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Financial and Forensic Issues Involving the Marital Estate

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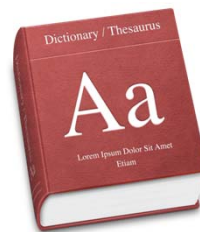
Disclaimer

- i. The following slides discuss common forensic issues and activities
- ii. The items discussed are not meant to be a complete listing
- iii. Each engagement is unique and has unique issues
- iv. These types of activities take time – get someone involved early in the process



What is Forensic Accounting?

Forensic Accounting utilizes accounting, auditing, and investigative skills to conduct an examination into a company's financial statements. Thus, providing an accounting analysis that is suitable for court.



Forensic Accountant

Seek out the truth



Communicate findings from investigation in a form of report, accounting schedule and document briefs



Investigate & analyze financial documents



Coordinate & assist in further investigations including the possibility of appearing in court as an expert witness



Common Financial Issues

- Determine components for inclusion in the marital estate
- Analyze the income of the parties
- Determine income available for spousal maintenance and child support
- Computing reasonable needs for living expenses



Common Financial issues (continued)

- Valuation of a family-owned business or other business interests
- Search for assets which may have been diverted or dissipated in anticipation of divorce



- Tracing assets to determine or refute separate property claims



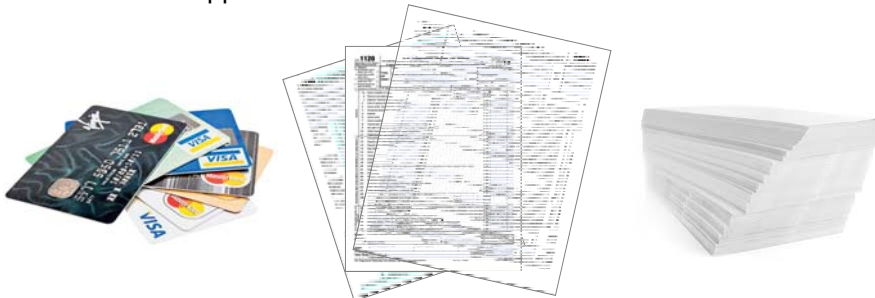
Common Document Requests

- Bank statements
- Savings accounts statements
- Investment statements
- Real estate appraisals



Common Document Requests (continued)

- Personal income tax returns
- Business income tax returns
- Credit card statements
- Statements of cash surrender value of life insurance
- Loan applications

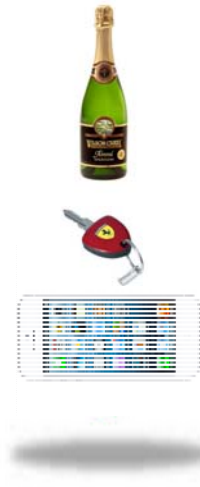




Common Forensic Activities – Business (continued)

- Review for personal/discretionary expenses
 - Travel
 - Meals
 - Entertainment
 - Automobile
 - Cell phones
 - Miscellaneous

- Example of items found in Florida divorce case



Common Forensic Activities – Personal

- Prepare historical comparison of personal income tax returns

- Analyze itemized deductions (Schedule A)

- Analyze fluctuations in sources of income
 - Schedule B – Income of dividends
 - Schedule D – Capital gains (losses)
 - Schedule C- Sole owner business
 - Schedule E – Pass-through entities



SCHEDULE A
(Form 1040)

Department of the Treasury
Internal Revenue Service (IRS)

Name(s) shown on Form 1040

Itemized Deductions

OMB No. 1545-0074
2013
Attachment
Sequence No. **07**

Information about Schedule A and its separate instructions is at www.irs.gov/schedulea.
▶ Attach to Form 1040.

Your social security number

Caution. Do not include expenses reimbursed or paid by others.

