

VALUATION OBSERVATIONS

*Some practical observations from a practicing
business appraiser.*

VLC

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LOOKING FOR SOMETHING?

In a divorce setting, we are so often looking for what I commonly refer to as missing pieces of the puzzle. Financial sophistication has increased substantially over the years. Assets are moving. And with the assets, go the income. So I asked a friend who is a forensic expert to give you an overview of what forensics is all about and how it works. J. Bradley Sargent, CPA, CFE, CFS, Cr.FA is a Director - Forensic Services at Stout Risius Ross, Inc.

Forensics and Family Law: Getting to the Facts of the Matter

Business disputes are often referred to as “commercial divorces.” When trust is perceived to be broken, participants in a relationship want to know the truth. Business partners seeking to dissolve a relationship will often hire forensic experts to help ascertain the facts of a dispute. Family Law practitioners are increasingly calling on forensic experts to ply their skills in the same capacity. Investigative professionals can provide value in a variety of areas: 1) capturing, preserving and researching electronic evidence, 2) identifying assets, 3) identifying sources of income and 4) uncovering “the unknown” facts that are hidden from view. All of these areas share one common thread: the sooner the better. Forensics professionals provide the greatest “bang for the buck” when they are called into a matter at the onset. As disputes escalate, the facts can be buried deeper and deeper and evidence can be altered or destroyed completely, rendering an incomplete fact pattern.

Electronic Evidence

What sort of evidence is contained in a computer? Basically two types: the actual files themselves (and their contents) and the artifacts left behind while using the computer, know as metadata. Common file evidence includes websites visited, images, files downloaded or transferred and emails sent/received, including “offline” accounts, such as yahoo and hotmail. Metadata identifies information commonly known as the file properties, such as: who created the file, when it was created, who accessed the file and when, how often and when a computer has been booted up, etc. Computer forensics allows the investigative accountant the opportunity to capture data in a complete snapshot at a point in time. If the data has been altered, the metadata contained in a drive can reflect when, where, how and by whom. In addition to computer electronic evidence, telephonic evidence can be captured, archived and searched.

Forensics experts utilize various software packages to capture electronic evidence. The goal in the acquisition phase is to create a mirror image, or clone, of the disk drive, which can then be physically transported to another location. This image is cloned once again, creating a copy that can be searched and manipulated. Searches are often based on key words, cultivating all of the captured data for relevant information.

Identifying Assets

All too often in a dispute, one party is planning the dissolution while the other party is completely unaware. Part of the planning process can be the intentional “hiding” of assets by creating new financial accounts and shifting holdings from an identified account to an unidentified account. Parties will frequently engage related parties to hold assets, effectively hiding them from partners. Forensic accountants specialize in tracing assets, sifting through the known information to surface unknown accounts and activities. By simply quantifying account activity, forensic accountants can establish that assets are “missing.” Financial account records will often point directly to the recipient of funds.

Once a hidden asset is uncovered, the hidden income the asset may generate creates additional opportunities for the forensic professional.

Identifying Income

In Family Law matters, parties can often be motivated to minimize income. In much the same manner as assets are hidden, income can be shifted to various unknown locations. Forensic accountants will trace the sources and uses of income, creating a picture of inflows and outflows. Identified income outflows that materially exceed identified inflows can be a leading indicator, or “red flag,” of possible under-reporting of income. It is always important to note that the IRS and local governments are interested to hear of under-reporting events.

Uncovering Unknown Facts

Forensic experts are trained in investigative skills. One of these skills, often overlooked, is the ability to effectively interview witnesses to gather information. The anecdotal evidence that surfaces in the course of an information gathering interview can lead to identifying new financial accounts, additional witnesses, property holdings, income sources and uses and information that was previously deemed irrelevant.

Forensic professionals are also expert in querying the witnesses that contain the hard facts; computers, telephones and public records. By combining anecdotal evidence with hard evidence, forensic professionals can establish a clear fact pattern that can aid in dispute resolution. As previously mentioned, investigative accounting is always most effective when initiated early on in a dispute. The opportunity to gain access to computers, books and records and other key witnesses before they can be compromised is critical.

A review of the relevant books and records, combined with a series of witness interviews, can focus the investigation directly to the key points, making the forensic work targeted, versus the “wide-net” approach that results in greater costs.

If you would like additional information, or have a question, please do not hesitate to call.

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Terri Lastovka is the founder of Valuation & Litigation Consulting, LLC. Her practice focuses on business valuations and litigation consulting in the areas of domestic relations, gift and estate tax, probate, shareholder disputes, economic damages, and forensic accounting. She draws from a wide range of experiences, including public accounting, law, banking, and CFO. She has received extensive training from the American Society of Appraisers in the area of business valuation and works closely with members of the bar to effectuate practical settlements. Terri also serves as the Director of Legal & Finance for Journey of Hope, a grass roots non-profit organization providing financial support to cancer survivors.