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AICPA Rules of Professional Conduct

By Dennis S. Medica – January 4, 2016

Whether you are engaging an expert or cross-examining one, it is critical to be aware of the professional guidance and ethical standards to which your expert witness must adhere. Failing to do so may result in unexpected challenges to your expert's qualifications or a missed opportunity to strike the opposing expert's testimony. Either way, you put your case at risk.

Consider the following when dealing with an expert witness:

- What specific professional guidance and/or standards must the expert comply with when serving as an expert witness?
- Has the expert complied with those standards?

These issues are particularly important when dealing with Certified Public Accountants (CPAs). In performing financial damage analysis and preparing related expert testimony, CPAs are required to comply with longstanding professional guidance and standards. The American Institute of Certified Public Accountants (AICPA) has promulgated standards that its members must follow in order to maintain the integrity of the profession and its members. CPAs performing litigation services must comply with (1) the general standards of the accounting profession contained in the AICPA Code of Professional Conduct (AICPA Code); (2) relevant standards established by state boards of accountancy; and (3) guidance in AICPA special reports, including *AICPA Consulting Services Special Report 03-1: Litigation Services and Applicable Professional Standards* (AICPA Special Report). You and your accounting expert should be fully aware of these standards.

The AICPA Code of Professional Conduct

The AICPA Code was revised effective December 15, 2014, and applies to all services provided by AICPA members. Relevant sections of the AICPA Code which have applicability to litigation services are as follows:

Integrity and objectivity. Financial experts should avoid taking any position that may impair their objectivity. CPA experts must not become blind to objectivity in an effort to support their client's position. "The expert does not serve as an advocate for the client's position and, therefore, should not subordinate his or her judgment to the client. The expert is engaged as someone who has specialized knowledge, skills, training, and experience in a particular area and presents conclusions and judgments with integrity and objectivity. The expert's function is to assist the trier of fact in understanding complex or unfamiliar concepts after having applied reliable principles and methods to sufficient relevant data." (AICPA Special Report, ¶ 13).

Legal counsel engaging CPA financial experts should exercise caution in asking their expert to take advocacy or potentially overreaching positions, which may result in loss of

credibility for the expert. In these circumstances, opposing legal counsel could readily cast doubt on the expert's objectivity and credibility.

General standards. The General Standards of the AICPA Code apply to litigation services performed by CPAs. These standards address professional competence, due professional care, planning and supervision, and sufficient relevant data.

Professional competence. Experts should undertake only those engagements the CPA can reasonably expect to complete with professional competence. The CPA expert witness “should consider that the reliability and relevance of the expected testimony is likely to be subjected to careful judicial scrutiny before it will be allowed to be presented at trial. When deciding whether to accept a litigation services engagement, the practitioner should consider whether it is likely that he or she has the knowledge and skills necessary to provide a reasonable basis to present relevant and reliable testimony on the issues to be presented in the particular case.” (AICPA Special Report, ¶ 17).

Due professional care. Practitioners must “[e]xercise due professional care in the performance of *professional services*.” (AICPA Code, ¶ 1.300.001). “Due care requires diligence and critical analysis of all work performed.” (AICPA Special Report, ¶ 18). Legal counsel should ask probing questions of his or her expert and address any issues in the expert's analysis early in the case.

Planning and supervision. CPAs must “[a]dequately plan and supervise the performance of *professional services*.” (AICPA Code, ¶ 1.300.001). “Planning consists of developing engagement objectives and translating them into the activities necessary for the CPA to form an opinion. Planning guides the conduct, supervision, control, and completion of the engagement.” (AICPA Special Report, ¶ 20).

Sufficient relevant data. Practitioners are required to “[o]btain sufficient relevant data to afford a reasonable basis for conclusions or recommendations in relation to any *professional services* performed.” (AICPA Code ¶ 1.300.001). Sufficient relevant data is “usually obtained through discovery, including depositions, interrogatories, and documents production motions.” (AICPA Special Report, ¶ 23).

