Forensic Forum

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Calendar

Recent and Upcoming Speeches Include:

January 2003

24 ICLE – Brown v Brown (Atlantic City)

May 2003

09 NJ Society CPAs Divorce Conference The Market Approach to Value (Iselin)

September 2003

11 AOC – Understanding Tax Returns & the CIS (to new family part judges) (Princeton)

12 AAML/ICLE – Retained Earnings Build-Up As Marital Savings (Atlantic City)

December 2003

15 ICLE – Cutting Edge Financial Issues in Divorce (Cherry Hill)

17 The Shenkman Series – Investigative Accounting (Teaneck)

..................continued on page 4

Our Litigation Team

- Kal Barson, CPA/ABV, CFE
- Vincent Bianco, MBA
- Marizoil Delossantos, CPA
- Beth Doblosky, CPA, JD
- Michele L. Dushkin, CPA (Director of Valuation Services)
- Stacey Jung
- Kartik Shah, ASA
- Eric Malinowski, CPA
- Marshall Morris, CPA/ABV, CFE (Director of Forensic Services)*
- Sean Weiland, MBA

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- Janet Barson (Editorial, Design & Layout)

* Marshall is chair of the Matrimonial Services Committee of the NJ Society of CPAs and co-chair of the Standard of Value Sub-committee (of the Matrimonial Accounting Committee of the NJ Society of CPA's). This sub-committee has been charged with developing a white paper on the standard of value appropriate for divorce cases – and coordinating that effort with the judicial and legal communities.

Volume 2 - Issue 3 *Fall 2003*

There is value,
and Then There is Value

Typically, when an attorney determines it is necessary to value a business, he/she often believes that a clear and unequivocal conclusion has been reached – the need to get the value of a business. However, very important steps need to be taken. We need to determine the appropriate "standard of value" for the matter at hand. Is it fair market value, fair value, intrinsic value, liquidation value…? Further, are we valuing the entire business entity, a majority ownership interest, or a minority ownership interest; and, if a minority, what size minority? All of these points can be very important in how the business valuator proceeds and, certainly, in how the business valuator concludes. Let us briefly address these various terms of art.

➢ **Fair Market Value** – perhaps the value most commonly thought of when the intent is to value a business – but, in New Jersey, thanks to Brown, not appropriate for divorce. The classic definition of fair market value has long been memorialized along the lines of:

> The price at which a business would change hands between a willing seller and a willing buyer, neither under any compulsion to sell or to buy, and both equally informed of all relevant facts. The classical arms length transaction.

Furthermore, the reference to price in that definition is universally agreed to mean a cash price - money up front. This was the standard of value common to most divorce cases - though various jurisdictions evolved their own style of what they considered fair market value, sometimes mixing in elements of other standards of value so as to bring a sense of equity aside from pure valuation theory to the matter at hand. This is the standard of value we typically see for gifting and estates.

➢ **Fair Value** – The major difference as contrasted with fair market value is that as to a minority interest (and we will discuss this further below), a lack of control discount is not applied. There is also some question as to whether a marketability discount should be applied (assuming that it is appropriate at all for the specific matter at hand). Fair value, which is usually the standard of value utilized in a shareholder oppression suit, calls for the determination of value as if various oppressive actions did not occur. As a result of Brown, this is also the standard of value (in New Jersey) in divorce litigation.

➢ **Value to the Holder** – This is not necessarily a "real value" in the sense of a theoretically correct approach to value theory, but rather takes into account the specifics of the situation and of the specific owner, to determine the value in the hands of that owner. This may have elements of sweat equity, it may also reflect that the business provides a living wage (or better) to the owner, the value of which in his/her eyes transcends what a third party would pay or consider to be value. If not clearly defined and "controlled", this has the potential to be "junk science", with value extremes of shocking dimensions.

➢ **Investment Value** – Generally applied to mean the value to a particular investor or group of investors – as contrasted with value to a wide range of (or

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Focus on the Economy

........By Michele L. Dushkin

It is important to consider the general economic climate at the date of a valuation as well as the outlook for the future. A common question is –which economic factors will affect the business being valued. Last article I discussed understanding the business cycle in which the company was operating. This article focuses on the Gross Domestic Product (GDP).

The GDP is an amalgam of many economic indicators which collectively can provide useful information about the overall economy. The GDP measures the dollar value of all goods and services produced in the U.S. economy in one year. It is measured by adding the spending by consumers, investment in both residential and non-residential assets, government spending, and exports minus imports. This calculation gives a good indication of the current production in the U.S. In order to compare this to prior years, the inflation effect is removed. The term "Real" GDP is the current GDP divided by a price deflator. Thus the real GDP can signify economic growth or economic decline. From 1999 to 2000, real GDP increased by 5 percent, compared to an annual increase of 4.2 percent from 1998 to 1999. The real growth rate in 2001 was 1.2 percent.

The rate of increase in real GDP has been higher in the last several years than in the first part of the 1990s and much of the 1970s and 1980s. Economic growth as measured by average annual changes in the real GDP, was 4.4 percent in the 1960s, decreased to 3.0 percent in the 1980s and 2.2 percent in the first half of the 1990s. In the last five years of the 1990s, GDP increased to 3.8 percent.

Often the relevance of an indicator's value is determined by its release date. There are leading indicators which anticipate a business cycle by turning down before the down cycle begins and up before the expansionary cycle begins. There are coincident and lagging indicators – the former in sync with the business cycle, the latter following the changes in the business cycle.

For each component of the GDP, there are many economic indicators. Each indicator examines a specific aspect of the economy and how that compares with the market forecasts. The most important sector of the U.S. economy is consumer spending.

