

Use of Hindsight Evidence

Typically when preparing a valuation at a specific date, expert valuers should not factor into the valuation events that occur after the valuation date, which had not been anticipated at that date.

This was reiterated in *Propell National Valuers (WA) Pty Ltd v. Australian Executor Trustees Ltd* [2012] FCAFC 31 (20 March 2012). This case involved the valuation of real estate in Perth as at 3 April 2007, valuing a property at \$1.6 million. Having regard to this valuation as security, a loan of \$1.2 million (75%) was advanced to the valuer's client. Soon thereafter the loan went into default and the client became bankrupt. The mortgagee took possession and the property was sold at auction in February 2010 for \$980,000. Claims were made under s. 51 of the *Trade Practices Act 1974* [now *Competition and Consumer Act 2010* (Cth)] that, inter alia, representations about the property were false or incorrect and not based on a reasonable degree of skill and care. The mortgagee called a valuer to provide expert evidence regarding the value of the property as at April 2007. Having regard to sales before April 2007, the expert considered the value of the property to be \$1.0 million and the original value excessive. The defendant disputed this and engaged another valuer, who suggested a value of \$1.475 million having regard to 13 sales, 2 before April 2007 and 11 after April 2007.

The key issue was whether or not hindsight evidence should be allowed. The trial judge, Justice Baker, found that the task was to be found without hindsight. In a split decision a Full Bench of the Federal Court reinforced the principle that in assessing allegations that a valuer has provided negligent advice and engaged in misleading and deceptive conduct, the evidence of expert valuers in making an assessment of other valuers' advice regard must not be had to hindsight information (comparable sales after the date of the original valuation).

However, there are examples of when hindsight can be used to determine "real value".

Forensic accountants and business valuers are sometimes requested to value a business or equity in an entity as part of assessing loss and damage in the context of misleading and deceptive conduct, tortious claims or breach of contract.

In such cases, the courts have allowed the use of hindsight in so far as it highlights the value of a business or equity as at the date of the transaction.

It is important to distinguish between the causes of any decline in value. Subsequent events should not be "independent, extrinsic, supervening or accidental events" (refer *HTW Valuers (Central Qld) Pty Ltd v. Astonland Pty Ltd* [2004] HCA 54 [12 November 2004]).

Example Case

In *IBEB Pty Ltd v. Duncan* [2011] NSWCA 368, a newsagency was sold in July 2005 by IBEB Pty Ltd to the Duncan family for \$405,000, including \$350,000 for goodwill. Mrs Duncan, a chartered accountant, had relied upon financial information provided in relation to the level of wages at the newsagency, which after takeover had shown to be much higher than had been represented.

The business incurred a loss of \$41,341 in its first year and small profits thereafter. The Appeal Judge stated that "where a misrepresentation has induced a party to purchase a business, the measure of damages commonly

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adopted is the difference paid and the real value of the business at the time of purchase” (quoting from the HTW Valuers (Central Qld) Pty Ltd case).

An expert calculated that the goodwill of the business actually purchased was \$46,057 rather than \$350,000. He also calculated the maintainable profit (after deduction for the proprietor’s salary) was actually \$12,294 pa, rather than \$97,100 pa as initially represented. The Appeal Judge confirmed that the expert could use the actual profit performance to illustrate the value of the business at date of purchase.

However, the Appeal Judge found the Duncans should not be compensated for on-going losses as that was already included within the calculation of the “real value” of the goodwill of the business and it would result in overcompensating the Duncans.

The Appeal Judge did allow further compensation for the first 10.5 months of loss when Mrs Duncan was attempting to remedy the problem.

Reliance on Assumptions

An expert’s report is often based on assumptions including the opinions of other experts.

Unless the assumptions relied upon are proved by admissible evidence, the expert’s evidence will become inadmissible.

This issue was highlighted in *Land Enviro Corp Pty Ltd & Ors v. HTT Huntley Heritage Pty Ltd & Ors* [2012] NSWSC 177 where the Court rejected two reports from an expert accountant.

The expert accountant had assumptions/estimates based on the material contained in various reports of other consultants (none of whom provided expert reports or were called to give evidence).

The Judge held that:

- the estimates were opinions and not statements of fact and must be properly proved as expert opinions in accordance with the Evidence Act 1995;
- there was no evidence as to the expertise of consultants reports nor the basis for which the opinions were formed; and
- the estimates were not admissible as it had not been established that the opinions were properly formed by a person with expertise in the relevant subject matter.

