of each assignment any personal or financial circumstances which might influence work for the client in any way not stated or implied in the instructions. Any actual or potential conflict of interest should be reported to the lawyer as soon as it is raised or becomes apparent and, if necessary, the assignment should be declined or terminated. Particularly important are:

- Any directorship or controlling interest in any business in competition with the client;
- Any financial or other interest in goods or services (including software) under dispute;
- Any personal relationship with any individual involved in the matter;
- Existence of any other client of the expert with competing interests.

Professional regulations

The American Institute of Certified Public Accountants (1993) has published a decision tree to assist practitioners in reviewing potential issues relevant to evaluating a conflict of interest in a litigation service engagement. Consideration of conflicts of interests in the context of engagement letters is dealt with further on.

Case law

Judicial attitude to conflict of interest can be traced back at least to the mid-nineteenth century, when Cranworth L.C. said in *Aberdeen Railway Company v. Blaikie Bros*:

“It is a rule of universal application, that no one, having such duties to discharge, shall be allowed to enter into engagements in which he has, or can have, a personal interest conflicting, or which may possibly conflict, with the interests of those whom he is bound to protect.”¹⁵

It is important to note that there need not be an actual conflict of interest in order to present a problem – the perception, in the eyes of the ‘reasonable objective person’ of a conflict is normally sufficient to give rise to difficulties.

The most obvious area of conflict is where a firm advises more than one of the parties to a transaction or a dispute. The courts have taken several opportunities to express their disapproval of such behaviour, even where the family lawyer finds himself, almost accidentally, advising several family members simultaneously. Indeed, the courts in England in recent years have placed an onus on banks to ensure that spouses

¹⁵ (1854) 1 Macq. 461.

obtain separate legal advice in certain circumstances (see, for example, *Barclays Bank plc v. O'Brien*¹⁶ and *National Westminster Bank plc v. Morgan*¹⁷). It is clear that the law disapproves of any apparent or real conflict of interest where one professional is advising more than one party.

Conflicts of interest can also arise when an individual or firm, having advised one party to a dispute or transaction, subsequently wishes to advise another party to the same dispute or transaction in relation to the same matter or different matters. Such a situation can arise, as in the Canadian case of *Martin v. Gray*¹⁸, where a former employee of a firm advising one party joins the firm advising another. In that case the Canadian Supreme Court applied a two-stage test: did the lawyer actually receive relevant confidential information as part of the lawyer-client relationship from the first party, and, if so, would a 'reasonable objective person' perceive a risk that the information will be used to prejudice that party?

This appears a sensible approach. It allows the court to exercise its discretion in the second leg of the test in assessing whether any confidential information would be passed between the former employee and the lawyers engaged by the other party, or conversely whether effective 'Chinese walls' are in place to prevent this. Recent Australian case law also follows this general approach¹⁹.

The recent landmark decision of the House of Lords in *Prince Jefri Bolkiah v. KPMG*²⁰ has, however, broken new ground in the area of conflicts of interest and Chinese walls. The facts of the case and the detail of its progress through the courts are complex. In summary, the plaintiff, a brother of the Sultan of Brunei, had previously engaged KPMG to undertake a very extensive financial investigation. This resulted in KPMG becoming very familiar with a large amount of confidential information relating to the plaintiff's assets and the manner of their ownership. The firm was then asked by the Brunei government to assist in an investigation of the financial affairs of the organisation that, under the plaintiff's chairmanship, managed the government's general reserve fund. KPMG recognised that the interests of this investigation might conflict with the plaintiff's interests. However, the firm concluded that the assignment could be accepted because the plaintiff was no longer a client and adequate Chinese walls could be constructed to prevent confidential information concerning the plaintiff being disclosed to the investigation team. KPMG did not seek the plaintiff's approval for their involvement in the investigation.

In unanimously allowing the appeal from the Court of Appeal's discharge of an injunction restraining KPMG from acting in the investigation, the House of Lords set a very high standard for the duty to keep information confidential. Lord Millett said:

"Whether founded on contract or equity, the duty to preserve confidentiality is unqualified. It is a duty to keep the information confidential, not merely to take all reasonable steps to do so. Moreover, it is not merely a duty not to communicate the information to a third party. It is a duty not to misuse it, that is to say, without the consent of the former client to make any use of it or to cause any use to be made of it by others

¹⁶ [1993] Q.B. 109; [1992] 3 W.L.R. 593; [1992] 4 All E.R. 983 (CA); [1994] 1 A.C. 180 (HL).

