

THE ISSUES OF WORKING ON CROSS-BORDER TRANSACTIONS AND DISPUTES

Cross-border disputes can present a number of technical and practical challenges for appointed financial or accounting experts engaged to investigate issues, value assets or estimate losses for their clients. This article sets out some of those challenges.

Cross-border disputes can arise in many situations where parties, assets or operations are based in different jurisdictions or transactions or investments occur across national lines. Increasingly, this activity involves high-growth economies in emerging and frontier markets such as China, India, Brazil, former Soviet Union and Eastern bloc countries, and African nations. With emerging and frontier markets often comes a less developed or transparent economic, political and legal system compared with the developed markets of the investor or trading partner.

An obvious challenge for financial experts can involve foreign currency considerations. Economic and political uncertainties have continued to cause volatility in global currency markets and, as a result, exchange rates can have a significant impact on valuation and damages assessments.

It may be argued that currency volatility has in itself contributed to an alleged loss. An expert may need to use an entity's books and records, as well as source empirical evidence, to assess the strengths of statements made regarding the relationship of foreign currency to the entity's financial performance and financial position.

Another significant consideration relates to when local currency cash flows included within a quantum loss assessment are translated into the currency in which damages will ultimately be paid. The estimated date that a cash flow would have occurred determines the relevant date for which the prevailing exchange rate should be used in translation. Any resulting currency gains or losses can significantly affect the quantum of the claim.

When an assessment spans a number of years, the cash flows need to be 'discounted' to the valuation date to reflect the time value of money (a dollar today is worth more than a dollar in 10 years). Generally, the later the estimated cash flow arises within a loss period, the lower the discounted value of the cash flow at a given valuation date. Therefore, the timing of foreign currency fluctuations and related gains and losses will affect the overall quantum.

Both foreign exchange gains and losses should be considered equally, so that the award puts an entity in the same financial position it would have been in but for an event—i.e. no better or worse off.

The discounting of future cash flows to a valuation date is fundamental and crucial to loss analysis. Not only does this account for the time value of money, but also the risks or uncertainty of achieving those cash flows. Discount rate assessment can be complex; but, at a high level, it is based on the expected returns of the market, those of a theoretical risk-free asset (generally government bond rates), as well as the volatility, or systematic risk, of the asset or business in question compared with the market as a whole. The higher the risk of future cash flows occurring, the higher the discount rate applied.

The discount rate has a significant impact on the calculation of quantum, particularly where the losses run over a long period or indefinitely. Cross-border disputes raise a number of unique considerations in determining the discount rate. Take as an example a US company whose main operations

are located in Venezuela and whose transactions are denominated in USD. Aspects of the discount rate to consider include:

- Whether the selection of an appropriate risk-free rate should be the basis of government bonds issued in the US or Venezuela—there is likely to be a significant difference between the two.
- The tax rate, theoretically, should be the marginal tax rate prevailing in the jurisdiction in which relevant profits are taxed, which may be the US or Venezuela.
- Whether the assessment should be affected by location—in this case, the risk of doing business in Venezuela. This conceptual question has roots in a fundamental aspect of finance theory—i.e. that the value of an asset should not be affected by diversifiable risk. In practice, adjustments to valuations to reflect country risk are routinely made; the task then becomes how this country risk is measured and applied and the extent to which country risk is reflected in the assessment.

Financial assessments also need to consider the basis on which financial information, particularly financial statements, have been prepared. Companies may adopt different accounting standards, which can produce divergent results and likely affect the conclusions of an analysis. Therefore, it is important for the financial expert to understand the basis of preparation and whether any adjustments ought to be made to reported figures.

International parties or operations also bring into play different tax regimes. Taxation issues in a valuation or damages assessment can have a significant impact on a claim and subsequent award. The treatment of tax in the calculation of damages that forms the basis of an award may be different from the tax treatment of the award in the hands of the recipient. The overarching principle of damages is to restore the claimant to the same position that it would have been in but for the complained-of event, including the impact of the tax treatment of the award. If the taxation of the award is not considered, the claimant may not be "made whole".

