Numbers in Family Law Cases

Accounting is a topic that can frighten otherwise brave professionals. All the asset, liability, income, and expense talk can be overwhelming if the listener is not trained in the field of accounting. The best forensic accountants are able to present financial issues in litigation so that they can be understood readily. Attorneys, judges, and juries often lack an accounting or finance background, so being able to break down financial topics in a way that is easy to understand is essential for forensic accountants.

Family law cases involving complex financial matters often require the assistance of a financial expert for the following issues:

- Preparing a financial disclosure, including creating a marital balance sheet
- Comparing balance sheets from period to period to evaluate changes in assets and liabilities
- Analyzing financial disclosures or affidavits prepared by the spouses
- Calculating the historical income of the spouses
- Determining income (or the ability to pay) in order to calculate support
- Determining the standard of living (or the need for support)
- Valuing business entities or other assets (such as real estate, pensions, and the like)
- Identifying assets and determining whether they are nonmarital (separate) or subject to division (marital or community)
• Tracing and finding funds or other assets
• Analyzing claims of dissipation, wasteful spending, or fraudulent conveyance
• Evaluating the income tax impact of various scenarios
• Assessing the work of an opposing financial expert
• Providing other litigation assistance, such as assisting with drafting discovery demands and interrogatories or preparing for the depositions of individuals with financial information

There are a number of different types of financial professionals who might get involved in such cases, including

• Certified Public Accountants (CPA)
• Forensic accountants (who may or may not be CPAs)
• Accountants or bookkeepers
• Investment analysts or advisors
• Financial planners
• Business valuators
• Appraisers
• Actuaries

This book focuses on the work of forensic accountants because that is my field of specialty. The other professionals listed here are perfectly capable of doing work in their areas of expertise. Nevertheless, the focus here will remain on the forensic accountant who works exclusively in the areas of litigation and fraud. They may be referred to here as forensic accountants, financial experts, or financial analysts.

In addition to the financial issues listed earlier, an accounting expert could also play the following roles in family law cases:

• Assisting with settlement activities, evaluating the financial impact of a settlement offer, making certain calculations, and giving opinions on various settlement scenarios
• Mediating a divorce case with financial issues to help the parties reach a settlement
• Acting as a neutral expert in the divorce, providing an objective opinion on financial matters (The parties may agree together on the financial neutral, or the court may appoint the accountant.)
• Participating in post-court activity and aiding in the evaluation of financial disputes, including things like allegations of fraud during the divorce process or motions for modification of support

Although a financial expert can be involved in family law cases in many different ways, this book focuses on determining income, determining the standard of living, identifying assets, and tracing and finding funds or other assets.

Choosing a Financial Professional

One of the most important considerations in choosing a financial professional to assist with a family law case is his or her qualifications. Although family law cases fall under state laws, the Federal Rules of Evidence are instructive in evaluating the qualifications. Some states have adopted the Federal Rules of Evidence as they relate to expert witnesses or variations that are strikingly similar to the federal rules.

Rule 702, Testimony by Expert Witnesses of the Federal Rules of Evidence, reads:

A witness who is qualified as an expert by knowledge, skill, experience, training, or education may testify in the form of an opinion or otherwise if:

(a) the expert’s scientific, technical, or other specialized knowledge will help the trier of fact to understand the evidence or to determine a fact in issue;
(b) the testimony is based on sufficient facts or data;
(c) the testimony is the product of reliable principles and methods; and
(d) the expert has reliably applied the principles and methods to the facts of the case.
The judge in the divorce case will decide if the financial expert meets these qualifications and is therefore permitted to testify as an expert witness.

A U.S. Supreme Court decision in *Daubert v. Merrell Dow Pharmaceuticals, Inc.*, 509 U.S. 579 (1993), is also instructive when evaluating a financial professional’s qualifications. In *Daubert*, the Supreme Court designated the trial judge as the gatekeeper for deciding whether an expert has used reliable methodology. The judge applies the following factors in deciding the admissibility of the expert’s testimony:

(a) Whether the theory or technique has been tested or can be tested,
(b) Whether the theory has been subjected to peer review and publication,
(c) Whether there is a known or potential error rate of the theory or technique,
(d) Whether the theory has general acceptance by the relevant scientific community.

