

**Litigation Support: Does The Job Manage You or
Should You Manage The Job?
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Many of us perform litigation support services as part of our valuation practices. Whether for divorce, shareholder disputes, tax disputes, economic damages or anything else, the type of litigation support services really does not matter. We all seem to have the same issues, regardless of where we practice. They include:

1. Attorneys wait too long to get us on board.
2. Short deadlines.
3. Clients without the money for our fees.
4. False client expectations.
5. Clients that want to lash out at us.
6. We cannot get the requested documentation.
7. Our staff is frustrated because we need them to do the work yesterday.
8. We do not want to upset the attorney that we are working with out of fear that we will not receive any additional work from that firm.

There are probably a bunch more, but do you get the picture? This litigation work is not always great stuff. Oh, one more item left out from the above list -- the client is ready to sue us for malpractice if he or she is unhappy with the result.

Let's see if we can address most, if not all of these items. I am going to tackle them in no special order. But let's start with the first item. The attorney waits too long to get us on board. The solution is pretty simple. Turn down the job. Nobody likes to turn away work but sometimes you need to recognized that last minute jobs not only places a lot of stress on you and your staff, it leads to errors that can lead to malpractice. Even if you are fortunate enough not to be sued, the judge may throw out your work, or the cross examining attorney may eat you alive for not doing many of the things that you would have liked to do if you had a reasonable amount of time to do your job. This is not a good alternative either since these types of courtroom nightmares are frequently spread among the legal community and there goes your reputation. Was the fee worth it? Chances are that type of job also has you waiting for your accounts receivable from the client, adding insult to injury.

Representing a party in any type of legal proceeding frequently results in problems. Representing the non-propertied spouse in a divorce, or the outside shareholder in a shareholder dispute, magnifies those problems. While this presentation cannot possibly cover every problem that you might encounter, we plan to highlight some of the more pressing ones. We will attempt to answer the following questions:

- What should you do if you cannot get the records that are requested to complete your assignment?
- What should you do if the client does not have the available funds to pay for the expert's services?
- What should you do if the cost to perform the services will potentially far outweigh the benefits that may be realized from the services?
- What should you do if the client is unreasonable regarding his or her expectations?
- What kinds of reports should you issue under various circumstances in litigation assignments?
- How do you manage staff in litigation assignments?

What should you do if you cannot get the records that are requested to complete your assignment?

There are many different types of services that the valuation analyst can be requested to perform in a litigation proceeding, particularly if the analyst has the background beyond valuation. Some of the more common include:

- If the analyst is also a CPA, determining the amount of spousal and child support that is required by a recipient payee (or conversely, the amount that can be afforded by the payer) is an additional service in a divorce.
- Again, if a CPA, preparing a marital balance sheet to effectuate either equitable distribution or a distribution of the community property for a divorce.

- Forensic investigations that may be required to determine the “true” income or expenses of a party. This could occur in almost any type of valuation assignment.
- Forensic investigations that may be required to trace property or ownership of a business or business interest of one of the parties.
- Valuation of interests in closely-held businesses or intangible assets.

Most services that will be performed require the obtaining of records for the purpose of evaluating them in order to provide the required service. The type of records requested will vary depending on the engagement. Most of us have standard checklists that are used to request this information. But what happens when you cannot get the information needed to do the job?

Even for a straightforward business valuation engagement, the analyst may send out a checklist that looks like this:

**Business Valuation
Company Documents and Information Checklist**

1. Annual financial statements for the last 5 years.
2. Interim financial statements for the last twelve months.
3. A balance sheet as of the valuation date.
4. Federal and state income tax returns for the last 5 years.
5. Copies of any forecasts or projections prepared by or for the company within the last three years, and in particular, a forecast or projection for the five year period beginning at the valuation date.
6. List of subsidiaries or other businesses in which the subject company has an ownership interest, together with their financial statements.
7. List of cash accounts and any significant cash investments.
8. Aged accounts receivable (and work in progress) listing as of the valuation date.
9. List of items comprising inventory (quantity, description and cost) and information on inventory accounting policies as of the valuation date.

