Discovery of Documents and Information

Used by Business Appraisers and Forensic Accountants in Family Law Matters

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The valuation of privately owned businesses in family law matters is oftentimes vital to the financial settlement of cases as the marital business may represent a significant asset as a component of the marital estate. The process that business appraisers employ begins with the request for documents and information that are necessary to properly conduct the appraisal. The ultimate goal is to have all necessary information to accurately assess the value of the business as well as to determine the true income of the business to be utilized for alimony and child support purposes which the parties, counsel and the Courts can confidently rely upon.

The American Institute of Certified Professional Accountants (AICPA) outlines in their Statements on Standards for Valuation Services, the necessary documents and information needed by appraisers for the valuation of a business or business interest. The first set of documents needed are Financial Information documents. This includes Historical Financial Information (including annual and interim financial statements for an appropriate number of years. According to the AICPA "the term Financial Statements refers to a presentation of financial data, including accompanying data, derived from accounting records and intended to communicate an entity's economic resources or obligations at a point in time or the changes therein for a period of time in conformity with a comprehensive basis of accounting." Interim financial statements are those prepared as of a date other than the last day of the subject company's fiscal year. Analysis of interim financial statements can give a timelier indication of the financial performance of the subject company.

The next set of required financial documents are the federal and state income tax returns. The tax returns are needed in addition to the financial statements. There are common reasons for discrepancies between the amounts & items reported in the financial statements and those reported

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on the federal income tax return. Many of the differences occur due to timing differences, such as different methods of revenue recognition and cost recovery of capital expenditures. If such differences exist, the appraiser must use his or her professional judgement to determine which amounts will provide the most appropriate basis for appraisal purposes. For smaller companies, it is not unusual for the business to have no formally prepared financial statements. In this case the appraisers' only basis is the income tax returns.

Prospective financial information such as budgets, forecasts and projections can have a significant effect on the subject company's value. Since the value of a business interest depends on what the business will accomplish in the future, reasonable estimates of future expectations should help in arriving at the value. Additionally, annual general ledgers and monthly bank statements for no less than three (3) years should be requested. General ledgers are accounting documents which summarize every transaction during the course of a year of the business and organized into asset, liability, equity and income and expense categories. They allow the business appraiser to do the necessary forensic accounting to arrive at the true level of income of a business.

The second class of documents outlined by the AICPA is Ownership Information. This class helps in assessing the control or marketability of the interest and includes the articles of incorporation, partnership agreements, or LLC agreements along with any amendments and other documents specifying rights attached to each class of outstanding equity. This is particularly important regarding businesses with multiple owners. Operating agreements are necessary, they describe the rights and privileges of each of the equity holders. Additional helpful information includes past transactions in the stock or offers to buy. To the extent that past transactions in ownership interest were at arm's length, they may provide objective evidence of value. Even if not accepted, a bona fide offer, particularly in writing, can at least corroborate the value. Additional information beyond that outlined in the standards should also be gathered by the lawyer in preparing for a valuation.

With a rise during the pandemic, electronic discovery (e-discovery) has become crucial in present day litigation. Electronic discovery is the electronic aspect of identifying, collecting, and producing electronically stored information. The processes and technologies around electronic discovery are more complex due to the sheer volume of electronic data produced and stored. In this age of technology, information is increasingly stored electronically in addition to and often in place of paper documents. Unlike hardcopy evidence, electronic documents are more dynamic and often contain metadata, such as time date stamps, author, file recipients and file properties. The metadata allows experts to recognize if the content produced is original content or if they were tampered with. Federal courts have held that the production of documents by electronic files must be made in a reasonably usable form. This change has brought up new and unforeseen issues surrounding electronically stored information. Federal judges have two major concerns when it comes to electronic documentation. The first concern is whether the electronic records produced in litigation have been manipulated. The second concern is whether the programs and procedures used to maintain the records are reliable and have remained intact during normal operations. The explosion of electronic documents has also created hurdles for the financial experts regarding the qualification, relevance, reliability, and authenticity of the information that forms the basis of their opinions. At the beginning of the engagement, the attorneys and the expert should consider the following steps when planning the electronic discovery process: (1) Identify relevant electronic information and the format it might be stored in. (2) Check state and federal rules to determine what limits, if any, are placed on electronic discovery. (3) Determine the methods to be used to discover electronic information. (4) Determine how the information will be processed and stored. In a matrimonial action, the issue of preserving electronic data should be addressed at the preliminary conference, but it is recommended that a preservation letter or notice is sent to the opposing counsel as early as possible.

The key to success is the cooperation between the attorneys and their financial experts. Financial experts and counsel must coordinate closely and extensively to provide the most valuable and effective information and recommendations to the court for the benefit of their client. Both the expert and counsel have obligations to each other to achieve the most successful outcome for the case. Obligations of the counsel to the expert include defining the scope of the engagement, outlining for the expert the expectations, resources and timing of the engagement, and explaining to the expert the applicable law, procedures, and deadlines for the engagement. The obligations of the expert to the attorney include exercising precision in defining the work to be performed and the time restrictions, limitations, and requirements that apply to the work. They must provide a case appropriate document request to the appropriate parties. A crucial obligation of the expert is to prepare the attorney to defend the expert's deposition and to examine the expert most effectively at trial. They must also prepare the attorney to depose any opposing experts and to cross-examine them at the trial. Frequent meetings between the experts and counsel are critical to maintaining a clear understanding of the issues, the documents requested, and the analysis of the financials. The expert and counsel need to be aware that all communication can be used in discovery.

In a collaborative divorce, the parties will jointly engage a neutral appraiser not allied with either spouse. This collaborative process allows both spouses and their attorneys to be part of the information gathering process to make sure that all parties are on the same page and that neither party feels

like they are in the dark. All information is shared with both parties and their legal counsel. This allows information to be acquired quicker and allows the whole process to be conducted in a more efficient manner than in traditional litigation. After the initial valuation the expert will present their findings to both parties and their legal representatives, and the expert will explain what assumptions and discounts were used and why. Both parties and their legal representatives will have the opportunity to review and question the findings. Any disputes can be addressed through negotiation or mediation. This is contrary to a traditional litigation in which the parties frequently will conduct discovery to obtain the necessary documents and information needed to perform the valuation. During these types of valuation engagements, the lack of information forces the expert to have to make more assumptions in their valuation. This not only increases the cost and length of the process but can also create distrust between the parties and the valuation expert.

Whether it be electronic documents or hard copies, the efficiency of the document collection process is one of the most crucial factors in determining whether the financial expert's value is accepted by the court. To achieve this efficiency both the attorney and expert must perform their obligations to each other and communicate regularly. The ability to process and collect electronic data at a quicker rate allows the whole valuation process to be generally more efficient which makes it the more effective method of data gathering. Given the demands of litigation and the importance of a financial expert in family law cases, counsel and the financial expert must assist each other from the initial inquiry about the engagement through to the entry of the court's orders. Having the ability to collect and analyze higher amounts of data allows the appraiser to have a much better understanding of the business, industry, and financial position of the entity which, in turn, allows them to be more confident in their value and increases the likelihood of the value being accepted by the courts. FA

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