Regardless of whether the court evaluates an expert witness under federal or state rules of evidence, the expert’s education, training, and certifications will be examined during the qualifications phase. This may include evaluation of the expert’s curriculum vitae (CV) outlining his or her education, credentials, work history, and relevant experience. Testimony may be taken from the expert to determine whether the witness has sufficient knowledge and experience in the area in which he or she is providing opinions.

In order for the expert to provide value to the case at trial time, he or she must be deemed an expert by the court. Thus, the qualifications phase is extremely important. The expert must be adept at demonstrating his or her training, skills, and experience and how they are relevant to the case at hand.

One important area often evaluated by the court is the credentials of the financial expert. A forensic accountant can possess a variety of certifications. It is important to evaluate these certificates and credentials to determine the substance behind them. The most widely respected credentials in the field of forensic accounting include the following:
• Certified Public Accountant (CPA)—Most forensic accountants serving as expert witnesses have a CPA license. The CPA license is granted by each state after successfully completing a very difficult examination and practice requirements. In addition, most states require ongoing continuing education in order to maintain the license. The CPA license is a broad credential signifying expertise in accounting in general. It is not necessary for a forensic accountant to have a CPA license in a state in which he or she is testifying. Typically, a CPA license from any state will demonstrate that the expert has a certain level of skill in accounting matters.

• Certified in Financial Forensics (CFF)—This credential is offered by the American Institute of Certified Public Accountants (AICPA), the national organization open to CPAs. The credential is earned by passing an exam and meeting certain experience requirements. Annual continuing education is required to maintain the credential. The CFF designation indicates knowledge and experience related to fraud, forensic accounting, and litigation.

• Certified Fraud Examiner (CFE)—The CFE credential is awarded by the Association of Certified Fraud Examiners (ACFE), the largest anti-fraud organization in the world. It is earned by completing an exam and meeting experience requirements, and requires annual continuing education credits. The CFE designation speaks to knowledge and experience in the areas of fraud and litigation.

• Certified Valuation Analyst (CVA)—The National Association of Certified Valuators and Analysts (NACVA) offers this designation to professionals who pass an examination and meet certain experience requirements. Continuing education is required each year to maintain the certification. The CVA credential indicates knowledge and experience in completing business valuations.

• Certified Financial Planner (CFP)—The CFP designation is issued by the Certified Financial Planner Board of Standards (CFP Board) to professionals who pass an examination and complete experience requirements. Annual continuing education is required to maintain the certification. The CFP credential signifies expertise in the area of financial planning, and CFPs may be qualified to render opinions related to pensions and investments.
• Chartered Financial Analyst (CFA)—A professional can obtain the CFA credential from the CFA Institute by completing an examination and experience requirements. Annual continuing education is required to maintain the credential. The CFA designation indicates knowledge in investment analysis.

Individuals working in the areas of fraud, litigation, and business valuations may possess many other credentials; however, the substance behind these credentials should be carefully evaluated. Some certifications have few requirements, as holders of one or more of the certifications listed here may automatically qualify. Many of the credentials offered today afford inadequate quality control, so those certifications mean little as it relates to the expertise of a financial professional.

Professional Standards

Each credentialing body has its own set of professional standards to which members must adhere. The AICPA’s standards are the most common standards applicable to forensic accountants. Under Rule 201, General Standards, the professional should only accept engagements he or she can complete with competence. This means that the forensic accountant should know what specific skills or knowledge are necessary for an engagement and should accept that engagement only if he or she (or the firm) possesses the requisite skills and knowledge.

Additional guidance on the performance of family law engagements may be found in the following AICPA publications:

• Consulting Services Special Report 03-1—Litigation Services and Applicable Professional Standards
• FVS Practice Aid 10-1—Serving as an Expert Witness or Consultant
• FVS Practice Aid 07-1—Forensic Accounting: Fraud Investigations
• FVS Practice Aid 05-01—A CPA’s Guide to Family Law Services
• FVS Practice Aid 04-01—Engagement Letters for Litigation Services
• FVS Practice Aid 96-3—Communicating in Litigation Services: Reports
Conflicts of Interest

The family law attorney should consider whether a forensic accountant has any actual or perceived conflicts of interest in the engagement. This is important because the professional may not be considered credible if there is an apparent bias or conflict of interest. One example of a potential conflict of interest is previously providing professional services for either spouse or a business owned by or involving either spouse.

