

The number crunchers

Philip Allsop considers the role of forensic accountancy in personal injury cases

Many personal injury, medical negligence and fatal accident cases are straightforward in numerical terms and so solicitors are comfortable to handle them, perhaps with some input from counsel. However, in certain cases, the input of an expert forensic accountant would be worthwhile and, indeed, it may be necessary if the solicitor is to fulfil his duties to his client.

What should you look for in a forensic accountant?

It is likely that a forensic accountant will be expected to act as an expert witness. For this reason, they should be a qualified accountant with a background in general accountancy, and probably continuing to undertake some work in the field in order to maintain their level of expertise. However, it is also important that they are trained and have experience in investigating claims, working with the Civil Procedure Rules, and giving evidence in Court. This expertise and experience could be substantiated by membership of either the Expert Witness Institute or the Academy of Experts.

Loss of earnings by self-employed individuals

There is clearly a case for using forensic accountants where the claimant was self-employed and had a varying pattern of earnings before the accident.

For the purposes of the claim, the post accident profits of the business

need to be evaluated on two bases:

- (a) the future profits of the business under the present circumstances, i.e. given that the accident has occurred and that the claimant makes their best efforts to mitigate the impact of the accident on their earnings from now on; and
- (b) the future profits of the business if the accident had not occurred.

The loss is the difference between the two sets of figures. The forensic accountant needs to get behind the historical numbers to understand the trends before the accident. They then need to investigate the market trends after the accident. Would sales or profit margins have grown if the accident had not occurred, because the market or demand for products or services was growing? Alternatively, would they have shrunk because of changing market conditions?

Loss of earnings for an employed individual

In this case, you are unlikely to need an expert witness report about the annual loss of earnings, although a few solicitors use forensic accountants to prepare the Schedule of Special Damages itself. You may well decide that you can handle this in-house, but do not forget to include the value of benefits lost such as health insurance premiums, company car, share option scheme, etc.

Loss of pension

Claims for loss of pension are great fun because of the wide range of pension arrangements that are available.

(a) Final salary schemes

The value of final salary pension schemes is now widely recognised and that makes it even more important to accurately assess the impact of the accident on the claimant's pension arrangements. Most public sector pension arrangements are final salary schemes, and a few of the larger private companies also still have them. However, as you may be aware from press reports, many private companies have closed their final salary schemes to new members, and so the prospect of finding a new private sector job with a final salary pension arrangement is increasingly remote.

Pension loss claims in relation to final salary schemes require a standard form of calculation and an experienced forensic accountant can assist with this. The forensic accountant can also interpret the pension documentation and ensure that the right bits of paper are obtained from the claimant, the employer, or the pension provider.

(b) Personal pensions

The pension which will ultimately be obtained from a personal pension arrangement is solely determined by the size of the pension pot upon retirement. Hence, it is really an investment arrangement with specific

tax advantages. The most obvious advantage is the fact that tax relief can be obtained in relation to the premiums paid. The simple approach to evaluating the loss of pension in this situation is the loss of tax relief. For individuals earning within the basic rate band of income tax (up to around £38,000 a year), relief will be given at 22%. For higher rate taxpayers, relief will be given at 40%.

For small claims and for basic rate taxpayers, this simple approach will be reasonably accurate. However, for large claims and for higher rate taxpayers, it is likely to overstate the claim because there are other tax consequences of having the investments within a pension arrangement. The alternative, more accurate, approach is to project the build-up of the pension pot during the working life of the claimant in order to establish the value of the pension pot at retirement. For modest pension pots, the funds would then be used to purchase a pension annuity and so the expected annual pension could be estimated

However, for large pension pots, more flexible arrangements are available, particularly since A-Day on 5 April 2006, such as alternatively secured pensions. Under these arrangements, the purchase of an annuity is deferred until at least age 75, and in the meanwhile, the pension pot continues to be invested, earning an investment return, whilst an annual pension is paid out of the pot. Until A-Day, the residual pension pot had to be used to purchase an annuity by age 75 at the latest. However, under the new regime, it is possible to avoid that and to continue drawing a pension from the pot. The assets left in the pot at death can then be passed on to beneficiaries. Not surprisingly, Gordon Brown wants his share of the residual pension pot in the form of

inheritance tax, but at least 60% should be available for beneficiaries, rather than being left with the insurance company.

If all of this sounds rather complex, it means that a forensic accountant should be called upon!

(c) Loss of state pension

For employed individuals who were contracted in to the state pension arrangements, there will also be a loss of pension benefits under the Second State Pension ('S2P'). This is frequently overlooked and yet the losses can be considerable. (S2P replaced the State Earnings Related Pension Scheme (SERPS) with effect from 6 April 2002, and that may be an acronym you are more familiar with.)

Fatal accident claims

All of the issues raised above could apply to a fatal accident claim. However, even with a straightforward employed individual, the calculations are relatively complex and a forensic accountant could assist in their preparation.

Periodic payments

The introduction of the new periodic payments regime poses problems for personal injury and medical negligence lawyers trying to advise their clients on the advantages and disadvantages of lump sums compared with periodic payments.

They are now required to consider whether, and to what extent, a periodic payment is preferable to a lump sum. Such a comparison is far from straightforward and has been likened to comparing apples with pears. Solicitors arguably now have a duty to direct their clients to obtain relevant advice so that they can make an informed decision.

Some solicitors consider that the

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question of which is preferable, a lump sum or a periodic payment, is purely academic, believing that a lump sum will always be better. However, consider an award for damages which settles in the sum of £3 million, but is adjourned by the Court to allow the parties to consider periodic payments.

In the unlikely event that the defendant were to offer, instead of a £3 million lump sum, a periodic payment of £500,000 a year, the claimant would be likely to accept with alacrity, assuming he or she believed that they were going to live longer than six years. Conversely, if the defendant were to offer a periodic payment of £10,000 per annum, the claimant would give such an offer short shrift. These two extremes serve to demonstrate that there will be a point at which the choice between a lump sum and a periodic payment becomes finely balanced.

A forensic accountant will be able to assist the claimant to identify their true capital requirements and their true income needs. These may both differ considerably from the amounts that they are eligible to claim. Having established the capital and income needs of the claimant, it becomes possible to address the question of how these needs can best be met and, specifically, to what extent they can be met by means of periodic payments.

The forensic accountant can then assist in the exercise of matching the form of award to the claimant's needs. There are advantages and disadvantages of periodic payments and these need to be considered in the specific circumstances of a particular case. A more detailed briefing paper in relation to periodic payments is available from the NIFA website, www.nifa.co.uk. ■