Sufficient relevant data also may include assumptions made by the expert and/or provided by legal counsel or clients. Some analyses may require the use of assumptions about what would have happened if certain behaviors or activities had been different. The expert should analyze key assumptions to determine whether they are reasonable. In several cases, experts have had their testimony

excluded because their opinions were based on assumptions that were deemed unreasonable.

- In the antitrust matter of *American Booksellers Association, Inc. v. Barnes & Noble, Inc.*, 135 F. Supp. 2d 1031 (N.D. Cal. 2001), the testimony of the plaintiff's damages expert, Franklin M. Fisher, was excluded because it contained "too many assumptions and simplifications that are not supported by real-world evidence."
- The Eighth Circuit in *Blue Dane Simmental Corp. v. American Simmental Assn.*, 178 F. 3d 1035 (8th Cir. 1999) upheld the lower court's exclusion of Alan Baquet's testimony. The lower court "found that the methodology he employed was unreliable, stating that the analysis was 'simplistic.' The court noted that Dr. Baquet attributed the entire difference in market price within the United States and Canada to the Risinger fullbloods, despite the fact that these animals made up a tiny fraction of the market, nineteen out of 138,169 total head."
- In *Concord Boat Corp. v. Brunswick Corp.*, 207 F. 3d 1039 (8th Cir. 2000), the Eighth Circuit ruled the testimony of Robert Hall should have been excluded because not all relevant circumstances were incorporated into the expert's economic model, which failed to account for market events which did not relate to anti-competitive conduct. Mr. Hall used a hypothetical market model which ignored inconvenient evidence and "failed to account for market events which both sides agreed were not related to any anticompetitive conduct." The court concluded, "Dr. Hall's expert opinion should not have been admitted because it did not incorporate all aspects of the economic reality of the stern drive engine market and because it did not separate lawful from unlawful conduct. Because of the deficiencies in the foundation of the opinion, the expert's resulting conclusions were 'mere speculation.'"

"Sufficient relevant data" also extends to the requirement that the expert not ignore facts or rely on irrelevant facts. When engaging an expert, provide all relevant documents to him or her. Do not only supply documents that may be beneficial to your client's position. Courts have excluded testimony of financial experts for ignoring facts or data, and relying on irrelevant facts, as identified in several cases below.

- *Johnson Electric N. Am., Inc. v. Mabuchi Motor Am. Corp.*, 103 F. Supp. 2d 268 (S.D.N.Y. 2000) involved patent infringement claims related to patented technologies associated with motors used in automobile accessories, including power door locks and mirrors. The testimony of Mabuchi Motor American Corp.'s damages expert, Jeffrey A. Dubin, was excluded for ignoring relevant facts. Furthermore, the court found that Mr.

Dubin used various unsupported assumptions in his twenty damage scenarios.

The court indicated, “Mabuchi cannot recover *any* damages, including those for price erosion, for the acts committed prior to July 15, 1988, when Mabuchi gave Johnson notice of infringement.” “Dubin's damages calculus is heavily weighted by the factor of estimated price erosion during earlier periods alone destroys the validity of his conclusions. The effect on the price of micro-motors of Johnson's presence in the market from 1985 through 1988 is simply irrelevant to the measure of damages in this case.”

- In the price fixing case of *Blomkest Fertilizer, Inc. v. Potash Corp. of Saskatchewan (PCS)*, 203 F. 3d 1028 (8th Cir. 2000), the class argued, “that its expert's econometric model provided crucial confirmation that the prevailing potash prices during the alleged conspiracy were above those expected in the absence of collusion. While their expert concedes that the prices have primarily steadily decreased since January 8, 1988, he asserts that prices would have been much lower absent an agreement to fix prices.” The court found that “the report in this case is not probative of collusion.” The expert admitted that his approach failed to take into account dramatic events in the potash industry including the privatization of PCS which resulted in reduced output and increased prices and anti-dumping proceedings which also increased prices of potash. “It is beyond dispute that even without collusion, those events would have led to higher potash prices. A model that does no more than report that prices did, indeed, rise after these events tells us nothing about the existence of industry collusion.”

