

Taking a Shortcut – The Good, The Bad & The Ugly

Regularly, when we forensic accountants/business valuation experts get contacted to discuss accepting a divorce assignment, one that includes the valuation of an interest in a business, it is not unusual for us to be queried along the lines of “What can be done to shortcut the process and save on fees?” To a degree, and unfortunately sometimes, the real consequence of that question is the cheapening of the product. That is not to say that every desire, every request, to find a way to contain fees, needs to be viewed as having the result of an inferior product, but rather sometimes that is the result, and sometimes it takes extra efforts on everyone’s part to ensure that, if a shortcut concept is going to be applied, it be done in such a way that still enables the expert to produce a professional product.

There are a multitude of issues that need to be considered. First, let’s segment the work that typically needs to be done as to investigating a closely-held business into the two major components common to our work – first is the forensic (investigative accounting) analysis; second, is the business valuation.

- ✦ Forensic accounting – perhaps not recognized by many non-accountants is that, even though the ultimate goal, the desired output, is a determination of value, more often than not, it takes much more effort and time (and thus fees), to first lay the groundwork to do the valuation by accomplishing the appropriate forensic accounting analysis of the underlying business. After all, by and large, valuations are driven by income – and very few of us are willing to accept (nor should we accept) the income as reported on the tax returns or financial statements. Without going into details, we all know there are a myriad of ways for and reasons why, the numbers have to be restated. That process commonly takes much more time than the valuation process;

- ✦ Valuation – in most situations, the valuation cannot proceed until the preceding item, determining the real income of the business, has been accomplished. The valuation aspect involves (with some exceptions, which this article will not go into) taking the forensic accounting results and translating that into economic value.

Thus, when we are asked as to what can be done to reduce the amount of work, it needs to be considered from the vantage points of both of those functions. To make this simpler than it really is, from the perspective of getting a worthwhile and accurate product, it is generally far easier to shortcut the business valuation process than the forensic accounting process. There are many exceptions, especially for larger businesses.

- ✦ Forensic accounting – the guts of coming up with a valuation is determining income. Besides that, very often we also need to know the income of the individual involved in the divorce – and that is typically determined in the forensic accounting analysis function, which has the end goal of being able to do a valuation, but also of having an income determination. To do that, we need to review, usually in depth, the business’ books and records, test various entries/postings, vouch various bills, follow transactions, and make judgment calls. Also, this is where often the non-business spouse has suspicions. This might be along the lines of “We took the whole family on a vacation to Europe, we spent \$20,000, and I’m sure that it was put through the business”. Similarly of course as to the proverbial 3 times a week eating out, all paid for by the Company. Or worse, we hear “I know there is cash”. All of these concerns mean that an accounting investigation needs to be performed. Anyway you cut it, if to be done correctly, it is going to take significant time. Shortcutting that process inevitably means that either we are going to miss things, or we are going to have to accept broad assumptions, or both.

Indeed, accepting assumptions provided to us by one or both of the litigants is not unusual, but the issue here is the degree of same – how much is it going to be relied on, how much testing is going to be done to verify that the assumptions we have been given are reliable. For instance, we are told perquisites or addbacks are \$50,000 per year. However, which side is giving us that information, and will the other side accept same? How effective is that type of shortcut assumption when no, or little to no, investigative work has been done? Is the number reliable at all? There are certainly gradations – but the critical concept remains the same;

- ✦ Valuation – it is in the area of business valuation that it is easier to make assumptions, but that area then gets us involved with standards as promulgated by the AICPA that CPAs must follow. These standards do not preclude us from taking shortcuts, but they still require we operate within professional guidelines. We can for instance agree that we will not apply the market approach, we will not do economic or industry research, and that we will accept certain basic information as to the likely risks of this business. The basic point here is that there’s a fair amount that we can accept to shortcut the process – but in any and all cases it weakens the product, potentially severely.

One major caution as to taking shortcuts is that in a business investigation and valuation, where shortcuts have been taken, rarely are we valuation experts willing to have our product be subject to trial. That is, if we’re going to do shortcuts, if we are going to perform an investigation and/or valuation with scope limitations, it needs to be understood (there are always exceptions of course) that this is generally not acceptable for rigorous

examination, and cross-examination in trial (or even in deposition). Rather, it needs to be accepted as something usable only in a negotiation process.

Connected to the issue of taking shortcuts and containing fees, is the matter of a report. When approached from the point of view of a full report in an unrestricted job, a report can well be anywhere from 20 to 50 pages or more. Also, in addition to merely developing our numbers, a lot of work needs to be expended in order to develop a report. Thus, eliminating the report can save a fair amount of money. However, commonly, counsel and litigants want some kind of document to which they can refer, and indeed it is reasonable to expect you need something for the file. Thus, when it comes to this concept of shortcutting, one of the steps we routinely take is to provide a letter, often no more than a few pages, briefly summarizing what was done and what was concluded. Sometimes it might include a couple of additional pages of schedules. As long as our client and counsel (or both sides if we are neutral) understand the import of the restrictions placed on us, then at least in theory an informed consumer has made a decision, and all is well.

A problem that arises with a shortcut approach is that sometimes it is contemplated as only a stopgap. The idea broached is that we'll employ a shortcut approach to save on fees; but that if it doesn't work out, then we'll have to "finish the job". Putting aside the extent of duplicative effort (and there of course will be some) – and thus putting aside that first doing a shortcut job and then expanding that to a normal full job, is more expensive than doing a full job from the start – one potential big problem is that a shortcut job comes with (this is a given) various limitations and restrictions, and therefore, a willingness (whether implicit or explicit) to accept what inherently has a greater risk of being wrong, or off the mark. Nevertheless, it can serve a useful function, when the idea is to negotiate a settlement.

If the ground rules are then changed on us, and one or both sides have a problem with the results of this shortcut process, and now insist on going back and making it into a full assignment, both litigants and counsel need to recognize that there is a fair chance that the results (conclusions) that will come about from the full job may be different than – and in some cases surprisingly very different than – the numbers resulting from the shortcut version. For instance, let us assume that for the shortcut process it was agreed that perquisites were \$20,000 per year, and that there was no cash income; but when the full job was done, we found out there was \$40,000 in perquisites and \$30,000 in unreported income. The actual income thus is \$50,000 a year more than originally thought; and the value of the business perhaps hundreds of thousands of dollars more than originally determined. Now, just about everybody is unhappy. In addition to all that, we experts have the practical concern as to how you are going to view our credibility when the full report reflects this type of change. We have a determination of income and value significantly different than the one originally expressed. It's the same expert who did both parts – yet with two very different results –

and the shortcoming, the problems, the reasons for that difference, are absolutely not our fault. Nevertheless, we've become associated with two significantly disparate results for the same business and for the same people.

Thus, while there is certainly merit in looking to contain fees, it must be recognized by all that pushing the envelope too far in fee containment via taking shortcuts can prove to be dissatisfactory to all, and not worth the money that it saved. In many such cases, ultimately it costs more when shortcuts are taken, and one or both sides are dissatisfied with the result, and/or the matter doesn't settle, and proceeds to trial. Even if the matter successfully settles, there is a fair chance one or both of the litigants will always have nagging, lingering concerns as to whether the numbers were right, whether they got a fair result.