¹⁷ [1985] A.C. 686; [1985] 2 W.L.R. 588; [1985] 1 All E.R. 821.

¹⁸ [1991] 1 W.W.R. 705; *sub. nom. MacDonald Estate v. Martin* [1990] 3 S.C.R. 1235.

¹⁹ *Carindale Country Club Estate Pty Ltd v. Astill* [1993] 115 A.L.J. 112; 42 F.C.R. 307.

²⁰ [1999] 2 A.C. 222.

otherwise than for his benefit. The former client cannot be protected completely from accidental or inadvertent disclosure. But he is entitled to prevent his former solicitor from exposing him to any avoidable risk; and this includes the increased risk of the use of the information to his prejudice arising from the acceptance of instructions to act for another client with an adverse interest in a matter to which the information is or may be relevant.”²¹

He went on to deal with the importance of a perception of confidentiality as well as its reality. He said:

“It is of overriding importance for the proper administration of justice that a client should be able to have complete confidence that what he tells his lawyer will remain secret. This is a matter of perception as well as substance. ... the court should intervene unless it is satisfied that there is no risk of disclosure. It goes without saying that the risk must be a real one, and not merely fanciful or theoretical. But it need not be substantial.”²²

In relation to the effectiveness of Chinese walls, Lord Millett had this to say:

“There is no rule of law that Chinese walls or other arrangements of a similar kind are insufficient to eliminate the risk. But the starting point must be that, unless special measures are taken, information moves within a firm. ... The Chinese walls which feature in the present case, however, were established ad hoc and were erected within a single department. ... In my opinion an effective Chinese wall needs to be an established part of the organizational structure of the firm, not created ad hoc and dependent on the acceptance of evidence sworn for the purpose by members of staff engaged on the relevant work.”²³

This decision has far-reaching implications for the management of perceived and actual conflicts of interest in all professions. Professional firms would be ill-advised to ignore its implications. In particular, a simple solution is the adoption of a blanket policy of refusing all new work, in situations where information has previously been obtained from a client and new work would involve ‘the acceptance of instructions to act for another client with an adverse interest in a matter to which the information is or may be relevant’.

It is safe to assume that the law will generally perceive a conflict of interest to arise where any partner in the firm or any member of staff engaged on the assignment holds a financial interest of any kind in a party to a dispute or transaction in which the firm is engaged. This is because such an interest will give rise to at least a perception of, if not actual, impairment of independence in advising a party to the dispute or transaction.

SELECTING EXPERT ACCOUNTANTS

Choosing an expert has always been a critical element in litigation case management. If a decision is made to appoint an independent expert then it is critical that the right person is selected. A poor appointment could have a significant impact on the outcome of the case. The process of selecting a forensic accountant requires careful

²¹ *ibid.*, at pages 235 – 236.

²² *ibid.*, at pages 236 - 237.

²³ *ibid.*, at pages 237, 239.

consideration of several criteria. The question must be asked whether the expert to be appointed is in fact an expert in the required subject.

There is no perfect firm size in the accounting profession and selection based on firm size will to some extent depend on the nature of the assignment. Some assignments might be appropriate for a very specialist sole practitioner working in a narrow field of expertise. International accounting firms, with offices around the world and large staff, may be suitable for projects that cross international borders or that require a significant time and human resource input.

Cost is a relevant consideration in selecting a forensic accountant. Fees and related costs should be discussed in advance. Forensic accountants will explain the procedures and billing of fees during the selection process.

ENGAGING EXPERT ACCOUNTANTS

The process of engaging an expert accountant requires careful consideration so that both the client and the expert accountant have a common understanding of the terms, objects and expectations of the engagement in advance.

Timing of engagement

If forensic accountants are hired early enough in a case, they can make a significant difference to its outcome. The expert can become more involved in the case and can contribute more extensively to the manner in which it is conducted. Lawyers often devote considerable efforts in dealing with the liability side of the case, with less attention spent on considering the damages aspects. Even when damages issues are considered, without the advice of an expert the lawyers may fail to obtain the necessary documents to support the damages calculations.

