



Uncovering The Truth

Understanding the role of forensic accounting in divorce

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Marital dissolution can present a complex maze of financial issues. Each party is required to disclose their income and assets; however, such reporting is not always clear cut. There can be a clear economic benefit for the “earning” spouse to minimize his or her reported income and assets. A forensic accountant with a specific background in marital dissolutions can assist in sorting through complex family finances.

The following is an overview of five common areas in which a forensic analysis may be necessary in a divorce proceeding.

Valuation Of Closely Held Business

A key component in the valuation of a closely held business is the determination of the company’s true earnings. Unfortunately, the earnings as reported on the company’s tax returns and financial statements do not always reflect the true operating performance of the business. Many business owners operate their companies based on their own personal needs and not necessarily the needs of hypothetical investors or employees.

As a result, a significant amount of discretionary expenses may make their way into the company checkbook. These discretionary expenses can be as simple as personal travel, meals, and gasoline or as extreme as exotic race cars, wine collections, and artwork. Identification of the personal and discretionary expenses in a closely held business is critical in determining the

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company’s true value, as this value may be included in the couple’s marital estate. Just as important, these expenses are also considered in determining a business owner’s income available for support.

Post-Judgment Modification

In recent months, we have seen a meaningful increase in the number of modification engagements in the post-judgment setting. The recent economic crisis has much to blame for this trend. When presented with a motion for modification, the court will first make a determination as to whether there has been a substantial change in the financial circumstances of one or both of the parties. In making this determination, the court is limited to considering only conditions arising subsequent to the date of divorce.

Imagine that, for example, in post-judgment, the “earning” spouse decides to claim that his or her income has materially diminished. The “non-earning” spouse could test the validity of this claim through a qualified forensic analysis. Such analyses may reveal that income is being deferred or the cash flow stream is manipulated to the benefit of the “earning” spouse. As a result, the “non-earning” spouse may be able to avoid modification to the original court-ordered alimony and child support awards.

Spending And Lifestyle Analysis

The standard of living enjoyed during a marriage is an important determinant in alimony and child support. However, making that determination can often be quite difficult. In many marital dissolution cases, there are allegations of unreported income, overstated expenses, or unreported assets. A spending and lifestyle analysis can help identify a couple’s true income and earnings,

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determine a couple's ordinary and necessary living expenses, and provide a detailed snapshot of a couple's marital estate.

A typical spending and lifestyle analysis includes examination of personal and business income tax returns, bank statements, canceled checks, brokerage accounts, credit card statements, and ATM activity. Such an expense analysis may uncover previously unknown spending habits, including drugs, gambling, or extramarital affairs. The analysis may reveal the existence of unreported assets through the acquisition of expensive art, jewelry, or other fine collectibles. Evidence of underreported income may also be uncovered by such an analysis, as it can illustrate that the lifestyle costs of the couple exceed their reported earnings.

A thorough and well-prepared spending and lifestyle analysis provides the court with an accurate picture of a couple's prior and current financial situation, and is an invaluable tool for determining alimony and support.

Search For Hidden Assets

In a divorce, assets are divided equitably. However, the court's opinion of an equitable division may not be viewed as equitable by one or both of the parties in the divorce. As such, it is no surprise that assets are often hidden in marital dissolutions. A conspicuous lifestyle and abundance of material goods may indicate hidden as-

sets or income. The techniques used in the spending and lifestyle analysis may also reveal whether an individual is hiding certain marital assets. Here are some of the ways that one spouse can try to conceal assets in an attempt to cheat the other spouse out of an equitable settlement.

1. Keeping cash or traveler's checks in safe deposit boxes.
2. Furnishing a business with expensive antiques and paintings.
3. Setting up a custodial account in the name of a child, using the child's Social Security number.
4. Conspiring with an employer to delay bonuses, stock options, or raises until the divorce becomes final.
5. Repaying a phony debt to a friend or family member.
6. Investing in tax-free securities which may not appear on a couple's individual income tax return.
7. Transferring assets to friends or family.

To ensure an equitable distribution in a marital dissolution, it is critical to have a complete inventory of marital assets. If there is an indication that one party may be concealing assets, a forensic accountant will follow the paper trail to find the assets.

Electronic Discovery

Electronic discovery can play a critical

role in today's marital dissolutions. With the increased use of computers, evidence relating to business and personal relationships can make a dramatic difference in a divorce. Examples of such evidence can come in the form of hidden or deleted bank records, spreadsheets, personal letters, emails, and all internet activity.

Such electronic evidence can often be discovered in various locations on a computer. Files can remain on a computer's hard drive even after they have been deleted. Similarly, when a file is saved, the previous version of the file is not permanently overwritten. A new version of the file is created, while the old version could remain on the hard drive for an indefinite amount of time. Gathering electronic evidence can be an extremely effective method of discovering a spouse's financial deceit or non-disclosure.

Conclusion

Forensic analysis can play a critical role in a marital dissolution. High stakes battles over marriage settlements make each attorney's strategy the key to an optimum outcome. By determining the true value of a business, discovering income manipulation, or uncovering unreported income and assets, a careful forensic analysis can result in a more equitable distribution of marital assets in a divorce. ■