

# Crouching tiger, hidden dragon: how to unlock the assets in family law ancillary relief cases

Ann FitzGerald\*

## Introduction

There has been a sea change in market conditions in the last six months. Family law ancillary relief cases are no longer invariably about the “size of the pot” in some circumstances it’s more a case of “no pot” or “where is the pot?” Despite these seismic changes, practitioners must establish the state of the parties’ finances, however bad.

Full financial disclosure by both sides in family law ancillary relief cases is central to enable the parties to reach a consensual negotiated settlement or to prepare for a court hearing. Financial disclosure made in an open and transparent manner is vital to building trust between the parties and their advisers and will determine the ease with which a settlement can be reached.

In the relatively old judgment in *J.D. v D.D.*,<sup>1</sup> McGuinness J. found that open letters were written by Mr D.’s solicitors to Mrs D.’s solicitors making an offer of a certain sum of maintenance plus the lump sum from the proceeds of the sale of the family home when the sale was completed. In the ensuing correspondence, the wife’s solicitors, not unnaturally, pointed out that they were unable to properly advise their client in the absence of any full disclosure of the husband’s assets and liabilities. Given the fact that the statutory position under s.20 of the Judicial Separation Family Law Reform Act 1989 (since repealed) and under s.16 of the Family Law Act 1995 is that the court, in fixing periodical or lump sum maintenance and on making Property Adjustment Orders, must take into account all the assets and liabilities of both parties, the court found that the attitude of the wife’s solicitors was perfectly proper.

Since the introduction of the Practice Direction of the High Court 2005 and the recent Circuit Court Rules (Case Progression in Family Law Proceedings Rules) 2008,<sup>2</sup> a case is now unlikely to be listed for hearing in the absence of full disclosure being made, as occurred in *J.D. v D.D.*

It is abundantly clear that in order to advise a client on what may constitute “proper provision” for a spouse in a judicial separation or divorce case, the extent of the assets and liabilities must be centre stage—“the size of the pot” and that until this has been determined with some certainty, it is impossible to advise a client on what would constitute a reasonable outcome.

I do not propose to address the issue of what may constitute “proper provision” in any particular case, rather I wish to consider how the necessary information should be accessed by legal advisers and how to interpret this information when it is made available.

## 1. How to read and interpret financial information

Let us assume for the purposes of this article that the husband runs the business or other enterprise and that the wife is the dependant or the recipient spouse. It is not however intended to suggest that husbands are generally the only business people.

At the outset, let us be clear: where the case concerns two PAYE employees owning one family home, it is usually unnecessary to embark on any serious quest for discovery or to instruct a forensic accountant to assist you in assessing the net asset position. In some cases it will be necessary to look at discretionary spending and credit cards but this is not universally required. The involvement of a forensic accountant is appropriate, however, in a case where there are multiple businesses, limited companies or partnerships, a number of investment properties and where the husband may be self-employed with several sources of income.

In some cases, the court in adjudicating on an application for an Order for Discovery may require an affidavit of the forensic accountant instructed in the case, setting out the shortfall in disclosure and what documentation is required.

See the decision of the Master of the High Court, Mr Edmond Holohan in *AK v PK*<sup>3</sup>:

“Standard discovery rules apply. No relevance, no reason, no necessity, no discovery! And no fishing, no way! A party may choose to employ an expert, but the purposes for which the expert has been retained, and the expert evidence (for the preparation of which he says he needs discovery) must be spelt out to enable the Court adjudicate the application. Experts will not be allowed to set their own agenda in litigation.”

Where dealing with a limited liability company, a partnership or sole trader, you should firstly seek a full set of accounts—in respect of a limited company, this will consist of the financial statements for the last three years including the director’s report, balance sheet, profit and loss account, cash flow statement and notes to the accounts, together with detailed trading profit and loss accounts. Abbreviated or draft, unsigned accounts are not acceptable. Audited accounts where available should be provided. The next step is to read all the documentation provided and cross-check it against the information already known.

In the case of a limited company, the annual accounts provide the following information:

- They are an overall health check of the company’s finances and its trading performance. They give an indication of the income and assets of a company and of its earning capacity. The fixed assets will invariably need to be valued separately to give their true market value and will not be accepted at face value in the accounts.

