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ARTICLES

The 3 W's of Engaging a Forensic Accountant: Why, When, and Who

BY DR. ROBERT J. RUFUS, CPA, CVA, CFF

It was 10 days and counting to April 15...and a much-needed break. I received an email at 3:20 p.m. on a Thursday (10 days before the tax filing deadline) from a local attorney (Jenny) marked URGENT, requesting a phone call ASAP. I made the call later that evening, explaining that I was in the final throes of tax season; I proposed a meeting for the last week in April. Jenny said the matter was urgent and requested a meeting the next day at 7:00 a.m. She agreed to forward a copy of the Petition for a conflicts check but preferred not to discuss the urgent nature or specifics of the case over the phone.

Jenny arrived at the meeting with her client (Ronda) and a small collection of records. After introductions, Jenny said that she had never engaged a "forensic accountant" *per se*, but routinely worked with CPAs. I gladly explained the nature of our work (as forensic accountants) and fee structure, including the need for a retainer. We then settled in to discuss the specifics of the case, described by Jenny as follows:

- This is a 7-year marriage; Ronda is a stay-at-home mother with two children (twin boys, age 5).
- The final hearing is scheduled for May 5 (less than 30 days).
- The Judge denied her last motion to continue (although two prior continuances had been granted).
- Primary marital assets include the marital residence, the husband's retirement, and his 50% interests in three family owned and operated franchised auto dealerships

(Honda, Volkswagen, and Ford), consolidated and reported as one company.

- During discovery, she had secured a copy of the company's restrictive stock agreement (which included a valuation formula in the

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event of divorce) and two years of corporate income tax returns (1120S).

- She had taken the husband's deposition. In general, he seemed unknowing and directed her to speak with the company's CFO and his personal CPA. Both had refused to talk to her without a waiver signed by the husband, which had not been provided.
- The husband had engaged a CPA to value his 50% interest in the company, who applied the formula mandated in the agreement. The CPA was also offering testimony that the husband's interest was nonmarital.
- She believed the restrictive agreement was controlling, although the valuation formula seemed self-serving. She had not analyzed or considered the company's tax returns.
- Although the values calculated by the CPA seemed low, she knew the CPA and considered her to be honest and objective. She had not taken the CPA's deposition.
- She believed the only real issues were child support and alimony.

Ronda stated that, although she knew little about the family assets and liabilities (husband paid the bills), she knew that two of the dealerships had been purchased within the last 5 years with a bank loan (which "they all had to sign"). Further, Ronda believed that he was hiding money and they (his family) were playing games with the company's books.

Jenny then proposed that I be engaged to assist in compiling a statement of net marital assets, including a "look" at the dealerships. In addition, Jenny requested that I critique the opposing CPA's valuation report (just in case) and determine the husband's income for the purposes of alimony and child support. Finally, Jenny explained that Ronda had no immediate resources but was willing to sign a personal note for the retainer.

I sat silently throughout Jenny's summary. After a short pause, I advised that there was little or nothing I could do given the time constraints (<30 days), the complexity of the marital estate (specifically the classification and valuation of the auto dealerships), the lack of discovery/information, and Ronda's inability to pay the required retainer. I

gladly waived my two-hour fee, wished them well, and walked them to the door.

FAST FORWARD TWO YEARS. ... I RECEIVE A SUBPOENA IN THE MATTER OF RONDA V. JENNY

The above scenario is not uncommon. Divorce cases are emotionally charged and filled with doubt and distrust. When the smoke clears, one or both of the parties will likely have seller's or buyer's remorse. As in the matter of *Ronda v. Jenny*, a common allegation is the attorney's failure to conduct adequate financial discovery, including the engagement of a financial expert (e.g., forensic accountant) to assist in identifying and valuing marital property.

INTRODUCTION (3-W'S)

The purpose of this article is to introduce the 3 W's for engaging a *forensic accountant* in divorce litigation—Why, When, and Who. My underlying proposition is that the more you know about what we (forensic accountants) do, the more effectively you can leverage the use of our services in advocating for your client/s. I've organized this article as follows: First, I discuss "why" a forensic accountant should be engaged. To this end, I define what forensic accounting is and describe our fundamental and specialized skills. I also identify ways you can leverage your forensic accountant's skills during discovery. Second, I discuss "when" a forensic accountant should be engaged, scope limitations and the budget problem. Third, I discuss "who" should be engaged and identify the most relevant characteristics and skills of financial experts. Finally, I conclude with comments and cautions.

THE WHY (AND WHAT IS FORENSIC ACCOUNTING?)