As a consequence, the expert accountant’s reports were inadmissible.

The above case illustrates that:

- An expert cannot attest to the reliability of an opinion of an expert in another field. They can only state that their opinion is subject to the acceptance of the other expert’s report.
- All assumptions the expert relies upon need to be independently established.

Future Newsletters

We propose forwarding future editions of our newsletter via email.

For those wishing to receive a copy kindly forward your email address to advice@mwforensic.com.au.

Family Law Case on Family Trusts

In *Harris and Harris* [2011], the Full Court of the Family Court of Australia overturned a decision by Justice Bell, who had held that property of a discretionary trust should be included in matrimonial assets of separating spouses.

In brief, this case involved:

- a trust established by the husband's father;
- at the relevant time, the appointor of the trust was the husband's mother and the controllers of the trustee company were the husband's mother, a son from a previous relationship and a friend;
- the main asset of the trust was a business which it was accepted was run on a day-to-day basis by the husband and wife;
- the main beneficiaries of the trust were the husband's parents and their children (i.e. the husband and his siblings); and
- distributions from the trust had been amongst the entire family group (including the wife), although the distributions to the wife ceased on separation with the husband.

In summary, the Full Court held:

- The trust and its assets were not an asset of the marriage.
- At most, the trust should be considered a significant financial resource for the husband.
- If a party to the marriage is not directly the appointor or in control of the trustee, then they do not have direct control.
- In order for there to be indirect control by a beneficiary, there must effectively be a situation where someone who has direct control is the mere puppet of the beneficiary.
- In order to demonstrate indirect control (e.g. through a 'puppet' scenario), there must be clear evidence to support the argument and merely reviewing a history of trust distributions of itself will not be sufficient.

The case defines the concept of indirect control (as set by French CJ in *Kennon v Spry* [2008] HCA 56), as a "puppet" situation and evidence to support a "puppet" situation must be provided.

Our Website

Our website at www.mwforensic.com.au has recently been updated and includes:

- Previous editions of our MW Forensic newsletters.
- Third edition of our booklet "Forensic Accounting for Family Law Matters".
- Third edition of our booklet "Forensic Accounting for Commercial Disputes".

Welcome to Lloyd Masocha

Lloyd Masocha recently joined Munday Wilkinson. Lloyd has 3.5 years accounting experience, has passed the CA program with the ICAA and is currently studying a Masters of Finance & Investment. We welcome him as a valuable addition to our team.

Our current staffing comprises:

- Russell Munday (Director)
- Paul Spence (Director)
- Lloyd Masocha (Forensic Consultant)
- Bruce Wilkinson (Director)
- Gerard Lim (Forensic Consultant)
- Josephine Scash (Office Administrator).

Recent Matters

In the past 12 months we have been involved in numerous matters including:

- Expert determination concerning adjustments for “Accrued Incomings” in regard to the transfer of an aged care facility.
- Expert report pertaining to an alleged fraud by a financial planner acting as advisor and administrator for the financial affairs of an elderly man.
- Expert report concerning loss and damage arising from actions of an investment adviser.
- Report to assist with an insurance claim for an alleged fraud of \$1.9 million by the internal accountant.
- Financial due diligence of an IT company for the purchaser.
- Expert report in relation to a loss of profits claim for fire damage to a Country Golf Club
- Expert report for shareholder dispute in a property development project.
- Expert report in regard to a fee dispute between an accounting firm and its former client.
- Numerous loss of earnings assessments for people diagnosed with mesothelioma.

Valuations of:

- Large IT software and consulting businesses
- IT recruitment business
- Educational publisher
- Manufacturer and supplier of plastic pots and containers to nursery industry
- Eye clinic and laser eye surgeon
- Australia’s largest truck body and heavy vehicle trailer manufacturer.
- Manufacturer and supplier of chemical lubricants
- Traffic engineering consultancy
- Serviced apartment business
- Plant and equipment hirer
- Registered training organisation
- Night club
- Accountancy practices
- Architect practices
- Medical practices
- Large plumbing and maintenance business
- Media buying company
- Light engineering businesses
- Supplier of computer hardware maintenance services, software support, disaster recovery, co-location data-centre services, outsourcing and cloud computing
- Importer and manufacturer of ostomy products
- Designer and manufacturer of conveyor chains and specialist transmission chains
- Numerous business valuations and loss assessments for the Valuer General Victoria in respect of businesses affected by the Regional Rail Link project.

Further Information

If you would like further information regarding this newsletter or our services, please contact us:

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