10. Fixed asset register and/or depreciation schedule including real estate and equipment lists, date of acquisition, cost, depreciation method, useful life and accumulated depreciation that corresponds to the financial statements and tax returns requested above.
11. List of items comprising significant other asset balances as of the valuation date.
12. Accounts payable listing as of the valuation date, preferably aged.
13. Analyses of significant accrued liabilities as of the valuation date.
14. List of notes payable and other interest-bearing debt as of the valuation date.
15. List of items comprising significant other liability balances as of the valuation date.
16. Copies of sales, capital or operating budgets for at least the next fiscal year.
17. Copies of any business plans prepared within the last five years that may continue to be applicable at the valuation date.
18. Schedule of officers' and/or owners' compensation corresponding to the financial statements and tax returns requested previously.
19. Schedule of key man life insurance.
20. Reports of other professionals:
 - a. Appraisals on specific assets, and
 - b. Reports of other consultants.
21. Brochures, price lists, catalogs or other product information.
22. List of stockholders or partners showing the ownership percentage of each person.
23. Organization chart for the company at the valuation date.
24. List of five largest customers over the past three years and the total amount of sales to that customer in each year.
25. List of five largest suppliers over the past three years and the total amount purchased from that supplier in each year.
26. Details of transactions with related parties.
27. Copies of significant leases or loans, including notes receivable and notes payable.
28. Copies of stockholder or partnership agreements.
29. Minutes of board of directors or partner meetings.
30. Copies of any buy-sell agreements and/or written offers to purchase the entire company or any portion thereof.
31. Copies of key managers' employment contracts.
32. Copies of any major sale or purchase contracts.
33. Details of any litigation, including pending or threatened lawsuits.
34. Details of any employee benefit plans, including pension plans, profit sharing plans and employee stock option plans.

35. Collective bargaining agreement.
36. Reports of examination issued by government agencies such as EPA, OSHA, IRS and EEOC.
37. Attorney's invoices/billing statements.
38. List of any of the following: patents, copyrights, trademarks or other similar intangibles.
39. Details of any contingent liabilities (such as guarantees or warranties) or off balance sheet financing (such as letters of credit) as of the valuation date.
40. Resumes or a summary of the background and experience of all key personnel.
41. Copies of other value indicators, such as property tax appraisals.
42. List of trade associations.
43. List of trade publications.
44. Standard industrial classification code.
45. Copies of any surveys received as part of a membership in a trade association.
46. Any other information that is deemed to be pertinent in order for us to fairly express our opinion of value (sometimes this information may include loan applications and bank loan files).

Do you ask for the same information regardless of the type and size of the business to be valued? Hopefully, not! While we would all like to obtain as much information as possible, the request for records should make sense in light of the type of business being valued. How much of the above list would be required to appraise the local hardware store? Asking for too much information can be as bad as not asking for enough.

There may be other jobs that require some forensic investigations to be performed where the following additional items are requested:

1. All Personal Financial Statements prepared during the last 5 years.
2. Federal and state income tax returns for the last 5 years.
3. All Fiduciary, trust, gift and estate tax returns filed as fiduciary, trustee or beneficiary during the last 5 years.

4. Bank statements for all checking, savings, brokerage, IRA and other accounts which may indicate savings or investments (including cancelled checks, deposit slips, and other miscellaneous advices) for the last 5 years.
5. All statements and other indicia of loans or equity lines for the last 5 years.
6. Credit card statements for all accounts that have been active during the last 5 years including all receipts.
7. Listing of property acquired by gift or inheritance for each spouse during the marriage.
8. Listing of life insurance policies, including cash surrender value.
9. Health and disability insurance policies.
10. Copies of closing statements and other legal documents evidencing the purchase, sale or ownership of real estate.
11. Appraisals for all real estate owned.
12. Partnership and trust agreements.
13. Documents evidencing ownership in closely-held businesses.
14. Documents evidencing ownership of vehicles, boats, jewelry and other miscellaneous assets.
15. List of all safe deposit boxes, their locations and exact contents at date of separation.
16. Support for all other loans or liabilities.
17. Records to support rental property income and expenses.
18. Records to support any other assets, liabilities, income, or expense that is pertinent in order for us to express a fair opinion as to the personal financial representations which have been made.