I commonly define forensic accounting as the use of accounting analyses in a legal setting, most often through expert witness testimony. It is far reaching, involving accounting, finance, economics, statistics, law, research, investigative methods and, of course, communication of findings. We are also defined by what we do. Common engagements include

business valuations, fraud investigations, financial statement fraud, economic damage calculations, asset tracking, bankruptcy, shareholder disputes and, of course, family law.

The wife knew little about family assets and liabilities.

The education, training, and work of a forensic accountant differs substantially from transactional accountants and auditors. Forensic accountants have (or should have) a three-layer skill set:

1. Core skills—functional competencies in accounting, economics, and finance. These skills are generally developed during one's undergraduate education.
2. Fundamental forensic skills—a working knowledge of the legal environment (e.g., rules and procedures, discovery, standard of proof, evidence, *Daubert*, attorney-client privilege, expert testimony), professional duties and responsibilities, and legally sufficient communications (e.g., testimony and reports). These skills are generally developed during post-graduate and professional education.
3. Specialized skills—concentrated studies in specific areas of practice (e.g., business valuation or fraud). These skills are generally developed during post-graduate and professional education and then honed through experience.

She was willing to sign a personal note for the retainer.

The above skills make us uniquely qualified to assist in divorce litigation. We understand the discovery process as well as the evidence (e.g., specific records) required to develop and support an opinion. Common contributions include the following:

- Assist in the gathering of evidence—requests for admission, interrogatories, requests for production, record subpoenas, and depositions

- Identification of witnesses and witness interviews
- Compilation of the net marital assets (marital balance sheet—FMV of assets and liabilities)
- Reconciliation of financial disclosures—compare and contrast the filings of each spouse to identify issues (specific assets, character, and value) in dispute
- Analysis of current financial data (tax returns, financial statements, bank records)
- Analysis of pre-divorce financial data
- Tracking of income and expenses (e.g., lifestyle analysis and wasting)
- Identification of undisclosed income or expenses
- Critique of opposing expert reports
- Valuing retirement accounts—pre-tax and post-tax
- Business valuations
- Consultation for settlement
- Expert witness testimony (e.g., classification of assets, valuation of assets, transmutation, wasting, tracking, alimony, and child support)

Generally, we are engaged as testifying expert witnesses. In that role, we independently and objectively develop our opinions—advocating for the opinion and not the client *per se*. This relationship, however, does not (and should not) prohibit a forensic accountant from leveraging this expert's skills to enhance management of the case. A starting point, of course, is an understanding of what those skills are.

THE WHEN (AND WHAT ABOUT THE BUDGET?)

The matter of "when" to engage a forensic accountant explores two questions: (1) *how large* or complex must a marital estate be to justify

the cost and (2) *how soon* or at what stage in the proceedings.

Let's first consider the question of "when" the nature (size and complexity) of a marital estate justifies the cost of hiring of a forensic accountant. Understanding that every divorce case is different (i.e., facts and circumstances), and that size and complexity are relative terms, I generally recommend engaging a forensic accountant if a marital estate includes any one of the following:

- Long-term marriage (>10 years)—allows receipt of Social Security benefits on an ex-spouse's earnings record
- Net marital assets, excluding the marital residence, more than \$350k¹
- Nonpublicly traded investments
- A closely owned and operated business
- Self-employment—especially with disputed income and/or expenses
- A highly compensated spouse—creates issues related to alimony, child support, lifestyle
- Substantial pre-tax investments (e.g., retirement)
- Claims of separate property (e.g., pre-marital, gift)
- Voluntary underemployment
- Deceptive behavior (e.g., indications of hiding income, fake debt, property transfers, manipulation of information, or wasting of assets)
- A client with limited or no knowledge of the marital assets and liabilities—requires more investigative work
- Substantial tax liabilities or other tax issues
- Inconsistencies in financial information (e.g., financial disclosure v. other personal financial statement or loan application)

- Request for alimony—needs analysis and capacity to pay
- A client who is distrusting and suspicious of everyone and the process itself—risk management

Given these various tasks, the scope of our work (extent of the analysis), and thus the cost, is usually driven by the complexity of the estate. Although a small estate often does not require (and cannot cost-justify) the services of a forensic accountant, a best practice is to (at least) consult with a forensic accountant if your case has one or more of the above factors.

Size and complexity are relative terms.

