

Legal Intelligencer

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COMMENTARY

What Constitutes Sufficient Relevant Data in CPA Forensic Services Engagements?

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By Jesse J. LaGrossa | February 07, 2023 at 10:10 AM

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Every CPA practitioner should be familiar with the general standards rule within the AICPA Code of Professional Conduct. It applies to AICPA members rendering any professional service to clients (including tax return preparation, financial statement audit, litigation services, etc.). SSFS No. 1 contains the exact general standards rule found in the broader set of professional standards, reiterating its importance when rendering forensic services. In the context of the CPA profession, forensic

services generally includes engagements with a client in connection with litigation (actual or potential, including alternative dispute resolution) or an investigation (in response to specific concerns of wrongdoing).

The general standards rule is comprised of the four broad pillars of the CPA profession: professional competence, due professional care, planning and supervision, and sufficient relevant data. Sufficient relevant data is further described in the professional standards as “obtaining sufficient relevant data to afford a reasonable basis for conclusions ...”

There is no one-size-fits-all approach to what constitutes “sufficient relevant data” in forensic services engagements. It is inherently subjective—open to the practitioner and trier of fact’s professional judgment and dependent on the facts and circumstances of the matter. While “sufficient relevant data” is a phrase embedded in CPA professional standards, the underlying concept is a topic courts frequently encounter when assessing whether a CPA expert has an adequate foundation for their opinions. “And as damages models are fact-dependent, ‘a distinct but integral part of the admissibility inquiry is whether the data utilized in the methodology is sufficiently tied to the facts of the case’,” (*Commonwealth Scientific v. Cisco Systems*, Fed Cir. 2015).

Let’s take a step back. During the course of a forensic engagement, a CPA practitioner may obtain data from multiple sources. For example, in a lost profits analysis, the practitioner may obtain historical financial statements, tax returns, industry data, macroeconomic data, and other data deemed relevant to support inputs and assumptions (such as projected sales, avoided costs, loss period, growth rates, etc.). Analyzing

this data forms the basis of their opinions. So, at what point has the practitioner obtained “sufficient” relevant data to provide a foundation for their opinions? “Experts are expected to make inferences and state opinions and they are granted wide latitude in determining what data is needed [emphasis added] to reach a conclusion.” See *JMJ Enterprises v. Via Veneto Italian Ice*, E.D. of PA. 1998.

We can derive insight from the AICPA’s professional guidance on prospective financial information, which is separate from the professional standards referenced above. It should note:

“The attention devoted to the appropriateness of a particular assumption should be commensurate with the likely relative impact of that assumption on the prospective results. Assumptions with greater impact should receive more attention than those with less impact.”

Practitioners performing forensic services are not necessarily bound by the AICPA’s standards governing forecasts and prospective information, because such standards govern other types of engagements outside the scope of forensic services.

Despite the wide latitude available to experts, and even if they offer an opinion based on some measure of data, “A court may conclude that there is simply too great an analytical gap between the data and the opinion proffered.” (*JMJ Enterprises v. Via Veneto Italian Ice*).

To consider sufficient relevant data, experts must analyze the facts and circumstances specific to each engagement. Let’s review a few situations where a trier of fact may question whether the damages expert obtained

sufficient relevant data to support their opinions. This might happen when the expert:

- Relies on company-developed projections;
- Fails to consider other events impacting the economic loss; or
- Accepts counsel-provided assumptions.

Reliance on Company-Developed Projections

Companies regularly prepare financial projections for various purposes, including budgeting operating expenses, planning capital expenditures, obtaining debt financing, raising equity capital, etc. These projections must be reviewed within the context of the subject litigation. An expert may raise certain questions, such as who, when, how, and why? “The mere existence of pre-litigation projections does not render them, per se reliable.”

- Who within the company prepared the projections and to whom were they presented? When were they prepared (what information was known or knowable at the time of preparation)?
- How accurate have the company’s projections been, historically speaking, relative to actual results (in hindsight)?
- Why were the projections prepared (i.e., loan application, board presentation, management planning, etc.)?

While not necessarily required, failing to raise analyze the preceding questions may cause problems for an expert if the projections offer an unjustifiably rosy—or—pessimistic—picture of a company’s future operations. An expert’s use of company-prepared projections as a basis for damages is not an opportunity for “simply presenting their unrealistic hopes through the mouth of an expert.” See *Chemipal v. Slim-Fast Nutritional Foods International*, District of DE. 2004).

I have been engaged on multiple occasions to assess plaintiff claims for lost profits based on projections developed by company management. Presenting overly optimistic company projections has been a possible avenue for cross-examination and rebuttal.

Failure to Consider Other Events Impacting Economic Loss

Damages experts may be asked to assume liability (i.e., the defendant will be found liable for damages resulting from alleged actions).

Assuming liability is a matter of law and generally outside the scope of a CPA expert's role (unless it relates to an area of the CPA's expertise, such as in accountant malpractice matters). However, it does not necessarily result in assuming causation.

Causation, or "proximate cause," is a legal concept that experts are also often asked to assume. However, experts who fail to consider other causal factors relevant to the matter before the court may jeopardize the credibility of their analysis. "Not only must the event and the consequences, i.e., damages, be temporally and logically connected, but also other potential causes of similar consequences must be excluded or otherwise factored into the analysis." See *Penn Mart Supermarkets v. New Castle Shopping*, Court of Chancery of DE. 2005).

In the matter above, the plaintiff (Penn Mart Supermarkets) experienced a decline in sales due to the defendant's actions. However, the damages analysis failed to "separate the effects of different events that occurred at the same time," including a major construction project near the main entrance of the shopping center, which adversely impacted all businesses in the area—not just the plaintiff.

Acceptance of Assumptions Provided by Counsel

During an engagement, it is possible counsel will attempt to “assist” the expert by providing specific data and assumptions. Failing to consider whether such assumptions are reasonable and based on the facts of the matter before the court (i.e., through documentary evidence produced in discovery, fact witness depositions, external research, etc.) could adversely impact the practitioner’s ability to present findings in a court proceeding.

Multiple issues could arise in this situation. For example, the expert could accept assumptions provided by counsel without performing an objective analysis of reasonableness. Or, the expert’s objective analysis expert could reveal fundamental flaws with the assumptions that the expert does not adequately address (either explicitly in the report or during expert testimony).

Conclusion

While this article does not, and cannot, conclude what does and does not constitute sufficient relevant data, it provides a basis for discussion among counsel and experts. Sufficient relevant data is a reasonable assessment within a specific context. Facts and circumstances of an engagement provide the backdrop against which these factors must be assessed.

There is a common theme intertwined within the three above scenarios: an expert could fail to perform an objective analysis of the data that supports the significant assumptions that formed the basis of their opinion. If an objective analysis is not offered in an expert’s report, the lack of analysis may become evident during deposition or trial testimony.

We cited economic damages expert services, specifically those based on a lost profits analysis, to illustrate the above points. However, the professional standards of sufficient relevant data apply to all forensic services engagements CPA practitioners perform, including forensic investigations, business valuations (for purposes of litigation), etc. This is especially relevant to all forensic services engagements today given the availability of large quantities of data and the emergence of data analytics.

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