Generally, consumption spending represents about two-thirds of GDP. It consists of spending on goods and services. It is often divided into spending on durable goods, non-durable goods, and services. Durable goods are items such as cars, furniture, and appliances. Non-durable goods are items such as food, clothing, and disposable products, which are used for only a short time period. Services include rent paid on apartments (or estimated values for owner-occupied housing), airplane tickets, legal and medical advice or treatment, electricity and other utilities. Services are the fastest growing part of consumption spending.

Investment spending consists of non-residential fixed investment, residential investment, and inventory changes. Investment spending varies significantly from year to year. Government spending consists of federal, state, and local government spending on goods and services such as research, roads, defense, schools, and police and fire departments. Exports minus imports is the last category. Exports are goods and services produced in the U.S. and purchased by foreigners. Imports are items produced by foreigners and purchased by U.S. consumers.

A further discussion of economic indicators will continue in the next issue.

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the ultimate hypothetical) investors. This type of value brings into play aspects and issues of interest or relevance to a particular investor, rather than to the general investing public. Generally this means that additional value may be placed on the business entity by that individual, value in excess of what a dispassionate hypothetical investor would consider.

➢ **Intrinsic Value** – In some sense, intrinsic value is similar to investment value, but calls upon the valuator to be more analytical and factual – it is a less personal sense of value. When (if) this approach to value is adopted by a sufficient number of investors, intrinsic value can become fair market value. We see intrinsic value used by stock analysts when they argue that the market doesn't yet appreciate the real value of a company, or conversely, when they argue that the market has grossly overvalued a company. These analysts will then refer to the intrinsic value of a company as being the "real" value that the market has yet to recognize.

➢ **Buy Sell Agreement** – This is not really a standard of value, but depending on the nature of the assignment, may very well be the most important method of valuing the business entity. It could also be totally irrelevant. Typically, in a divorce context, because of the generally overriding issue of equity, especially where the party whose interest is being valued is a majority shareholder or at least a significant shareholder (and for these purposes partner can be used in lieu of shareholder) in a family business, a shareholders agreement is often disregarded. This is especially so if it has not been used in the past, if the amounts are unrealistic, if it is essen-

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Show Me the Cash

–by Marshall A. Morris

The more liquid an asset, the more vulnerable the asset is to theft. Therefore, it stands to reason that the asset that is most frequently pilfered is cash. This article will direct its attention to cash sales. Establishments that are most vulnerable to these fraud acts are generally retail businesses, such as bars, restaurants and groceries.

Skimming is the act of misappropriating the proceeds of a cash sale before the transaction is entered into the books of the company. To illustrate, a cashier neglects to ring up a cash sale and retains the cash paid by the customer. That's why it is a good idea to post signs at the register reminding customers to watch the way in which the sale is handled, to insist on getting a receipt, and to report suspicions to floor managers. Some of the signs for supervisors and managers to watch for include: a) receipts and deposits differing from norms or expectations, b) currency receipts decreasing while checks and credit card remittances increase, c) cash register tape destruction, d) diminishing margins, e) sudden increase in complaints from customers.

If theft is occurring, it should become apparent as daily recorded cash receipts drop. This becomes obvious when a trend analysis is prepared comparing the inflows of daily cash receipts to inventory movement. If cash sales decline, while inventory out remains constant, or even increases, there is a probability of employee theft. One method of resolving the problem is to have spotters watching the suspected employee at differing intervals in anticipation of catching him/her in the act. Another method is to place a different employee at the register, while the culprit employee is rotated to another register – and tracking the cash sales recorded at both registers.

A related method of absconding with cash is the theft of daily deposits. While skimming is a before book entry act, stealing daily deposits occurs after the cash sale has been recorded, resulting in a paper trail. Once assumed through analytic procedures, the steps to take to reveal the activity are comparing bank deposits listed on bank statements to actual deposit slips and to cash receipt records. Preparing a proof of cash will probably highlight the activity.

Other ways that employees take cash involve fraudulent sales returns and voids, especially in collusion with customers, and stealing cash on hand. Although not quite as prevalent as skimming or stealing deposits, once acts of employee fraud have been uncovered and the culprit employees identified, appropriate action is necessary to try to prevent other employees from doing the same. A clear message of intolerance toward such behavior is sent to all employees when the appropriate authorities are notified and the guilty party(ies) prosecuted.

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E-MAIL REQUEST – We are looking to send this newsletter to as many attorneys and judges as possible via e-mail. In this fashion, we save paper, making a minor contribution to saving our trees. We also make it easier for some of you to access the newsletter – and frankly we also save on printing and postage. To that end, it would be helpful if as many of you as possible would submit your e-mail address so that future issues can be sent by e-mail. Please send your e-mail address to janet@barsongroup.com.

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Calendar........continued from page 1

Recent and Upcoming Media Situations:

February 2004

21 ICLE – Cutting Edge Financial Issues in Divorce (Fairfield)

Ongoing

the BARSON GROUP CLE series

BOOK: ***Second edition of Investigative Accounting in Divorce*** by Kal Barson, published by John Wiley and Sons

CHAPTER: Divorce Taxation - NJ Family Law by Lexislaw (April 2003) – To be updated early 2004

ARTICLE: ***Standard of Value in Divorce Business Valuation –*** by Marshall Morris – American Journal of Family Law (Spring 2003)

ARTICLE: ***Cursed Infirmities Impact on Valuation*** - to be in New Jersey Family Lawyer (October 2003)

ARTICLE: ***Forensic Accounting – A Force for Good*** - to be in New Jersey Family Lawyer (Winter 2003-2004)

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