- They give an idea of the company's main activities, although generally more information will be needed. Accounts give information on the directors and their shareholdings although the annual return must be checked for full details of all shareholdings.
- The balance sheet is only a snapshot of the company's assets and liabilities at the date of the year end and it is often stated at historical values. The profit and loss account gives the turnover, cost of sales and gross profits and should be reviewed and compared to previous years. A review of expenditure will also give an insight into how the company is run, for example, where it operates, the level of spending on entertainment and so on. A dramatic decline in profits may relate to the initiation of family law proceedings.
- Loans may indicate related-party transactions. The loan account transactions should be reviewed in the same way as one reviews personal bank accounts. Transactions within the loan account may also point to related (or undisclosed) companies and other assets. Most importantly a loan due to the company may be a liability of the spouse and a loan due from the company may be an asset. Arguably this is an asset of the husband's and should be disclosed as such in the First Schedule of his affidavit of means, with the rider that ability of the company to actually repay may be an issue in the current economic climate.
- Details of investments by the company, depending on the type of investment, may give an indication of the liquidity of the company if they can be readily realisable, require revaluation or show related companies. In terms of related companies, it is possible occasionally for a husband to attempt to move trade to another so-called "parallel company". The related company may be one undisclosed by the husband. In terms of surplus assets one has to ask whether there are assets which may easily be sold without greatly affecting the business in order to finance a settlement? Post-balance sheet events should be disclosed in the accounts. These events may include the purchase or sale of assets, the diversification into other lines or other important

information regarding the state of the company and the finances.

- Hidden benefits: car allowance, telephone rental, entertainment, unpaid dividends, consultancy fees. For small companies, we can often identify duplication in the expenses of the business and the personal budget.

The accounts in fact do *not* give an accurate picture of the company and do not provide empirical accuracy on the state of the company's well being. The values stated are historical values, not current values and much can happen in the months after filing of a set of accounts.

Additionally, the fact that the balance sheet balances does *not* mean that all the figures involved are absolutely accurate and cannot be open to interpretation. This is far from the case and it is an error lawyers frequently make. For example, buildings will usually be shown in the accounts *at cost* and yet they may be valued at considerably more. An inventory of stock may be actually worth less when eventually sold. However, trends can be apparent from reading of several years' accounts and may for instance reveal changes in accounting practice coincidental with the commencement of family law proceedings. For example, the gross margin on stock in sale may have been 40 per cent and then suddenly changes to 30 per cent for no obvious reason.

The accounts do *not* provide an understanding of the business, i.e. its strategy, its expansion plans and future prospects. In rare cases, it may be necessary for the forensic accountant to undertake a personal visit to the company's premises if permitted. The High Court Practice Direction 2005 and the new Circuit Court Case Progression Rules 2008 will effectively provide for the accountants instructed on both sides to meet before the hearing and this should reduce areas of disagreement prior to the hearing of the action.

In some cases, attempts at manipulation of the accounts will be made and some husbands will deliberately seek to conceal their wealth, possibly by undervaluing fixed assets. The easiest parts of the accounts to manipulate are the intangible assets, which may be undervalued, and provision against stock and debtors may be increased. There may be a change in the accounting treatment of work in progress as to whether it is recorded at cost or at net recoverable value. Provision for contingent liabilities may also be included in the accounts for events that are really very unlikely to happen. A company will rarely include a figure for goodwill in the accounts and this intangible asset may be very valuable.

Some husbands may undertake the exercise of setting up a so-called "parallel" trading company. This is a company that in theory is owned by a third party but is in all practicality run by the husband. This can occur between the ending of the judicial separation proceedings and the application for divorce but where the parties have little interconnection and the parties do not reside in close proximity. In examining the accounts, one may suspect such activity where the trading profits are down but the husband is just as busy as previously, and in a case where some bigger clients have

been lost but the number of employees have not been reduced. The “parallel” company will take over a larger percentage of the trade (and also of the staff) of the first company and will often be run from the same premises. After the separation or divorce has been finalised, the husband will then be given back the “parallel” company having avoided giving the wife a larger portion of his assets. A wife can be given some measure of protection against non-disclosure if her advisers seek to attach the agreed, dated net asset schedule as disclosed to any settlement so that if it becomes apparent later that the husband had misled the wife, she may have the option to re-enter the proceedings. There is significant UK case law on this issue and it is likely to become a feature of Irish case law shortly.

In filing an affidavit of means, the best practice has always been to provide backing documentation with the affidavit of means by way of vouching documentation under s.38(7) of the 1995 and 1996 Acts or in response to a request for voluntary discovery.

Also the new Circuit Court Case Progression Rules<sup>4</sup> provide for such vouching to be supplied and set out in a new Form 37L a useful list of documentation to be supplied on an automatic pilot basis. Failure to provide vouching may now have serious consequences in that a court may order under Ord.59 r.4(17)(c)(ii) that a party shall not be permitted to pursue or defend a claim for ancillary relief in the absence of proper vouching.

