



FORENSIC ACCOUNTING - THE ANSWER TO A FAIR AND EQUITABLE DISTRIBUTION OF MARITAL ASSETS



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In a matrimonial proceeding, a forensic accountant can be an invaluable member of your team. He/she will help you negotiate or litigate a fair and equitable settlement for your client by analyzing the couple's finances to uncover hidden assets. The forensic accountant will examine source documents and analyze the lifestyle of the parties to determine if it is consistent with the income being reported.

The starting point for most forensic analyses is the business and personal income tax returns of the spouses. A forensic accountant will assist the attorney in analyzing all aspects of the tax returns and performing investigative services to uncover any hidden income and/or expenses.

If either party is an owner of a closely held business, a comparison of the company's gross profit margin to the industry standards can often highlight this issue. For example, if the business buys materials for the 100 widgets it sells, but only reports the income from the sale of 80 of them, the gross profit percentages will vary from the industry norms. Unfortunately, people who tend to hide income are aware of this and may be clever enough to pay cash for the materials, thereby keeping the gross profit percentage in line. Therefore, this is not always a useful tool for analyzing service businesses.

A thorough examination of the sales and purchase invoices may reveal cash items. By tracing these items to the reported business income and expenses, the forensic accountant can determine if they were properly reported.

Personal observation may also be beneficial, especially in retail and businesses catering directly to the public. Watching how many people enter a pizzeria can give the accountant a basis for calculating the level of sales. This can then be compared to the actual sales reported. I remember valuing a rental car business and while the owner assumed I was buried in the books and records, I took time to see how the income from customers was recorded. He didn't realize I saw him open a small metal box into which he placed any cash sales that occurred. When I reviewed a year's worth of bank deposit slips for the company and found not one deposit that included cash, I knew there was an issue.

Another way to look for unreported income is to compare the income being reported by the business owners to the lifestyle the owners are living. If the reported income is \$50,000 and the owner is living in a million dollar house, the forensic accountant would then trace how the couple is paying for the house.

The use of the Case Information Statement ("CIS") could be critical for this type of analysis. A carefully completed CIS will show the spending pattern of the family. If the spending exceeds the income, and there is not an increase in debt and borrowing by the owner, a red flag should be raised. Sometimes the CIS is not complete or is only estimated. A forensic accountant can analyze the personal records of the owner to recreate the spending history. The personal records would include bank accounts, brokerage accounts, and interests in other entities, inheritances, loan documents and credit card statements. This type of analysis is commonly called a Lifestyle Analysis.

The Lifestyle Analysis can be of prime importance if you have a post judgment case in which one party is alleging a change of circumstances. Careful and thorough work must be done to determine the validity of such a claim and the forensic accountant can provide this with a Lifestyle Analysis.

On the expense side of the coin, a forensic accountant will perform statistical analyses to highlight potential problem areas and will then delve into the records of the business to determine if there are expenses being paid through the business which are not valid business expenses. The accountant will begin with the reported expenses and then trace them to source documents, such as paid invoices, purchase orders and cancelled checks. For example, I once was reviewing the records of a dental practice and the dentist had regular payments to a dental lab in the western part of the country. While this did not particularly arouse my suspicion, I did decide to do a spot check of the payments just to make sure no stone was unturned. I asked the dentist for a copy of the paid invoices for this dental lab. After weeks of stalling, he finally admitted that he had no invoices. The owner of the lab was a friend of his and the two would write checks to each other's business, cash the checks and return the money to the other. The business would show a payment to the dental lab, but in fact, the dentist got the money back.

The schemes that people devise are endless. Detailed analysis is the key to getting the complete picture. The accountant can take on the role of detective, code breaker and even confidant of an owner's partner or employee. Discussions with the business owner and key personnel can yield valuable information. I have learned to let those people do most of the talking, as inevitably they tell me something useful or something that will necessitate further examination.

A visit to the business location should also be done. This enables the accountant to verify the types of operations, the number of employees, the physical needs and uses of the business and other important issues. One visit to a professional office showed that another professional was using one of the offices. Upon further questioning, it was revealed that the rent this tenant paid went directly to the business owner and was never reported.

Each and every category of income and expense claimed by the business owner has the potential to create otherwise unknown cash flow. The forensic accountant must use skilled training, an analytical mind, and creative thought processes to make sure the cash flow is properly determined.

When handling a divorce case, the attorney must be thorough. When a business is involved, the use of a forensic accountant to determine the proper level of cash flow in order to make decisions on the level of support can make or break your case. If there is no business, the forensic accountant can use these same techniques on the personal assets of the spouses to make sure that all accounts are known, the values are proper and no funds have been diverted. To be able to present clear, concise information to your adversary or the court will enhance your ability to get the best possible, and in reality a truly equitable, result for your client. The forensic accountant will help you do this. For more information on the Forensic Accounting Services offered by Cowan, Guteski & Co., P.A contact Lynne Broza, CPA, ABV, CFF, Director at 732-676-4100.

About the Author

Lynne Broza, CPA, ABV, CFF, Director is an expert in the financial aspects of matrimonial litigation and the valuation of closely-held businesses. With 30 years of experience in public accounting, Ms. Broza has been retained as an expert witness in litigation matters including divorce proceedings, personal injury claims, shareholder disputes and estate valuations. She has testified in cases in both New Jersey and New York.