A previous engagement with the attorney will not constitute a per se conflict of interest. However, an expert witness may appear to be biased if he or she has performed numerous engagements for the retaining attorney. A lengthy financial relationship between the forensic accountant and the attorney does not necessarily mean that the expert lacks objectivity, but the issue may arise in court and may affect the perception of credibility.

Consulting Versus Testifying

A financial professional can fill two distinct roles in family law cases. He or she can be a consultant who provides analysis and opinions privately to the attorney and client. In this case, the consulting expert’s work and conclusions are not intended to be presented in court but are intended to be advisory. The other role is that of a testifying expert, alternately called an expert witness. The testifying expert must be disclosed in the event that the case goes to trial.

The services of a consulting expert may include any of the following:

- Explaining financial topics to the attorney and client
- Providing opinions and advice on financial matters, including the value of assets and liabilities, the taxability of settlement scenarios, and the strengths and weaknesses of the financial portion of the case
• Helping to develop a litigation strategy
• Devising a strategy for presenting financial issues to the court
• Evaluating a testifying expert’s work as a “second set of eyes,” which may help identify weaknesses or opportunities in the testifying expert’s work
• Scrutinizing the work of a financial neutral appointed in the divorce

The work of the consulting expert, including his or her notes, communications, calculations, e-mails, letters, and other documentation, is typically protected as attorney work product. Accordingly, the knowledge, opinions, and files of the accountant are not discoverable by the opposing party.

However, it is important to recognize that the consulting expert could later become a testifying expert. In that case, the materials developed during the consultation process will likely become discoverable. Thus, the consultant should carefully maintain his or her files in the event that the work product is someday discoverable, even if this possibility is remote.

A forensic accountant retained as a testifying expert may do many of the same things as the consulting expert. Opinions on the value of assets or liabilities, analysis of the tax impact of various settlement scenarios, calculation of the “lifestyle” of the divorcing parties, or evaluation of the financial issues in the case may be done. In addition, the expert witness may be required to testify in depositions or at trials, explaining his or her work, file materials, opinions, and conclusions. Remember that the file of the testifying expert will be discoverable.

As discussed previously, the objectivity of the testifying expert will be carefully scrutinized. The expert witness is expected to evaluate evidence and come to independent conclusions that are not biased. The witness must be careful to avoid the appearance of being a “hired gun” in the case.

Reasons for Hiring an Expert

Some family law attorneys are reluctant to retain forensic accountants. Money may be a factor, but sometimes the need for an outside expert is not clear. Even though law firms may have paralegals or attorneys on staff
who are very knowledgeable about financial issues, the outside forensic accountant offers the following advantages:

- Experience in financial investigations means the work can be completed quicker and more efficiently. The results are often presented better since experts present their results in court and are used to making things understandable for non-accountants.
- An outside expert can testify, whereas law firm personnel cannot. Even though the family lawyer might not intend for the case to go to trial, it is always a possibility; therefore, it pays to have a financial professional who could testify if necessary.
- An outside expert is generally perceived as more objective. Ethical forensic accountants attempt to be independent and objective in their opinions, which bolsters the credibility of the calculations.
- Forensic accountants have experience finding red flags and issues. Their analysis is often more thorough, and their ability to spot problems is often more developed. This can be invaluable for finding issues that were previously unknown.

Accountants and Attorneys Working Together

The expert’s assistance with the discovery process can be invaluable to the family law attorney. By virtue of the expert’s familiarity with personal and business financial documents, the financial expert can play an important role in the discovery process. He or she can help with the following:

- Determining which documents should be requested or subpoenaed
- Identifying the individuals or companies most likely to possess those documents
- Drafting discovery requests, using the common names of the financial documents in conjunction with descriptions that may be important in the event that the person or company uses a different name for the documents or reports
• Evaluating documents produced in discovery to determine if they are responsive to the requests or subpoenas
• Drafting follow-up requests to either reiterate or reword the original requests or to create additional requests or demands
• Explaining the documents and data to the attorneys
• Assisting with the preparation for depositions of individuals who have financial information relevant to the family law case
• Attending depositions of parties with financial information in order to provide the attorney with suggested lines of questioning

The forensic accountant may also assist the family lawyer with the development of strategy for the financial portion of the case. The expert’s financial and business experience may aid the attorney in understanding and litigating the issues related to the finances of the family. It is important that the financial expert not be afraid to point out weaknesses and errors in the financial case, perhaps guiding the attorney to a better understanding of the financial issues and an alternative, more viable approach.