The following information is usually required where the husband has shares or an interest in a limited company, a partnership, profession or business:

- a) Full financial statements (not the abbreviated accounts) for the last three years;
- b) The director’s loan account—how much money is he owed/does he owe the company? This is often an area where wealth can be hidden. Seek a transaction listing of all movements on the director’s loan account and usage/narrative for any unusual transactions.
- c) Income tax returns and notices of assessment with supporting documents and calculations; where applicable, rental income schedule.
- d) Credit card statements for the last year; view the credit limit and see if it has been recently changed.
- e) A notation of the bank statements for all transactions over a certain sum (€2,000 for example) and a narrative/explanation of the purpose of each bank account where there are numerous accounts operated by the husband. This is vital in larger/more complex cases where unannotated piles of bank statements can be impossible to decipher. This is not a matter appropriate to discovery but could be sought by way of a query on

the documentation furnished. The preparation of a narrative as such falls outside the ambit of a request for discovery.

- f) Management accounts since the date of the last statutory accounts;
- g) Any shareholders’ agreement—this can be requested on discovery;
- h) Loan application forms—when applying for a loan the company must declare all its assets and liabilities to the bank. It is often useful to compare these figures to the figures given in the accounts. (Usually requested on discovery only),
- i) Details of all pension entitlements of whatever kind to include details of the type of scheme and up-to-date statement of benefits; and
- j) Any health insurance, life cover and sickness benefit/protection.

At all times in this process, it is the solicitor’s job to keep a clear view of the “big picture” and to avoid becoming bogged down in unnecessary and irrelevant detail. The client should be ready to cut a compromise and move forward.

## 2. The role of the forensic accountant

It is usually preferable to instruct a forensic accountant who both practises in family law work and who is a stranger to your own client, who will be independent and willing to give tough advice when required. Counsel will need five or six critical points on the company accounts or other disclosure documents and if possible the forensic accountant should meet with counsel well in advance of the hearing date.

The role of the independent expert forensic accountant is as follows:

- (i) To summarise in simple terms a complex financial situation and provide a report to the solicitor;
- (ii) To review the value given on the financial assets such as shares in private companies;
- (iii) To advise on how a settlement may be financed having regard to liquidity issues and taxation consequences;
- (iv) To assist in the preparation of a complex Affidavit of Means;
- (v) To assist in drafting a list of documents required to ensure that voluntary discovery is in place;
- (vi) To advise on valuations issues arising;
- (vii) To investigate and trace assets;
- (viii) To examine adverse inference reports and discover whether there are contra-indicators on the accounts. In other words, we should not just get a summary of the accounts, rather the

- forensic accountant should point to where the problems lie within the accounts;
- (ix) To provide assistance in the preparation of affidavits to support a freezing order application;
  - (x) to provide analysis of income and potential future income, budgets, and liquidity;
  - (xi) to examine taxation issues on maintenance and financing of a settlement; and
  - (xii) to provide a “reasonableness review”, examining the overall picture provided. Is there anything obviously missing? For example, is income much less than expenditure? Is there a corresponding overdraft or borrowing?

The report of the forensic accountant should be short, accurate, easily intelligible and with a “one page” balance sheet attached, that being the matrimonial balance sheet showing the assets and liabilities of both spouses, net of any inherent capital gains tax liability. (See *B.D v J.D.*<sup>5</sup>)

The report should include a comment on tax issues arising on maintenance and the anticipated net position of the parties—net to husband and net to wife on maintenance of €X. The report should identify the literature or other material which the expert has relied on in making the report and give a summary of the conclusions reached. The report may need to be qualified and should indicate the basis for any opinion given. The right expert will be impartial, independent, credible and have the appropriate expertise.

The forensic accountant may where appropriate undertake a process of “asset-tracing” whereby assets are traced from their separate property beginnings through all of their mutations and demonstrates that the resulting asset in existence at the date of the separation/divorce is either the separate asset of one spouse, marital or a combination of the two. Asset-tracing techniques are relevant, particularly where ownership has become obscured as funds are transferred through the banking system or pooled from different sources. The forensic accountant’s role is also to understand the business/activities and to analyse the data—often large amounts of data are furnished and this has to be sifted through and analysed forensically using computer forensics, data mining techniques or background searches.

Pensions and their value will usually be addressed by other specialist advisers such as a pension consultant/actuary and there are several experts who offer this service in family law cases.

### 3. How to find the hidden assets—what are the grey areas?

Where do forensic accountants look for information? They will examine bank statements, credit cards and telephone bills, looking at the insurance brokers, financial planners, and stockbrokers employed by the husband and will be on the

lookout for safes for gold and jewellery, and Swiss or offshore bank accounts. There is a line of UK decisions allowing access to personal home computers and emails although there is presently no case law in Ireland in this area.