Imagine being on the receiving end of this checklist after receiving the first one. Now let's go one step further. Imagine if you receive all of the information that you have asked for. Do you have the financial budget to review all of this documentation? Be careful what you ask for as you may get it.

The analyst should try to figure out what information is truly needed to complete the assignment and not ask for more than is needed. As simple as this seems, the reason that documentation is frequently not received is because we overwhelm the other side of the litigation by asking for too much.

There will also be times that a forensic investigation will have to be conducted. The financial aspects of all litigations are resolved either through negotiation or by trial based on the financial information submitted by each party. Ideally, each party is obligated to provide complete and accurate disclosure of all income and expenses, assets and liabilities and any other information that may be required. The representations of both parties should be the same. However, parties going through a litigation may decide to overlook certain income and/or assets in disclosing information to the other side. This may be intentional or unintentional. Frequently, one party is in control of the records, and therefore, the other party may not have access to the same information.

This raises several issues that can become interrelated; first, how do you get the necessary documentation; second, will the procedures to be employed cost more than they are worth; and third, if the procedures are redesigned to eliminate costly steps, will the analyst be sued for malpractice if something is missed? These are serious problems facing the analyst, and by extension the attorney, in any litigation assignment.

In the real world, financial disclosures often become tools of negotiation. They tend to support the position of the party that makes the disclosure and may be inaccurate, incomplete, or designed to advocate a position favorable to that party. For example, leaving off a marital asset may allow one party to keep the undisclosed asset if the party is not caught. There may also be a strong incentive to understate income, particularly when support will be an issue of the divorce.

In many instances, it becomes necessary to examine underlying data to determine the reasonableness, fairness, and accuracy of financial disclosures made by one or both

parties. CPAs are uniquely qualified to perform such examinations and therefore are usually engaged to perform this function.

However, there are many analysts that take on these types of assignments that are not CPAs. Frankly, I cannot image why someone would do this unless they have CPAs working for them.

When a disclosure made by an opposing party appears questionable or lacks credibility, an analyst may be engaged to test the reasonableness of the financial disclosure by performing a forensic examination. For example, if an individual claims to earn \$15,000 annually, but the family travels to Disney World every year, traveling first class, the client spouse may engage an analyst to find the source of the monies used to pay for the first class vacation.

Forensic examinations may be conducted to determine the following information:

- The total disposable income of the parties.
- The standard of living of the parties during the marriage.
- The true income of the business (cash business).
- If there are related entities.
- Is there self-dealing between the company and the owner that operates the business.

Hidden, Transferred, or Deferred Income

If you ask your divorcing client, when did the marital problems begin, he or she will probably tell you that the problems began on the day they got married. Most marriages that end in divorce are in trouble long before one of the parties files for the divorce. The sad reality is that many individuals plan their divorces when they know that the divorce is imminent. With

that in mind, the analyst should be aware that there may be income that has been hidden, transferred to someone else (very often a relative or paramour) or deferred. This will frequently be done to reduce the support obligation of the party with the higher level of earnings. Some of the ways that this may be accomplished include:

- Using unreported cash income from a closely held business.
- An individual may have a bonus or other amount paid directly to someone else.
- Deferral of the receipt of a bonus or other compensation until after the divorce is final.

Unless an individual is careless, it is not an easy task to find hidden, transferred, or deferred income. The process can be extremely time consuming for the analyst, and as a result, costly for the client. Generally, the party that is hiding income usually tries to hide the income from the Internal Revenue Service also. More often than not, little documentation will be provided to the analyst that will support the income ever existing.