The Lifestyle Analysis

This book focuses solely on the lifestyle analysis in the family law case, although other services from a financial professional may also be needed in a case. The lifestyle analysis is the process of tabulating and analyzing the income and expenses of the parties. The lifestyle analysis is then used to determine the standard of living of the parties, which will influence support calculations, and possibly property division.

Calculating the lifestyle of the spouses prior to separation can provide insight into the lifestyle the married couple enjoyed and the cost of that lifestyle, as well as the income that was or is required to fund the lifestyle of the married couple. The results may be used to prove a spouse’s financial needs following divorce. In other words, a detailed analysis of the spending during the marriage can be the basis to calculate the funding the spouse needs to maintain a similar lifestyle after divorce.
The lifestyle analysis may also help confirm or refute income claims made by a spouse. If a spouse has declared income that is well below the cost of the lifestyle he or she is leading, the lifestyle analysis may suggest that undisclosed sources of income exist. It may also help identify previously undisclosed assets, which may have a substantial impact on the property division.

The lifestyle analysis is typically used to sort out the numbers post-separation, but it may also be used to evaluate the finances of each party at the time of a prenuptial agreement. If a party did not make a full and accurate disclosure prior to the signing of the premarital agreement, the spouse may attempt to have the agreement set aside. A prenuptial agreement can also be instrumental in the forensic accountant’s work post-separation, as it provides a point at which to start tracing funds or assets.

**Determining Support**

The lifestyle analysis can be a key component in the determination of support, including both alimony and child support.

The following four types of spousal support are typical in divorces:

- **Temporary support** is paid on a short-term basis. It may also be called rehabilitative support. This type of spousal support is awarded for a limited period of time, as the recipient is expected to be working toward becoming self-sufficient. It is typical to award temporary support when a spouse is returning to school, receiving job training, or working on career development. Usually temporary maintenance is modifiable if there is a change in circumstances.

- **Long-term spousal support** can also be called permanent support and is generally intended to be paid to the spouse for the remainder of his or her life. In addition to terminating upon death, permanent support may also be terminated if the spouse remarries or has a change in circumstances. A change in circumstances could also cause the amount of permanent maintenance to be modified. Common reasons to modify permanent support include significant health issues, changes in income, or changes in need.
Reimbursement support is meant to compensate the recipient for expenses paid during the marriage. For example, if one spouse used nonmarital funds to put the other spouse through medical school, the divorce may include reimbursement support for the cost of the education. Reimbursement support could also cover things like real estate taxes on separate property paid with marital funds.

Lump sum support is paid as a specific amount up front. This type of support generally arises out of a settlement agreement during a divorce.

Support can be calculated using a number of different factors, including:

- The actual earnings of each person, including wages, investment income, and other sources of income
- The earning capacity of each party, both independently and relatively
- Future earning capacity of the parties
- The value of the assets divided and the ability of those assets to produce income
- The cash flow of each party
- The length of the marriage or relationship
- The ages of the individuals
- The needs of the spouses or parties and the needs of the children
- The ability of the parties to pay support
- The standard of living (or lifestyle) established during the marriage
- Impairment of earning capacity due to devoting time to domestic duties, delaying education or employment, and the like
- Contributions to the other party’s education, training, or career
- Income taxes that will be incurred by each party
- Short-term and long-term expenses expected to be incurred

Most of these factors have a great deal of “gray area.” Reasonable people can disagree on how to calculate them or how significant a role they should play in the calculation of support. Consider, for example, the following issues:

- Actual earnings—What should be included or excluded from this calculation? Are there certain types of earnings that are nonrecurring or
so uncertain as to make it unfair to include them in a calculation of ongoing earnings?
• Earning capacity—What is the spouse’s true earning capacity? What if the spouse cannot find employment within his or her area of expertise? What if the spouse no longer wishes to work in the area of expertise? What if the spouse needs or wants to work less than full-time? What if the spouse quits a job to start a business, and that business will not create income for a period of time?
• Value of assets divided—The parties may disagree on the value of assets being divided, as well as how much income will be derived from those assets in the future. They may also disagree on whether a spouse should sell an asset to generate funds.
• Cash flow—Cash received from work and business activities is not necessarily the same thing as income from those activities. How heavily should the cash flow be considered? Is it more or less indicative of the need for support or the ability to pay than some other factor?
• Needs of parties—What is truly “needed” by the parties following the divorce? Should the post-divorce lifestyle include all of the things that were enjoyed during the marriage? Were portions of the lifestyle “excessive”? If so, should they not be considered a true need?
• Ability to pay—Which items of income or cash flow should be included when calculating a spouse’s ability to pay? Should certain funds or earnings be excluded, as they are necessary to starting or growing a business venture? If so, should the future earnings from that business venture be included in support calculations at a later date? Should a spouse be allowed to save certain funds, rather than have them considered income on which support is calculated?
• Standard of living—Jurisdictions vary regarding how standard of living is defined. Chapter 2 will discuss this in detail.
• Impairment of earning capacity—How impaired is the earning capacity? How can we fairly estimate what the earning capacity could have been without the impairment or what it will be in the future?
• Contributions—How do we value and weight the contributions of one party to the other party’s career?
Short-term and long-term expenses—Which expenses should be considered, and how heavily should they be weighted? Should any expenses be excluded because they are discretionary?

Of course, states vary in the factors to be considered regarding support or maintenance. For example, the Illinois Marriage and Dissolution of Marriage Act, Section 504, states that temporary or permanent maintenance will be paid based on a consideration of the following relevant factors:

a. the income and property of each party, including marital property apportioned and non-marital property assigned to the party seeking maintenance;
b. the needs of each party;
c. the present and future earning capacity of each party;
d. any impairment of the present and future earning capacity of the party seeking maintenance due to that party devoting time to domestic duties or having forgone or delayed education, training, employment, or career opportunities due to the marriage;
e. the time necessary to enable the party seeking maintenance to acquire appropriate education, training, and employment, and whether that party is able to support himself or herself through appropriate employment or is the custodian of a child making it appropriate that the custodian not seek employment;
f. the standard of living established during the marriage;
g. the duration of the marriage;
h. the age and the physical and emotional condition of both parties;
i. the tax consequences of the property division upon the respective economic circumstances of the parties;
j. contributions and services by the party seeking maintenance to the education, training, career or career potential, or license of the other spouse;
k. any valid agreement of the parties; and
l. any other factor that the court expressly finds to be just and equitable.
You can see that the list provided earlier in the chapter is a bit more generic, whereas the list of factors from Illinois gets a bit more specific.

Post-divorce budgets play a huge role in determining support. One of the most basic uses of a lifestyle analysis is creating those budgets. By analyzing historical expenditures of the parties, a more precise budget for future expenses can be created. This is not simply a matter of tabulating historical spending. Certain adjustments may need to be made to past expenses to include or eliminate certain items.

For example, consider a case in which the parties were living rent-free in a residence owned by the wife’s parents during the marriage. Following the separation, one or both of the parties may need to pay for housing, and this must be added to the budget. Conversely, consider a case in which the parties had a large expense for an anniversary party for themselves. Since they will be divorced, this expense will not occur again in the future, so it should likely be removed from the budget.

Evaluating historical spending and creating budgets will be covered in detail in Chapter 8, where we will discuss more considerations in assessing these figures.

Separate Property

Jurisdictions vary in their definitions of separate property and how a party must go about proving or documenting the separateness of the property. Regardless of a jurisdiction’s rules, a lifestyle analysis can be used to trace assets, how those assets were acquired, the source of funds used to acquire the assets, and the use of the proceeds of sales of the assets. In Chapter 10, we will cover the issue of separate property in more detail.

Hidden Income

The lifestyle analysis can be used to uncover hidden sources of income. In Chapter 9, we will discuss how income is defined and a number of the common complications that can arise in calculating it. We will also discuss
common ways that sources of income are hidden and commonly used methods to uncover them.

When income is difficult or impossible to calculate because documents are not being produced or financial information is being obscured, a lifestyle analysis may be used to prove the level of income circumstantially. If the level of spending can be proven or reasonably estimated, an inference can be made that income sufficient to fund that spending exists.

**Hidden Assets**

The lifestyle analysis can also be used to uncover hidden assets. We will discuss this in detail in Chapter 10, including how to identify and classify assets, methods used to hide assets, and techniques used to uncover hidden assets.