

The Newsletter from The Network of Independent Forensic Accountants

NEW STANDARDS FOR EXPERTS

The Ministry of Justice is intent on issuing mandatory minimum standards for expert witnesses providing evidence in the family courts. It is likely that, having been adopted by the Family Court, similar standards will be issued to apply to other areas of litigation.

Those instructing accountancy (or indeed any) expert witnesses should not only be aware of the new rules, but would also be well advised to include in any letters of instruction to experts a request that the experts confirm their compliance with the standards.

By doing so, the experts will confirm that they have relevant expertise and experience and that they comply with the appropriate Continuing Professional Development requirements.

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“Our standards are very high. We even have high double standards.”

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CHOOSING THE RIGHT 'MULTIPLE': IS IT SIMPLY A MATTER OF PLUCKING A NUMBER FROM THIN AIR?

The most common method of business valuation relies on the application of an 'appropriate' multiple to adjusted annual earnings, but to what extent should the choice of multiple be a matter of science or judgment?

There is no doubt that judges have an understandable mistrust of experts who quote multiples without any justification. However, there will almost inevitably be a degree of professional judgement that should be applied to the selection of the multiplier and, indeed, it is arguably that very 'expertise' that the forensic expert witness has been instructed to provide to the court.

There seems to be a tendency by the courts to prefer expert evidence that begins with an objective measure, such as the p/e ratio of a quoted public company that is ostensibly similar to the entity being valued. Typically such p/e ratios are then reduced to reflect such matters as the fact that, when compared with their unquoted counterparts, quoted companies are usually:

- Larger
- More diverse
- More asset rich
- Have access to the capital market; and
- Seldom rely on the input of a few key individuals.

Arguably, if one applies an entirely subjective discount, say 50%, to a supposedly objective p/e ratio, the net result has lost any element of objectivity that it may once have had.

'some measure of justification or benchmarking will always be advisable'

Nevertheless, experts risk criticism if they are seen simply to pluck multiples from thin air and some measure of justification or benchmarking will always be advisable. If, as is often the case, there are no publicly quoted companies that are even broadly comparable with the business that is being valued, then one can consider other published indices of multiples.

One of the most frequently quoted is BDO's Private Company Price Index ('PCPI'). This tracks the Enterprise Value ('EV') as a ratio of Earnings Before Interest Tax Depreciation and Amortisation ("EBITDA") for private company sales to trade buyers.

The fact that the PCPI is based on a number of undisclosed transactions means that it lacks sufficient transparency to be entirely reliable. Its reliance on EBITDA also means that, if it is to be used to derive a value for the shares in a company, further subjective adjustments will have to be made to take into account a company's net debt.

Another measure that is worthy of consideration is the Small and Medium Enterprises Valuation Index that is compiled by the UK200Group, an association of independent accountancy firms. This index was published in November 2009, 2011 and 2012. It is based on data in relation to transactions in the preceding five years and on which UK200Group member firms were instructed as corporate finance advisers. The most recent figures are based on an average deal size that was reported to be £2.2m and reflect a median p/e ratio of 6.1.

That figure broadly accords with data from the private company Price Earnings Ratio Database ('PERDa'), compiled by members of the Leading Edge Alliance, a global alliance of independently owned accounting and consulting firms. This index measures the price paid for companies as a ratio of Earnings before Interest and Tax ('EBIT') and has had a long term average of 6.4 if one excludes a period of exceptional and arguably unsustainably high figures during 2007/08.

The critical issue for any expert witness who wants his or her testimony to be credible at court and preferred by the judge is to ensure that, whatever indices are quoted, there is an explicit recognition that any generic statistic will have its shortcomings and none will be entirely reliable. The best that can be achieved is to apply professional judgement, but to do so in the context of, whilst not in blind reliance on, publicly available information.

THE BENEFIT OF BREVITY

Sitting in the Family Division of the High Court last year and commenting on the evidence of one expert witness, Mrs Justice Pauffley lamented the trend towards ever lengthier expert reports.

In the case of *IA (A Child)* [2013] EWHC 2499 (Fam), she noted that the medical expert's report was 35 pages long and contained a "lengthy section comprising the relevant background information" followed by detailed sections giving opinion on matters on which he had not been requested to comment and which had been addressed by another expert. It was not until the 27th page of his report that the expert addressed the specific questions asked of him.

The judge recalled nostalgically the days in the 1980s and 1990s when expert reports were issued "in the form of letters which extended to about a page and a half" that "contained all the judge needed to know". By contrast she criticised the "modern way" of producing "absurdly lengthy reports", which she said was "doubtless expensive" and was "no longer acceptable".

Few would argue with the judge's call for experts to

"distil essential information and opinion within an impressively succinct report".

As to whether a concise report will take less time to prepare and therefore be cheaper than a longer report, it is perhaps worth considering the sentiment famously expressed by George Bernard Shaw who once wrote "I'm sorry this letter is so long, I didn't have time to make it shorter."

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'a requirement for experts to have a current practicing certificate'

If the terms of the Standards are in line with those that appear in the draft that was submitted for consultation there will be a requirement, primarily for medical experts and those doing children work, to have a current practicing certificate. There is nothing proposed at present to extend this requirement to accountants, but should this eventually happen it is likely to have an impact on expert accountancy witnesses from the Big Four and other larger accountancy practices, whose expert witnesses are frequently 'Directors' or 'Senior Managers' and may not be partners in their firms. Those who are not partners of their firms are unlikely to have been required to apply for a practicing certificate. This will impact on instructing Solicitors when they come to choosing a forensic accountant.

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HOW LOW CAN YOU GET?



To steal is bad, but to steal from a Charity is surely worse? Yet, according to the National Fraud Authority's survey of charities with incomes over £100,000 per annum, a staggering one in ten had suffered from fraud in the previous financial year.

These figures are undoubtedly an underestimate because many incidents go unreported. As lawyers who represent the charity sector know only too well, charities are often justifiably concerned about the risk to their reputation if thefts become public knowledge. Tellingly, the Institute of Chartered Accountants in England and Wales' own recent research into a sample of charities identified general weaknesses in fraud detection policies.

Sadly fraudsters all too often avoid the full consequences of their crimes and instead benefit from their charity's aversion to publicity and their fear of appearing to have done too little to prevent the thefts.

However, if the victims of fraud can be persuaded to take legal action against the perpetrators, it is sometimes possible for a significant proportion of the misappropriated funds to be recovered.

'one of the largest and most sophisticated alleged frauds in English history'

In many cases, the forensic accountancy evidence will play a key role and NIFA members are particularly experienced at following complex money-trails. Such asset tracing exercises are not limited to charity sector cases. Indeed, one NIFA member is currently advising in relation to a long running complex case arising from one of the largest and most sophisticated alleged frauds in English history, concerning the analysis of the flow of several hundreds of millions of pounds across numerous jurisdictions.

One of the most challenging aspects of any large fraud will be the almost inevitably large volume of documentation. It will therefore be of critical importance that both legal advisers and experts are adept at dealing efficiently with e-disclosure and the associated technologies.

With access to IT specialists, NIFA is well-placed to provide 'joined-up' litigation support solutions for even the most complex fraud cases, be they civil or criminal.