Any incomplete information provided which remains unexplained or unclear gives rise to suspicions, as does any expenditure which exceeds declared earnings, payments to or from unknown sources, unexplained peaks and troughs in earnings, unexplained transfers in bank statements and unexplained receipts on bank statements. Self-help remedies for the client should be utilised where appropriate. The client should initially be asked to comment on the credit card bills and assess travel by the husband and any information gleaned from the client should be passed on to the forensic accountant—this may work out cheaper for the client in the long run. It is worth remembering that, for example, in the case of *J.D v D.D.* referred to earlier, the wife spotted that her credit card bill had been paid from an undisclosed bank account.

It is beyond argument that the ownership of shares in a limited company constitutes an asset like any other and no argument can be made to omit same from an affidavit of means. Equally the fact that a spouse may be involved in a business or partnership with third parties does not diminish the liability to make full disclosure. There is a grey area here in that some spouses will argue that their business partners do not consent to information being disclosed, as it may prejudice the running of the business by the release of sensitive trading information. The legal position however is that the spouse must still disclose and provide vouching, yet in practice some lawyers seek to restrict access to this information by making same available for inspection only to the other spouse’s forensic accountant or providing a single copy of information on condition that it is not copied and that it is to be returned after a stated period. The proceedings in such cases are in camera in nature and the rules are strictly adhered to, hence a recipient spouse is obliged to observe strict confidentiality. See McKechnie J. in *B.D. v J.D.*<sup>6</sup> where he “agreed with the submission that the company and Mr. J.D. can be fully associated together and treated as one” and stated that the court “has jurisdiction over all the assets of the parties and can make use of them in the most appropriate manner feasible to make proper provision for the parties.”

In the case of an offshore trust or a family trust, the obligation to provide information applies as in all other cases— if one of the spouses is one of a number of named beneficiaries under a trust or settlement then all pertinent financial information should be provided so as to ascertain if the husband has received any benefit to date, and whether the trust is in fact a creature of the husband’s making and operated and directed by him. The court may have regard to the terms of a settlement created prior to or post the marriage under s.9(c) of the Family Law Act 1995 and s.14(1)(c) the 1996 Act, although a trust is unlikely to be considered one of the assets of the husband and in “the pot” unless he has derived some benefit from it or is certain to in the future.

Whether the trustees of an offshore trust are amenable to a discovery request is a separate issue although letters

rogatory to the UK High Court or other court may have some application—see the lengthy judgment of Budd J. in *O'D.(P.) v O'D.(J.)*.<sup>7</sup> The Brussels II Regulation may also have some relevance here.

In the case of *FJW v CNRTM & Others* the matter came before the court by way of a preliminary issue as to whether a particular trust came within the provisions of s.9(1)(c) of the Family Law Act 1995. The approach of McKechnie J. was that the assessment should be made at the trial date and once arrangements in the trust conferred a benefit on the spouses or either of them, then same should be treated as a settlement within the statutory provision of the 1995 Act. Accordingly information within the beneficiary's reasonable power of procurement, such as would be required to establish the status of the benefit or its potential, is relevant and discoverable.

The leading case on this issue is now the recent judgment of Abbott J. in the High Court case of *A.M.W v S.W.*<sup>8</sup> In an extensive illuminating judgment, the court addresses the issue of financial disclosure in regard to trusts, as to what may constitute a “fishing expedition” and what documentation should be reasonably provided to ensure full

disclosure is made. Abbott J. (at p.18 of the judgement) reviews recent English case law and sets out that there should be “proportionality” as to a “broad framework of enquiry” which amounts to “taking a cost benefit analysis approach in monetary and human terms towards the issue”. In deciding what information should be disclosed, the court must have regard to whether the requirement is “proportionate to the amount of money involved, the importance of the case, the complexity of the issues and to the financial position of each party”. Abbott J. refers also to the provisions of Art.41.3.2 of the Constitution which sets out that “proper provision” in the case of a divorce is only in place “where and only where” the court has “enquired into all the relevant facts which may touch on the adequacy and propriety of such provision”. Further Abbott J. states that same should apply whether the case be one of judicial separation or divorce. This judgement will be of serious import on the entire issue of financial disclosure from all its aspects in family law cases.

*This is an updated version of the paper delivered by Ann FitzGerald on December 6, 2008 at the Round Hall Annual Family Law Conference.*

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\*Partner: FitzGerald Solicitors, Cork.

<sup>1</sup> [1997] 3 I.R. 64.

<sup>2</sup> S.I. No. 358 of 2008.

<sup>3</sup> [2003 No. 69M] Decision of the Master of the High Court, July 27, 2005.

<sup>4</sup> S.I. No. 358 of 2008.

<sup>5</sup> Unreported, Supreme Court, December 8, 2004.

<sup>6</sup> [2005] IEHC 407.

<sup>7</sup> [2000] IEHC 173.

<sup>8</sup> Unreported, April 18, 2008.