In cases where there is a limited budget or the client is uncertain about the cost-benefit, I recommend a stair-step approach wherein the scope of the forensic accountant's work is incremental and may stop at some point. For example, Step 1 might be limited in scope to a preliminary review of records (first impressions); Step 2 might include an analysis of tax returns; Step 3 might include a business valuation; Step 4 might involve a settlement conference, and so forth. A major drawback to this approach is the forensic accountant's availability as you move up the stairs.

The decision to engage a forensic accountant (or not) ultimately belongs to your client. To that end, the client must be informed (educated) regarding the added-value of our services. Coming full circle, an experienced forensic accountant will generally advise you when his/her services are not cost-justified.

Let's now turn to the question of "when" (at what stage) in the proceedings to engage a forensic accountant. Simply stated, my recommendation is as soon as possible—for three primary reasons:

1. *Selection of expert.* Early engagement increases your chances of retaining your first-choice expert.
2. *Improved efficiency and effectiveness of pleadings and discovery.* Early engagement allows you to leverage the expert's skills during

the early stages of discovery (e.g., requests for production, requests for admission, and interrogatories).

3. *Improved case management.* Early engagement facilitates the management of resources—money and time. Delaying the engagement to potentially save resources inevitably has the opposite effect.

The work flow in a law practice, like the work flow in a forensic accounting firm, is uneven—peaks and valleys. A practice of retaining experts early will help you manage larger case-loads more efficiently, effectively, and with less stress.

THE WHO (AND DOES IT MATTER?)

Does it really matter “who” you engage? In short, YES! Forensic accountants, like attorneys, come in all shapes and sizes with a mix of skills, strengths, weaknesses, certifications, and price tags. What does the research tell us?

In 2009, research conducted by Davis, Farrell, and Ogilby² identified the skills and traits believed *by attorneys* to be essential for forensic accountants. The top five are listed in *Table 1*.

Table 1. Essential Skills and Traits for Forensic Accountants

Rank	Core Skills	Essential Traits	Enhanced Skills
1	Effective oral communicator	Analytical	Analyze and interpret data
2	Ability to simplify information	Detail-oriented	Testifying
3	Critical thinker	Ethical	Knowledge of professional standards
4	Ability to identify key issues	Responsive	Evidence
5	Auditing skills	Insightful	Asset tracing

Compiled from Davis, Farrell and Ogilby (2009)

This research also identified reasons, again according to attorneys, why forensic accountants are ineffective. Their findings are summarized in *Table 2*.

Table 2. Reasons Why Forensic Accountants Are Ineffective

Rank	Reasons Why Financial Experts are Ineffective
1	Inability to simplify the information
2	Ineffective oral communication
3	Inability to understand the case
4	Lack of investigative intuitiveness
5	Ineffective written communication

Compiled from Davis, Farrell and Ogilby (2009)

In 2014, I surveyed 35 family law judges to get another perspective on the characteristics and skills of forensic accountants. As summarized in *Tables 3* and *4*, the study identified five most relevant skills for forensic accountants and five primary reasons why they are ineffective as experts.

Table 3. Most Relevant Characteristics and Skills for Financial Experts

Rank	Most Relevant Characteristics and Skills
1	Case preparation
2	Ability to orally communicate
3	Ability to simplify information
4	Knowledge of relevant law and judicial decisions
5	Effective written communication and legally sufficient reports

Table 4. Reasons Why Financial Experts Are Ineffective

Rank	Reasons Why Financial Experts are Ineffective
1	Ineffective oral communication
2	Inability to simplify information
3	Adversarial bias (client advocacy)
4	Failure to consider case-specific facts and circumstances
5	Failure to understand the applicable law and judicial decisions

My judicial survey also identified the following beliefs:³

- A testifying expert should have an advanced degree (78%)
- A testifying expert should have a relevant credential (97%)
- A testifying expert should have at least five years of experience in the subject field (83%)

- Generally, financial experts assist me in understanding a fact in issue (94%)
- Generally, financial experts offer independent and objective testimony (40%)
- I am generally satisfied with the integrity of the financial expert (63%)
- Male and female experts are equally effective (92%)
- Generally, I read the expert's written report (89%)
- Generally, I give more weight to an expert's oral testimony than his written report (32%)

The research above (especially that from the bench) suggests that communication skills and the ability to simplify the complex in a legal setting are mandates for an effective forensic accountant. Moreover, it is clear that judges *expect* testifying experts to possess these higher level skills as well as relevant credentials. What this means to you, of course, is the significance of the "who."

To assist you in the selection process, I've identified and present in *Table 5* ten positive expert attributes. Although each case (and court) is different, I've assigned weights (importance values) from 1 to 5 based on my 2014 survey. During the selection process, you determine if (or not) the prospective forensic accountant possesses a specific attribute and how strong or weak it is (rating, again 1 to 5).