There will be times that the analyst performs extensive tests of the financial records of a party and cannot definitively confirm unreported income. If this occurs, the following two investigative techniques may prove effective in establishing the existence of income:

- The analyst may attempt to find unreported income by comparing total personal expenditures to the reported income. If the parties are spending more than they are showing as being their income, there may be unreported income. The analyst should verify any other sources of cash flow that may be available to the parties. Borrowing on life insurance policies, bank loans and credit card advances are some of the reasons why more income could be available than is being reported. Once all explainable sources of cash flow have been covered, any excessive spending may be coming from unreported income.

- The analyst may also be able to compare the family's net worth at the beginning and end of a period in order to attempt to reconcile the amount of increase to the reported income for the period. A simple analysis can be performed to determine if the parties' net worth has increased due to something other than inflation.

$$\begin{array}{r} \text{Net worth at the beginning} \\ + \quad \text{Reported net cash earnings for the period} \\ + \text{ or - Gifts received or made during the period} \\ + \quad \text{Inheritances received during the period} \\ - \quad \underline{\text{Living expenses for the period}} \\ = \quad \underline{\text{Net worth at the end}} \end{array}$$

Distributions of capital from trusts, partnerships and similar investments may not be reflected above since they may not constitute taxable earnings. The forensic investigation should be intended to ascertain whether any of these types of investments exist, and if so, obtain sufficient documentation to determine if there are any of these types of distributions.

The net worth at the beginning and at the end, if stated at original cost will avoid the necessity of factoring in inflation or deflation of any of the items included in the net worth.

Hidden or Transferred Property

Frequently, if a party to a litigation is going to go through the trouble of hiding income, the same will be true about assets. If assets can be hidden, they will not be subject to valuation and possibly distribution. Hiding assets means that property is transferred to an unknown account or location not disclosed to the other party. Transferring assets may be a means to hide property from the other party. Frequently, the assets are transferred to a relative, a friend or a paramour.

A forensic examination designed to look for hidden or transferred assets may be performed because of a client's doubts about the truthfulness of the opposing party. However, the analyst should be careful in this area of practice because many clients will send the forensic analyst on a wild goose chase looking for something that does not exist or is too well hidden. The nature of most litigation engagements is such that trust dissipates quickly between the parties. This point can be illustrated by the client that sends the analyst looking for a stock portfolio that is supposedly hidden. In reality, the other party only earns \$34,000 per year, and there could not possibly be a portfolio unless there was another source of funds.

Disposable Income of the Parties

A good starting point to determine the disposable income of the parties is their tax returns. However, even tax returns are not always totally accurate. Certain items do not always show up on a party's tax return, making it more difficult for the forensic analyst to account for all income. Some of the adjustments might include:

- Tax-free income.
- Unreported cash taken from a closely held business.
- Other perquisites from closely held businesses.
- Cash flow from rental or farm activities reflected as losses on the tax returns.

- Income from the disposition of assets.

Standard of Living During the Marriage (for divorce assignments)

One of the most important factors in determining the amount of alimony and child support awarded by the courts is the standard of living that existed during the marriage. Analysts are often requested to piece together the standard of living that couples experienced during the marriage. More often than not, this is accomplished by reviewing checking account records in conjunction with other receipts and disbursement records to allow a summary to be prepared of the spending habits of the parties. A review of the expenditures will allow the analyst to determine which disbursements are for necessities, such as food, clothing, and shelter, and which are for non-essentials, such as vacations, entertainment, jewelry, and luxury automobiles.

Some of the more common reasons for performing a forensic examination of the records of a closely held business include the following:

- To determine if the business has been used to purchase personal assets.
- To determine if personal expenses have been paid for by the business.
- To determine whether there is any unreported income.
- To obtain necessary information for the business valuation.

Business Funds Used To Purchase Personal Assets

A business owner can purchase personal assets from the business that he or she controls. These assets may be purchased with or without the other party's knowledge. Frequently, the non-business owner spouse or the outside shareholder is the best source of what is really going on in the business. However, some of the assets may be secretly purchased and hidden from that individual. The most common types of personal assets acquired by closely held businesses include automobiles, boats, real estate and collectibles. These

items may have been capitalized on the balance sheet of the company or expensed along the way.