In accounting for tax on the award, there are inherent uncertainties. For example, the timing of any award may not be known if a hearing date has not been set and therefore the tax position of the entity at that time can be unclear. The claimant may have complex tax structures spanning multiple jurisdictions designed to minimise tax liabilities. Some jurisdictions have more complex tax systems than others—there may even be no taxation, such as the British Virgin Islands or the United Arab Emirates. The issue of tax can be an additional complex element in an already complex dispute.

Aside from technical issues, cross-border disputes also present a number of challenging practical hurdles that may affect both the timeframes and costs involved.

First, consider access to information and relevant individuals. A fundamental step in undertaking a financial analysis is to gather and analyse financial information, and, where necessary, make enquires of relevant personnel. There may be limitations in the information available depending on the subject's document-retention policy or the overseas country's legal requirement for data retention. There may even be laws that prohibit data from being taken outside of the jurisdiction.



A clear challenge is coordinating across time zones. It may be more effective to deploy a team to the location of the business, either by flying in the project team or, where available, using personnel from local associated firms.

Site visits can be pivotal to an understanding the financial issues by directly observing the operations and conducting face-to-face interviews with key personnel. Given that the subject business or asset is likely to be located in a foreign jurisdiction, proper planning for the visit is paramount to ensure that time is used effectively and efficiently, particularly having regard to the time and costs incurred in travel. The fruitfulness of a site visit also depends on the level of cooperation extended by those in the country, as well as those being interviewed. Investing time to brief the expert on cultural differences is important to minimising issues along the way.

The information (written or spoken) may be presented in a language other than English. This requires translation, either by instructing counsel, the client, or by a member of the expert's team. It may be a substantial exercise depending on the volume and complexity of the information. Additionally, a translator is required during discussions between the expert and key individuals where a common language is not shared. Care must be taken to ensure that there are no errors or discrepancies between the native and translated text, particularly where it may affect the expert's analysis and conclusion. Similarly, nuances and slight differences in phrasing between languages should be appreciated to ensure that there is no misunderstanding between what is said and what is translated, particularly with financial "jargon".

Cultural differences, particularly in the conduct of professional relationships, should be acknowledged to ensure that a constructive working relationship is established and maintained with the client throughout the process. Observing the details of business etiquette goes a long way to fostering a positive working relationship.

Lastly, a vital consideration for your experts engaged in cross-border matters relates to risk management and their code of ethics, just as it does to legal advisors. This requires specific attention where a matter involves jurisdictions that are exposed to a high risk of bribery and corruption or money laundering. Emerging and frontier markets are often considered high risk and service providers, including your experts, will be cognisant of the potential reputational risks that may arise. Take, for example, the scrutiny of London-based law firms working with Russian oligarchs.

Your experts will be fully aware of their obligation to report any illegal behaviour that has become known to them through the services they render. From 1 January 2018, a framework for responding to non-compliance with laws and regulations (NOCLAR) was put in place in

Australia to provide all professional accountants with a process to follow when they become aware of non-compliance or suspected non-compliance with laws and regulations. A key aspect of NOCLAR is that accountants may set aside the duty of confidentiality where disclosure to an appropriate authority is appropriate. ¹



Janine Thompson

A Partner of McGrathNicol Advisory, specialising in dispute advisory and forensic investigations, Janine Thompson is a Chartered Accountant with more than 17 years of dedicated forensic experience. Janine has led and worked on a broad range of dispute advisory engagements and forensic investigations across a number of industries within Australia.



Cathy Zhao

As a Senior Manager of McGrathNicol Advisory and a Chartered Accountant with more than seven years of forensic experience, Cathy focusses on dispute advisory services involving business valuations, economic loss assessments, financial analysis and investigations.