Let's consider an example:

You've just been engaged to represent Mr. X, president of a local hospital. The marital estate is both large (\$5m) and complex. You want to engage

Table 5. Positive Forensic Accountant Attributes

Attribute	Weight	Rating	Value
Advanced education	3		
Specialized training	4		
Certification/s	5		
Experience—practitioner	3		
Experience—courtroom	5		
Communication skills—oral	5		
Communication skills—written	4		
Knowledge of legal environment	4		
Availability/rate	3		
Responsiveness	4		
Total value			

a forensic accountant ASAP and have narrowed your search to either Laura or Bob.

- Dr. Laura is a local self-employed CPA and seasoned forensic accountant (15+ years) with specialized training and certification in business valuations and family law; she also works as an adjunct professor and frequently presents at professional conferences. Dr. Laura's billing rate is \$325 per hour. That said, Laura's schedule reduces her availability and responsiveness.
- Bob is CPA with a master's degree in Accounting. He has worked in the forensic accounting section of a local CPA firm for 3 years and has recently completed specialized training in business valuations. Bob has co-authored 10 expert valuation reports but has not testified as an expert witness. Bob's billing rate is \$200 per hour. Bob, and his managing supervisor, are anxious to get some trial experience and have expressed a willingness to reduce the hourly rate to \$175 and make the engagement top priority.
- *In this scenario, who would you engage and why? Let's consider the attributes identified above and rate them for each expert.*

Table 6. Expert Attributes Analysis

Attribute	Dr. Laura			Bob	
	Weight	Rating	Value	Rating	Value
Advanced education	3	5	15	4	12
Specialized training	4	5	20	5	20
Certification/s	5	5	25	5	25
Experience—practitioner	3	3	9	3	9
Experience—courtroom	5	4	20	2	10
Communication skills—oral	5	4	20	3	15
Communication skills—written	4	4	16	4	16
Knowledge of legal environment	4	4	16	3	12
Availability/rate	3	2	6	5	15
Responsiveness	4	2	8	5	20
Total value			155		154

Based on your experience and discussions with Dr. Laura, you rate the existence of each specific attribute (e.g., 5 for certifications and experience and 2 for availability) and then calculate a total attribute value. The attribute values are then aggregated to provide an overall assessment. As illustrated in *Table 6*, Dr. Laura's attributes are valued at 155, while Bob's are valued at 154. Does this mean that Dr. Laura gets the engagement?

The above example has two objectives: (1) to identify the attributes considered essential for forensic accountants and (2) to create an awareness that each attribute is case-sensitive. In other words, you might value Bob's availability and responsiveness equal to or greater than Dr. Laura's courtroom experience (or not).

Not all CPAs are forensic accountants.

CONCLUDING CAUTIONS AND COMMENTS

The overall objective of this discussion is to broaden your understanding about forensic accounting and forensic accountants—our specialized skills and added value in divorce litigation. As noted, your decision to engage (or not) a forensic accountant will generally be driven by the nature of your case (size and complexity) and your budget. That said, I caution that as a best practice you (at the very least) consult with a forensic accountant if any one of the case attributes identified above (e.g., self-employment, highly compensated spouse) are present.

During the course of my career, I've witnessed firsthand the importance of engaging the right expert (the "who"). Moreover, I appreciate the challenge of vetting experts and measuring the expert attributes described above. To that end, an awareness and working knowledge of what makes an effective financial expert (essential skills), what the court expects (ability to communicate) and why they fail (inability to communicate / bias) cannot be overstated.

In closing, I caution that not all CPAs are forensic accountants and not all forensic accountants are CPAs. It's important to balance the nature of your case, the attributes of your expert and expectations of your client.

NOTES

1. There is no specific dollar threshold. An equitable distribution with significant investments (e.g., retirement, stocks, real estate) requires the consideration of tax consequences (to achieve an apples-to-apples comparison). For example, a \$25k CD is worth more than a \$25k IRA account. Why? Because IRA distributions are subject to income tax (federal and state). Assuming a combined tax rate of 20%, the IRA is worth \$20k.
2. Davis, D., Farrell, R. and Ogilby, S. (2009). *Characteristics and Skills of the Forensic Accountant*. Sponsored by the AICPA. Available at: <https://www.aicpa.org/InterestAreas/ForensicAndValuation/Resources/PractAidsGuidance/DownloadableDocuments/ForensicAccountingResearchWhitePaper.pdf>
3. Agreed or strongly agreed.