



AICPA Practice Aid Addresses Reasonable Certainty in Damage Calculations

Certain to become relevant in Daubert challenges in the future

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On Aug. 5, 2015, the American Institute of Certified Public Accountants' (AICPA's) Forensics & Litigation Services Damages task force issued its non-authoritative Practice Aid titled *Attaining Reasonable Certainty in Economic Damages Calculations*. This document is likely to become indispensable in not only the preparation of damage calculations, but also a valuable resource to legal counsel on both sides of a Daubert challenge.

The Practice Aid relies on more than 50 specific cases by trial and appellate courts, as well as various published works from noted legal scholars. Its stated objective is to identify information and factors courts have found to be relevant when evaluating testimony and proof of damages. Ultimately, the task force cited the intent of the Practice Aid as being "to help practitioners understand the expectations courts impose on the expert as a result of, for example, Rule 702 of the Federal Rules of Evidence or comparable tests at the state level."

While the 107-page Practice Aid is not considered an accounting standard or authoritative pronouncement, it examines four basic damage calculation controversies and provides guidance to CPAs who are expert witnesses. Litigators who try commercial damages cases will be well served by familiarizing themselves with the Practice Aid.

Reasonable Certainty

The task force concluded, based on its analysis of various judicial opinions, that damage calculations **do not** need to be certain to adduce a calculation of damages. Rather, reasonable certainty will have been attained when the calculation itself has a reasonable basis and is calculated with a sound methodology. In addition, the task force, citing case law, opines that once there is a high degree of certainty that a plaintiff was damaged, damage calculations that are based on sound methodologies – even if the chances of achieving the calculated amount is less than 50 percent - **do not** fail the test of reasonable certainty.

Expert's Reliance on Client-Supplied Data

The issue of an expert providing testimony based on projections from his/her client, for example, has been the source of countless hours of debate. CPAs have always been obligated to follow the profession's Code of Professional Conduct, which among other things, requires the CPA to obtain sufficient relevant data to provide a reasonable basis for the conclusions reached. The task force examined 11 cases in depth in the Practice Aid and determined that the courts appear to prefer experts who:

- use management-supplied projections that rest on assumptions that are testable and that have a linkage to the operative reality of the company's business;
- rely on management representations that are made by client personnel who are qualified to make the representations, as opposed to representations made by client personnel who are unqualified based upon their day-to-day responsibilities or background, to provide the information;
- consider the underlying data and assumptions that go into management-provided information and consider further corroborating evidence;
- use management-supplied projections that are prepared in the normal course of business, as opposed to projections that are prepared solely for litigation purposes.

Expert's Role in Proving Causation

Once again, the task force examined numerous cases. One of the most interesting observations was that courts were less likely to exclude an expert when multiple experts were retained – including an expert who provided reliable opinions regarding causation. The implication here was that a damages expert's credibility can be enhanced when the client retains other experts to bolster the causation argument. Other notable observations included that experts are less likely to exclude a damages expert when:

- the alleged damages occur in less technical circumstances, which may include, for example, personal injury, wrongful death or business interruption actions;
- the court has found that the expert has applied accepted methodologies to calculate the amount of damages;
- the calculation of damages does not rely on seemingly speculative assumptions - the more complications that exist in other aspects of the damages expert's testimony, the more likely causation may be identified by the court as a factor for exclusion;
- no other obvious unaccounted for causes of the damages are evident.

Calculating Damages in Newly Established Businesses

The trier-of-fact is often concerned with awarding damages to businesses with no or limited operational history. Plaintiffs have historically had to overcome the speculative claim in proving damages for businesses that are new, unestablished or unproven. Some states have specific rules for the recovery of damages by "new businesses," but the task force found cases where courts made exceptions to their states' "new business rules." The task force again provided a lengthy analysis of several cases and found that plaintiffs who had a limited operational history were more likely to be awarded damages if their claim had a sufficiency of analysis or had evidentiary sufficiency. The task force reported that experts who had several bases for their opinions and those who relied on other experts, over and above those who

simply relied on representations from their clients were, not surprisingly, more likely to succeed in proving damages. One of the key components of a successful damage claim was reported to be the use of the yardstick approach.

The yardstick approach is a common method for calculating damages in a range of cases, but appears to be especially well suited for use in a case involving a newly established business. Rather than basing a damage calculation solely on a plaintiff's internal projections, the yardstick approach succeeds by basing the calculation of damages on the actual performance of another business that can be evidentially tied to the plaintiff's business by product, service, industry or location. The Practice Aid provides a useful table of cases that can be used to help the expert and the attorney bolster use of the yardstick approach.

In the event the facts of the case do not permit the use of the yardstick approach, courts have embraced experts who use projections prepared by their client, with some caveats. As discussed previously, the CPA expert may rely on client-supplied data, but the burden is far greater for an expert representing a business without a historical track record for an established business. The task force reported that courts are more likely to place reliance on pre-litigation (normal course of business) projections, tested by an expert who was well qualified and made appropriate adjustments to the projections that were consistent with the facts of the case and other data relevant to market conditions.

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