Recognize the risks of your financial expert proffering an opinion without sufficient relevant data. He or she may be subject to a *Daubert* challenge and potential exclusion of his or her testimony. In addition, consider the following professional standards which CPAs must adhere to, when performing litigation services.

Compliance with standards. “This Rule requires all CPAs to comply with standards promulgated by bodies designated by the AICPA Council. For practitioners, that body is the Consulting Services Executive Committee. This committee issued SSCS No. 1, *Consulting Services: Definition and Standards*(AICPA, *Professional Standards*, vol. 2, CS sec. 100),and all practitioners are required to adhere to its standards” (AICPA Special Report, ¶ 25). *See* Statement on Standards for Consulting Services (SSCS) No. 1, *Consulting Services: Definition and Standards*.

Accounting principles. “To the extent that generally accepted accounting principles (GAAP) are applicable in a litigation services engagement, the practitioner shall apply the appropriate accounting principles.” (AICPA Special Report, ¶ 26).

Confidential information. “The practitioner may not disclose confidential client information without the client’s consent. Due to the ethical obligation to preserve client confidences, practitioners may be confronted with the risk of breaching client confidentiality.” (AICPA Special Report, ¶ 27).

Contingent fees. A CPA in public practice shall not:

- a. Perform for a contingent fee any *professional services* for, or receive such a fee from a *client* for whom the [CPA] or [CPA’s] firm performs,
 - i. an audit or review of a *financial statement*; or
 - ii. a compilation of a *financial statement* when the [CPA] expects, or reasonably might expect, that a third party will use the *financial statement* and the [CPA’s] compilation report does not disclose a lack of *independence*; or
 - iii. an examination of prospective financial information; or
- b. Prepare an original or amended tax return or claim for a tax refund for a contingent fee for any *client*.

(AICPA Code, ¶ 1.510.001.01). Although litigation consulting services performed by CPAs are not specifically identified in this rule, contingent fees associated with these engagements would be problematic. Accepting contingent fees by CPAs performing litigation consulting services may create an appearance of bias and/or lack of objectivity.

Acts discreditable. A CPA “shall not commit an act discreditable to the profession.” (AICPA Code, ¶ 1.400.001.01). These acts include such things as not returning client records when demanded; negligence in the preparation of financial statements or records; failure to follow requirements of governmental bodies, commissions, or other regulatory agencies in performing attest or similar services; and others.

Consulting standards. In addition to the general standards, specific consulting standards apply to CPAs performing litigation consulting services. These standards are established by the AICPA Statement on Standards for Consulting Services under *Compliance with Standards* of the AICPA Code of Professional Conduct, which include serving the client’s interest, entering into an understanding with the client, and communicating with the client.

Summary

Financial experts have been excluded for failure to meet professional standards as indicated in the cases above and many others. Consider reviewing the following cases for additional examples: *Bailey v. Allgas, Inc.*, 148 F. Supp. 2d 1222 (N.D. Ala. 2000); *In re Aluminum Phosphide Antitrust Litig.*, 893 F. Supp. 1497 (D. Kan. 1995); and *Lantec, Inc. v. Novell, Inc.*, 306 F. 3d 1003 (10th Cir. 2002). Recognize the professional standards and guidelines to which your expert is required to adhere while engaged to assist you and your client. Ask probing and thorough questions of your financial expert regarding the work performed and be confident in the responses, before going to trial.

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[Dennis S. Medica](#), CPA, CFF, CGMA, CVA, CFE is a forensic accountant and managing director of Medica, LLC, in Cleveland, Ohio.