Medical and Dental Expenses	1 Medical and dental expenses (see instructions)	1		
	2 Enter amount from Form 1040, line 38 2	2		
	3 Multiply line 2 by 10% (.10). But if either you or your spouse was born before January 2, 1949, multiply line 2 by 7.5% (.075) instead	3		
	4 Subtract line 3 from line 1. If line 3 is more than line 1, enter -0-	4		
Taxes You Paid	5 State and local (check only one box):	5		
	<input type="checkbox"/> Income taxes on	6		



SCHEDULE B
(Form 1040A or 1040)

Department of the Treasury
Internal Revenue Service (IRS)

Name(s) shown on return

Interest and Ordinary Dividends

OMB No. 1545-0074
2013
Attachment
Sequence No. **08**

Information about Schedule B (Form 1040A or 1040) and its instructions is at www.irs.gov/scheduleb.
▶ Attach to Form 1040A or 1040.

Your social security number

Part I

Interest

1 List name of payer. If any interest is from a seller-financed mortgage and the buyer used the property as a personal residence, see instructions on back and list this interest first. Also, show that buyer's social security number and address ▶

	Amount

(See instructions on back and the



SCHEDULE D (Form 1041) **Capital Gains and Losses** OMB No. 1545-0092
Department of the Treasury Internal Revenue Service
▶ Attach to Form 1041, Form 5227, or Form 990-T. ▶ Use Form 8949 to list your transactions for lines 1b, 2, 3, 8b, 9 and 10.
▶ Information about Schedule D and its separate instructions is at www.irs.gov/form1041. **2013**

Name of estate or trust _____ Employer identification number _____

Note: Form 5227 filers need to complete only Parts I and II.
Part I Short-Term Capital Gains and Losses—Assets Held One Year or Less
See instructions for how to figure the amounts to enter on the lines below.
This form may be easier to complete if you round off cents to whole dollars.

(f) Proceeds (sales price)	(e) Cost (or other basis)	(g) Adjustments to gain or loss from Form(s) 8949, Part I, line 2, column (g)	(h) Gain or (loss) Subtract column (e) from column (f) and combine the result with column (g)

1a Totals for all short-term transactions reported on Form 1099-B for which basis was reported to the IRS and for _____



SCHEDULE C (Form 1040) **Profit or Loss From Business (Sole Proprietorship)** OMB No. 1545-0074
Department of the Treasury Internal Revenue Service (99) ▶ Information about Schedule C and its separate instructions is at www.irs.gov/schedulec.
▶ Attach to Form 1040, 1040NR, or 1041; partnerships generally must file Form 1065. **2014** Attachment Sequence No. 09

Name of proprietor _____ Social security number (SSN) _____


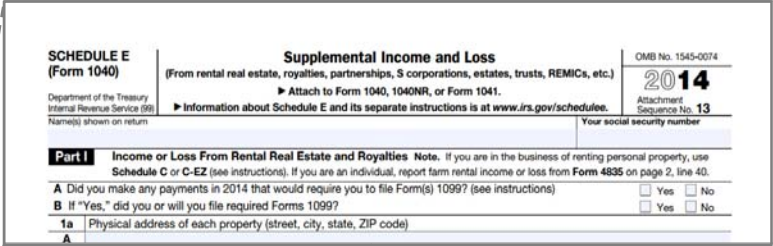
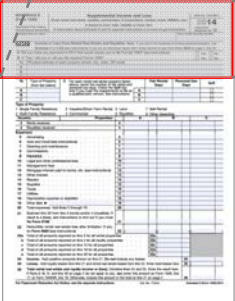
A Principal business or profession, including product or service (see instructions) _____
B Enter code from instructions _____

C Business name. If no separate business name, leave blank. _____
D Employer ID number (EIN), (see instr.) _____


E Business address (including suite or room no.) ▶ _____
City, town or post office, state, and ZIP code _____

F Accounting method: (1) Cash (2) Accrual (3) Other (specify) ▶ _____

G Did you "materially participate" in the operation of this business during 2014? If "No," see instructions for limit on losses. Yes No

SCHEDULE E (Form 1040) Supplemental Income and Loss
 (From rental real estate, royalties, partnerships, S corporations, estates, trusts, REMICs, etc.)
 Department of the Treasury Internal Revenue Service (IRS) OMB No. 1545-0074
 2014 Attachment Sequence No. 13
 Name(s) shown on return Your social security number
Part I Income or Loss From Rental Real Estate and Royalties Note. If you are in the business of renting personal property, use Schedule C or C-EZ (see instructions). If you are an individual, report farm rental income or loss from Form 4835 on page 2, line 40.
A Did you make any payments in 2014 that would require you to file Form(s) 1099? (see instructions) Yes No
B If "Yes," did you or will you file required Forms 1099? Yes No
1a Physical address of each property (street, city, state, ZIP code)
A