Business Funds Used To Pay Personal Expenses

One of the well known advantages of owning a closely held business is the perquisites that may be available to the owner. These may include medical and life insurance coverages, private club memberships, or a company car. In addition, some business owners may use the company checkbook as if it were his or her own, making it available to pay for various types of personal expenses that are not usually considered to be related to the business. Some of these types of expenses may include home utility bills, personal travel and entertainment expenses, charitable contributions, repairs and landscaping expenses for the personal residence, or salaries paid to nonworking family members.

The extent to which a business owner uses business funds to pay personal expenses varies from case to case. In some cases, the personal expenditures may be relatively small. In other situations, the business owner may try to hide as much as possible. All of the personal expenses should be considered as an increase in available income for dividends or distributions.

Unreported Income

By definition, unreported income is usually considered to be business revenues that are not reported on a tax return. In most litigation engagements, this income may also not be reported to all of the business owners. "Cash" type businesses are frequently the forensic analyst's nemesis. The more cash a business receives, the easier it is for the owner to take cash and not report it.

The ownership distribution of a business can make it more or less conducive for the business owner to take unreported income from the business. A business that is owned

by only one person rather than several persons is more likely to have unreported income. Without any oversight from other owners, a sole owner can more easily take unreported income out of the till and not report it. Similar procedures will be applied to a business as were discussed previously.

One major difference between personal and business forensic investigations is that most business owners that take cash from a business need to document the transactions for one reason or another. This is especially true if a company bills all or most of its sales through accounts receivable. Even if the customers pay their bills in cash, the owner of the business must reflect a credit against the accounts receivable of that customer. The analyst will review accounts receivable documentation including credit memos to uncover this practice.

Value of a Closely Held Business

One of the initial steps in valuing a closely held business is to obtain the company's historical financial statements for the past several years. These financial statements are then reviewed to determine if any GAAP or normalization adjustments are necessary. Some of the required adjustments may be identified as a result of performing a forensic examination of the financial records of the business.

All of the procedures that have been discussed above require a considerable amount of documentation. The analyst must understand which procedures will be employed in a given assignment and make certain that only information that is required be asked for. For example, can the last two years worth of records be requested instead of the last five years? This can cut down the documentation fairly significantly and still get what is required to do the job. However, before the analyst asks for all of the documentation, think about the cost of performing the services so that the client knows up front what a reasonable estimate of the fees might be.

What should you do if the client does not have the available funds to pay for the expert's services?

Before an analyst accepts an engagement, he or she needs to carefully screen the assignment. There is nothing worse than getting started on an assignment to find out that you cannot be paid for your time. Several things can be done to prevent this from happening.

First, make certain that you have a clear understanding of the assignment. Know what you are getting into before you get into it. Estimate the amount of time that the assignment will take and discuss this with the client. Frequently, the client will tell you that he or she cannot afford the service. At that point, you may wish to discuss this with the attorney so that either an application can be filed with the court for expert fees or other arrangements can be made. What this may also do is allow the attorney the opportunity to narrow the scope of what really needs to be done within the client's budget.

Another solution to consider is the possibility of obtaining a mortgage against the client's property. Although this does not put cash flow on the table, you may feel protected by knowing that you will most likely be paid at a point in the future. The analyst should check with his or her own legal counsel to make certain that this is legal in their jurisdiction as well as enforceable.

What should the analyst do if the cost to perform the services will potentially far outweigh the benefits that may be realized from the services?

This is always a tough one. The client wants you to do everything under the sun but you know that you will never be able to cost justify the services. The danger in not performing the services is when the client decides to sue you for malpractice because you did not do your job!

When we figure out that an assignment will most likely cost more than the benefit to be realized we try to be up front with the client. We even suggest that the client obtain competitive fee quotes to perform that portion of the assignment. Unfortunately, there are many firms that will perform services without the client's best interest in mind. The classic example is the client that wants a big forensic investigation of the cash business because the spouse always has cash to spend.

What should you do if the client is unreasonable regarding his or her expectations?