Lawyers may be tempted not to hire an expert early in the case in order to keep costs down. In the long run this may be counterproductive if the damages side of the case suffers as a result. The importance of bringing an expert into a case early is eloquently illustrated by Plummer and McGowin (1995) as follows:

“A typical disaster scenario. The damage expert gets hired two days before the deadline for expert disclosure. A pile of documents and depositions arrive at the expert’s office a week later. When the expert calls the attorney to ask for key data that was not in the pile, the litigator says ‘It looks like we never asked for that in the document request or at depositions. Oh, by the way, they want to take your deposition next week.’ The expert must do damages analyses that makes assumptions about key facts and then alter those assumptions depending on trial testimony. This often results in poorer analysis and increases expert’s costs by a factor of 2 or 3.”

Terms of engagement

Forensic accountants should receive clear instructions from lawyers, preferably in writing. Experts have more to lose by not agreeing terms in advance, but such agreement should also be in the interests of the instructing lawyer and the client to ensure the contractual relationship with the expert is clear.

Accountant-client privilege

If the client hires the expert without the lawyer being a party to the engagement, expert information may not be as easy to protect from discovery by the opposing party. The reason for this is the rule on legal professional privilege (referred to as attorney-client privilege in the US). This rule protects from disclosure any communications between parties and lawyers made in contemplation or furtherance of litigation, or for the purpose of obtaining legal advice. However, including the client (along with the lawyer) as a party to the engagement may have the advantage of helping to prevent misunderstandings and disputes regarding the selection of the expert, the expert's services and the expert's fees.

In US federal courts, the principle of no accountant-client privilege was established in the case of *Couch v. United States*²⁴, and was confirmed more recently in *Mattco Forge Inc. v. Arthur Young & Co.*²⁵. In about half the states, some limited form of statutory accountant-client privilege exists. Such privilege does not exist in common law and is of little value in federal cases. However, lawyer-client privilege extends to accountants under the Kovel rule²⁶ when an accountant acts at the direction of a lawyer to provide information for the client (Pacine, Hillison, Fennema and Placid, 2004). Jones (1998) discusses the Kovel rule which extends the protection of the attorney-client privilege to accountants hired by a lawyer as non-testifying expert witnesses. The basis for this decision is that the accountant is deemed to be acting as an agent of the lawyer. This attorney-client privilege only operates under certain conditions and breaching these conditions may result in loss of privilege.

The Internal Revenue Restructuring and Reform Act of 1998 extended attorney-client privilege to accountants in relation to tax advice between taxpayers and federally authorized tax advisors. This privilege only applies to tax advice, and does not extend to preparation of tax returns, general business consultations or personal financial planning. These provisions are not as broad as attorney-client privilege. It applies only to civil disputes over interpretations of federal tax laws, not to state taxes or criminal proceedings. Corcoran (2000) discusses in more detail the extent to which accountant-client privilege is protected under this legislation.

Accepting the assignment

The agreed terms of the engagement should include the nature and extent of the services to be provided, responsibilities of the parties to the engagement, and other business terms including the method of determining fees for the services, and the dates the fees are to be paid. The expert is advised to only accept an assignment where he has the:

- Knowledge, experience, qualifications and professional training appropriate for the assignment;
- Resources to complete the assignment within the agreed time scales and to the standard required. Experts should not accept instructions if they are not able to

²⁴ 409 US 332 (1973).

²⁵ 60 Cal. Rptr. 2d 780 (1997) (CA).

²⁶ Named after the decision in *United States v. Kovel*, 296 F.2nd 918 (2d Cir. 1962).

prepare a report within reasonable time, having regard to the timetable of the case. A time frame for production of the report should be agreed in advance.

Forensic accountants should make clear to lawyers, in advance, what can and cannot be expected on completion of the assignment. In particular, as soon as possible after being instructed, they should identify any aspects of the engagement with which they are unfamiliar, or which they are not competent to handle, or on which they require further information or guidance.

If any part of the assignment is to be undertaken by persons other than the individual instructed then:

- Prior agreement from the instructing lawyers must be obtained; and the
- Names, qualifications and experience of the individuals should be provided

When a firm has been instructed the names of the members of the team to work on the assignment should be provided, if requested.