Common Searches for Hidden Assets

- Tax returns are a great place to start
- Compare interest and dividend income to bank and investment statements provided by the parties
- Financial and investment institutions are required to file a form with the IRS listing the amounts paid to the taxpayer annually
- Any sources of income which cannot be traced to statements supplied need to be investigated



Common Searches for Hidden Assets (continued)

- Review sources of capital gains reported
- Trace receipt of proceeds to investment or bank statements supplied by the parties
- Here again, financial and investment institutions are required to file a form with the IRS listing the proceeds paid on the sale of the investments
- If proceeds cannot be traced to a statement supplied, investigate where funds went



Common Searches for Hidden Assets (continued)

- Review bank statements
- Analyze receipts
 - Unknown sources
 - Known source but receipt not seen in account
- Analyze disbursements
 - Large outgoing amounts
 - Payments for expenses (real estate taxes, utilities, etc.) for properties unknown to spouse
- Review credit report for unknown sources (such as credit cards)





Common Searches for Hidden Assets (continued)

- Analyze income from pass-through entities shown on Schedule E of personal income tax return
- Pass-through entities are those which are not taxed at the corporate level, such as a Subchapter-S corporation, partnerships and limited liabilities companies
- Compare to known entities
- Investigate those unknown



Construction of a Lifestyle Analysis

- Alerts spouses of potential hidden assets
- Reconstructs spending habits and identifies day-to-day living expenses
- General standard of living
- Compares to known sources of income

✦ Construction of a Lifestyle Analysis (continued)

- Can reveal inconsistencies between incoming money and spending
- Investigate for financial resources coming from an unknown source
- Potential sources could be debt, loans, gifts or unreported income and assets
- Once an inconsistency is found, next step is to investigate what the unknown source is

✦ Common Sources of Income for Available Funds for Spousal Maintenance and Child Support

- W-2 earnings
- Interest and dividend income
- Capital gains (or losses)
- Schedule C business income (or losses) from a sole proprietorship
- Schedule E income (or losses) from pass-through entities





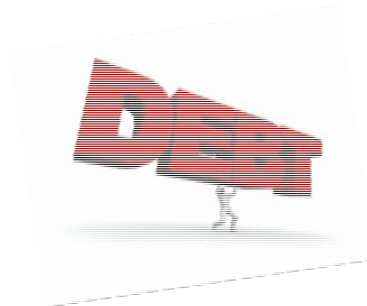
Common Marital Assets and Liabilities

- Cash
- Investments
- Personal residence
- Business interests



Common Marital Assets and Liabilities (continued)

- Bank debt
- Credit card debt
- Personal loans





Valuation of Business Interests

- Process is similar to appraisals of real estate
- Three approaches
 - Cost or asset approach
 - Income approach
 - Market approach



Valuation of Business Interests (continued)

- **The cost approach** adjusts the assets of the business to fair market value
- Generally most appropriate for asset intensive entities, such as investment holding companies, real estate holding companies, etc.
- Investments are adjusted to current market value
- Most often need real estate appraisals to adjust to current market value

* Valuation of Business Interests (continued)

- **The income approach** is often used in valuing business interests
- In general, the approach computes a value based on cash flows adjusted for market risk
- If business has been fairly stable, can look to historical cash flows
- If business is in a growth mode, generally look to estimations of future cash flows



* Valuation of Business Interests (continued)

- **The Market approach** is considered in most instances
- In general, the approach computes a value based on sales of similar businesses or comparison to publicly traded entities
- Can sometimes be difficult to apply to smaller entities

Valuation of Business Interests (continued)

- Valuation should consider whether there are any elements of earnings which should be “normalized

- Common adjustments include
 - Compensation
 - Benefits and perquisites
 - Non-business related expenses (meals, travel, entertainment, etc.)

Valuation of Business Interests (continued)

- Look for non-operating assets
 - Cash-surrender value of life insurance
 - Receivables from owners
 - Non-business related property (lake house, beach house, etc.)
 - Automobiles





Questions?



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