Before the analyst decides to accept a litigation engagement, there are several items that need to be considered. Any litigation can become a highly emotional battle for both parties going through the litigation. According to Sylvan J. Schaffer, J.D., Ph.D., "many professionals consider it to be the most prone to anger and acting out by the parties." Dr. Schaffer relates this behavior to the fact that this type of litigation is "intensely personal."

The analyst should be aware that the fighting and anger by the parties may be turned against the professionals involved. If the client, or even sometimes the non-client perceives (rightfully or wrongfully) that a professional has harmed them, professional complaints may be filed. The client may blame the analyst for not getting enough value out of the business.

The non-client may file complaints with professional organizations, state boards of accountancy and any other body that will listen. The first time that the analyst gets notified that a complaint was filed against him or her, is the worst. However, the second, third or fourth time is not much better.

Responding to even frivolous complaints takes a considerable amount of time, which can cost the analyst many hours of unbilled work and countless hours of aggravation. Screening the cases that come to the analyst is a major part of risk management. The analyst must carefully select which assignments to accept.

Other Ways To Protect Yourself

A common problem for an expert is communication. Communication is time consuming and therefore, expensive. However, if one action has great return, it is documenting every action and letting the attorney and client know what is you are doing. It protects against malpractice claims, it helps the lawyer enforce document demands and it helps the client understand what is happening.

The analyst may understand the issues but not realize that the client does not. The analyst may believe that he or she has explained him- or herself but find that he or she was not understood. The analyst may be actively working on a client's matter but since there is no report, the client thinks nothing is happening. Communication is key and written communication essential.

When it is difficult or too expensive to obtain the documentation that is desirable, it is important to work directly with the client and attorney to decide upon alternatives. Clients know more than you do about the opposing party in a litigation more often than not. They often can focus the search and, therefore, help you to most efficiently apply your time. However, the client must be helped to tell you what you need. Simply asking the client what he knows, may not be enough. Suggest possible avenues to explore so that the client can then tell you what is known. Once an approach is agreed upon with a client, this should be memorialized, preferably in writing.

Sometimes, the analyst does not want to talk to the client who is difficult or demanding. In that case, communicate in writing. These clients are the most dangerous and often, the most abused by the process. Because they are difficult, they distract experts from more worthy tasks and tend to make the expert avoid contact. The lack of contact brings the unfortunate consequence of dissatisfaction and missed opportunities.

Most attorneys have been able to protect the outside party to the litigation by obtaining a good written record of the efforts made by the analyst. That record includes written requests for documents; timely follow-up requests for missing documents, prompt review of the materials provided and good records of the documents provided. Do not be afraid of serial requests for documents if they are made promptly and follow from the last production of documents. At the same time, copies of all communications should be sent to the client.

Finally, let the attorney know as soon as a problem develops. Delay punishes the outside party to the litigation. The judges are under pressure to move cases. The inside person is frequently in no rush to provide discovery. Too often a prompt discovery notice is sent but nothing is produced and the expert moves on to other cases. Set up a reminder system and send out regular notices and reminders. If you do not get the information, follow up immediately. The judge will then punish the other party, not your client. It will also increase your likelihood of obtaining an award of fees. The court can and will order a party to pay for expert's fees when it is felt that the work is necessary and being done properly. This is even more likely when the court believes that the opposing party is being recalcitrant.

Finally, be creative. Offer suggestions and solutions. All of the direction cannot come from the attorney and the client. Passive acceptance of directions will not bring the next referral. The attorney is busy and the client is unfamiliar with the system. Make yourself familiar with the applicable case law. Read articles on forensic investigations if you are going to do them. These will suggest solutions that may be cost effective or provide an approach that you did not know. Talk to other experts. See if they have done similar work. Use computer programs to organize data. Get access to statistics and other experts in the business that is in issue. Sometimes, the solution is in getting more familiar with the way business is done in the industry. The client may be able to set up a meeting with someone who will not testify but who can explain the business and where to look for money. This is a team process. Anyone on the team can initiate the solution.