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Forensic Accounting: Digging a Little Deeper

Attorneys usually recognize the complexities involved in determining a valuation, whether for divorce, shareholder, or other litigation purposes.

Often, it's important to look behind the numbers since they form the basis for the valuation. Properly applied, forensic accounting can help assure the valuation is reliable.

Too often, valuation experts stop short of reaching into the deepest corners of the documentation on which they base their assumptions. As a result, those assumptions may not reflect reality because the valuator has simply relied on the tax returns and financial statements given to him or her rather than digging into the numbers.

In one divorce case, for example, an appraiser was engaged to value a significant business that had reported annual operating losses. The forensic accountants were asked to determine whether the tax returns the appraisal was based on were reasonable.

The accountants found significant amounts of personal expenses were being deducted on the tax return. As a result, rather than operating at a loss, the business was, in fact, making a substantial profit. Consequently, the appraiser's opinion changed dramatically.

In another case, involving the valuation of a scrap dealer, an individual purchased the business based on the prior few years' tax returns. Unbeknownst to the buyer, the seller had kept some inventory off the books in order to show exceptional profits in the years just before the sale.

The forensic accountants were able to determine the extent of the inventory understatement and the effect on the value paid.

When reading a valuation report, attorneys shouldn't just accept the assumptions an expert made — numbers aren't always what they seem to be. If the expert hasn't supported his or her assumptions by reliable, verifiable means, the results could be costly.