Engagement letters

Experts are not required to use engagement letters when providing services. However, using engagement letters provides a convenient means of outlining the engagement, of documenting the parties' understanding of the engagement to prevent misunderstandings, and of providing for a method of resolving future disputes should they arise. Engagement letters can help prevent misunderstandings about the services to be provided, responsibilities of the parties, and the terms of engagement. In addition, they may help document that the experts' opinions, expert's work output, and facts known or relied upon by the expert are protected from discovery by the opposing party until the lawyer decides that he expects to call the expert to testify.

The content of engagement letters will vary depending on the court system, circumstances, professionals and clients involved. Issues to be covered might include some of the considerations discussed below (Gafford, 1996).

Identification of parties to the engagement

Direct engagement of the expert by the lawyer (or the lawyer and the client) may be the first step that the lawyer can take to protect expert information from discovery by the opposing party, until the lawyer decides to call the expert to testify. This is particularly the case if the initial briefing of the expert regarding the issues at hand effectively amounts to an advisory consultation at a time when legal proceedings are yet to be contemplated.

Identification of the case and parties to the litigation

Identifying the case and the parties to the litigation helps document that the expert was retained in anticipation or contemplation of litigation or for preparation for trial. This is another key element to protect expert information from discovery by the opposing party until the lawyers decide to call the expert to testify.

Effective date of engagement

This should be specified in the letter.

Initial services to be completed and expected timing

The engagement letter should describe any initial services to be provided and, if possible, the expected completion times.

Availability of information

Details of the documentation and information to be supplied to the expert by the lawyer and/or client should be identified. A standard paragraph appearing, for example, in an audit representation letter might also be included in the expert's letter of engagement to the effect that to the best of the lawyers' and client's belief the information or documents provided are true, complete and correct. The effect on the engagement of the client/lawyer not supplying the information in a timely manner may also be referred to.

Conflicts of interest

Engagement letters should include an affirmative statement that the expert is not aware of any conflicts of interest. If the expert has conflicts of interest that have been waived by the appropriate parties, the statement should be changed to describe the conflicts of interest.

The lawyers and the expert should consider the effect on the strength and credibility of the expert when conflicts of interest exist. If the lawyers restrict the engagement to an advisory role that is protected from discovery by the opposing party, and with no requirement for expert evidence to be given in court, this may not be a concern.

Discovery of information, opinions and work output of experts

The expert witness's work product is usually not available through discovery. This is because it normally attracts the privilege associated with the contemplation or furtherance of litigation, referred to above. In general, discovery is allowed for of any unprivileged documents containing material relevant to the case. Discovery may even allowed be for information that is not admissible at trial if the information appears reasonably calculated to lead to the discovery of admissible evidence.

Amount and timing of fee payments

The agreed terms of engagement should indicate arrangements concerning fees – whether an hourly rate, a fixed fee or amount recoverable on taxation. The hourly rate charge is generally the most advantageous for the expert. The terms should be agreed at the outset and should cover all matters including:

- Expert's method of charging;
- Basis of expert's charges (rate of hourly charge, amount of retainer, etc.) including any different rates for attendance at court;
- Staff working on the assignment;

- Rates chargeable for each member of staff;
- Rates for support-staff;
- Charging rates/daily rates for attending at trial;
- Charging rates during travel time and waiting;
- Whether cancellation fees are chargeable;
- Whether disbursements are to be charged by the expert or absorbed in his fee;
- Frequency of billing;
- Payment arrangements.

An example of a fee schedule and retainer agreement is available at Zengler Economics (<http://home.earthlink.net/~zengler>). Although somewhat basic, it provides a guideline on various aspects to be agreed concerning fees. Responsibility for payment of the accountant's fees usually rests with the instructing lawyer, and not the client, unless the parties come to a different arrangement. Difficulties may arise where the amount of work required turns out to exceed initial estimates. Where this is the case, the instructing lawyer should be informed as soon as practicable. The lawyer then has the option of not having the extra work done.

Clear communication in the engagement letter about the expert's fees is important in preventing misunderstandings. The model terms of engagement (applying to experts generally) of the Expert Witness Institute (EWI) are an example (available at www.ewi.org.uk). These model terms deal with ten issues, eight of which relate to the expert's fees! Professional accountants may wish to adapt this using more professional forms of expression.

Limitations that may require other experts

The development of, reliance on and ability to support certain assumptions in relation to valuations of damages in personal injuries, wrongful death and in business valuations may require additional experts, over and above those that have the qualification to make the valuation. Non-valuation experts that the case might require include actuarial experts, and experts in medical, psychiatric, psychological and vocational rehabilitation fields. Determining the appropriate evidence to present in the case is a legal matter for which the lawyers are responsible.

Update of written report prior to testimony

Considerable time may elapse between preparation of the expert report and the case coming to trial. A paragraph in the engagement letter might provide for the expert's report to be updated prior to giving evidence, or at the lawyers' request.

Limitation on responsibility

Many factors may affect the resolution or outcome of a case. The expert is hired to provide objective opinions and work product (i.e. without taking account of whether the plaintiff or defendant will benefit). The lawyers are not required to accept or use the opinions or work product of the expert.

An expert's responsibilities must be limited to his opinions and work product. Those responsibilities must not extend to all factors that affect the ultimate resolution or

outcome of the case. Such a limitation of responsibility in an engagement letter will help clarify that the expert is not a biased ‘hired gun’.

Resolving disputes

Methods of resolving disputes involving experts include out of court negotiations, settlement by the parties, litigation and alternative methods to litigation. Arbitration is a common alternative to litigation. The sample engagement letter might include a contractual agreement for any disputes to be decided by arbitration. It might also specify the arbitration rules to be followed. In addition, responsibility for payment of the costs of arbitration might also be set out.

Terminating engagements

Engagement letters might include provisions for terminating, e.g. as a result of;

- Fees not being paid;
- Change in lawyers and/or parties involved in the case; or
- Information becoming available that makes the expert’s services inappropriate. Such situation might arise where there is disagreement between the lawyers and the expert concerning the contents of the expert opinion. The expert has a duty to provide an objective opinion.

ACCOUNTANTS’ FEES

The issue of accountants’ fees has already been touched upon and is expanded on here.

Contingent fees and expert testimony

If the client’s ability to pay the fee were dependent on the outcome of the case, this would amount to a situation akin to a contingency fee arrangement. This in turn might lead to accusations of lack of objectivity on the part of the expert and may undermine the credibility of the expert. As an expert should be, and should be seen to be, independent and objective, the employment of an expert witness on a contingency fee basis would generally be inappropriate. The Academy of Experts Code of Practice²⁷ prohibits the payment of fees on a contingency, no win/no fee basis. Under the professional ethics of the professional accountancy bodies, accountants acting as expert witnesses are not allowed to accept instructions on a contingency fee basis.²⁸

If the instructing lawyer is being paid on a contingency fee basis it is important to make it clear that such a basis for charging is not appropriate and is not allowed for someone acting as an expert witness.

²⁷ See www.academy-experts.org: “An Expert who is retained or employed in any action, suit or other contentious proceeding shall not enter into any arrangement to receive a contingency fee in respect of that proceeding.”

²⁸ For example, paragraph 4.0 of Section 1.210 of the Institute of Chartered Accountants in Ireland *Ethical Guidelines* states “Fees should not be charged on a percentage, contingent or similar basis in respect of audit work, reporting assignments, due diligence and similar non-audit roles incorporating professional opinions and expert witness assignments.”

Records

Daily records of time spent and expenses incurred by each member of staff should be kept. The daily record should also cover the activities and nature of the work being done on each day. Daily contemporaneous attendance notes/time records should, if completed properly, ensure compliance with the requirements associated with the taxation of costs, where necessary.

Order for costs, taxation of costs and accountants' fees and legal aid

Courts give parties to litigation wide discretion in deciding whether to call expert witnesses. If costs are awarded to one party they will normally not be able to object to the costs of an expert witness, unless they can show that it was unnecessary to call that witness – even where the expert is not actually heard by the court.

CONCLUDING COMMENT

The current system where both parties to litigation call their own witnesses has been criticised as expensive. Several recommendations for reform have been made, some in relation to expert witnesses, including:

- Use of single, court appointed 'neutral' experts;
- Courts should have the power to compel expert witnesses to meet in advance and agree issues;
- Statements by expert witnesses should be let stand as evidence in chief of witnesses.

There is little doubt that the use of forensic accountants as experts in general is at best inefficient. Many cases that would benefit from forensic accounting input do not get it, or get it too late. In other cases, several experts appear where fewer, or even one, would suffice in all the circumstances. New rules would help, but the onus is ultimately on parties to litigation and on their lawyers to make adequate and appropriate use of the skills available to them.

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