

Understanding Financial Statements:

“There Is No Such Thing As A Stupid Question”

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For Presentation by: Gillian D. Marriott
Pro Bono Law Alberta
Calgary, Alberta

I. INTRODUCTION

Understanding financial statements can be problematic for those of us “lawyers” who became lawyers because of our aversion to math and numbers. My advice to you is to take the position that “there is no such thing as a stupid question” just stupid lawyers who don’t ask questions. Having said that there are steps that you can take to be more knowledgeable and aware of the information you need and how to get it.

One of the first things that most lawyers need to be reminded of is that family law is a form of civil litigation and therefore the Rules of Court do apply to the process, at least until the new ‘family law rules’ come into force (all references are to the Alberta Rules of Court, AR 390/68). As we do not know when that will happen I have continued to refer to the existing Rules in this paper. My second piece of advice to you is to “read them, know them and use them”. Too many lawyers get caught up in the “avoid court at all cost” mindset and actually increase the legal costs their clients pay as a result. At some point in time, if the matter is not moving towards settlement in a cost effective manner, the lawyer and the client should conduct a cost-benefit analysis and assess whether it may just be more cost effective to go to court, even if it is just to exert some pressure to bringing everyone to the table. I am often amazed by the number of chambers applications brought for disclosure, the number of times those applications have been adjourned, and the time that it has taken for the applicant to get to court. In most of those cases nothing can really happen in the case until at least minimum disclosure is exchanged.

When you are looking for financial statements to be disclosed either support or property is going to be an issue. Unless you obtain the documents nothing much is going to happen either way. If you are dealing with a support application the court can “guess” but that does not usually provide the best result. For example, in *Lapierre v. Campbell*, 2008 ABQB 529, the Defendant failed to provide the financial information necessary to determine his income. The Applicant was seeking child support and sought to have the father’s income imputed at \$50,000. The father was a self-employed designer. The Court indicated the difficulty of imputing income in part as a result of the father being “somewhat tardy in providing relevant information”. Justice Langston held that in the absence of any firm evidence establishing that the father was earning more than was disclosed in his income tax returns he was not prepared to impute an income of \$50,000 but rather added \$6000 representing personal benefits to his personal net income of \$30,588, notwithstanding the father had business sales in excess of \$75,000. He did however order that all “relevant” financial information was to be exchanged and that was to include

the financial statements. He also ordered costs against the father mentioning that the application was necessitated in part by his inability to provide timely and relevant information.

The “guess” can also be problematic in a property action. In *R.V.M. v. W.F.L.*, 2009 ABQB 138, Justice S.L. Martin commented that it was difficult to value the parties business as the only documents before the court were unaudited financial statements and a corporate income tax return for the year 2001. The parties were in a common law relationship and although they had separated in 2002 they continued to have a relationship until the fall of 2005. Notwithstanding trial took place in 2009 there was no other financial information provided to the court. The father kept the assets including the corporation after the separation but then sold them and started a new corporation. He did not tell the mother, who owned 49% of the shares in the original corporation that he had transferred the business to his new company. He had never accounted to her for any of the monies in the corporation or resulting from the sale of its assets. The court utilized the retained earnings for 2001, which it discounted for tax, and then extrapolated that into the 2002 year. The Justice then used the value of the capital assets from the 2001 statement but allowed for some depreciation and arrived at a value of \$134,000 for the company and provided the mother with her 49% share. My reaction to the decision is twofold: “who knows” if that is even close and how did it get to trial in the absence of the information being exchanged and disclosed.

II. WHAT DO YOU NEED AND WHY

So what do you do when you can't, for whatever reason, get the information you need, and in this case we are discussing financial statements and income tax returns, but this paper could be useful in a variety of areas. Firstly, you have to assess what information you want and or need and why you want or need that information.

If you are acting for the business owner this should be relatively straight forward, although there is always the client that doesn't want to share the information let alone the property and “pulling teeth” may seem to resemble the approach you may need to take. A long chat about “costs” as in those that he or she could wind up paying to the other side but also those he or she will incur in your legal fees may assist in resolving this, but not always. In the event it does not you, as the lawyer, need to address whether you want to continue to deal with a client who is not helping his or her case. Be wary of these clients or at least ensure that you have a large retainer and maintain it: quite frequently these are the clients who will

dispute your bill at the end of the day, whether they win or lose. You also have to consider the reputation you are establishing if you are not cooperating with opposing counsel in the exchange of necessary information. Remember, what goes around comes around and really at the end of the day there is likely going to be another client, but you only have one reputation.

If you are acting for the spouse of the business owner or the party that has not really been involved in the operation of the business you have to start asking questions and you can never ask too many. Quite frequently spouses know more about the operation of the business than they think they do but if not they can provide helpful information as to work patterns, staffing, fluctuations in income and the acquisition of assets (even if they don't know who owns what). So ask away.

In either situation if you are dealing with the type of case that may require an accountant or business valuator you should hire them sooner rather than later. Quite frequently you can phone the expert and have a short discussion as to whether they think their services will be needed. If you can obtain some preliminary information he or she can have review it and determine whether they need to be involved rather quickly. As you become more experienced you may be able to assess whether the expert is needed by reviewing the information yourself. When in doubt, however, have the expert take a look at it.

Whether your case involves the determination of income or the valuation of property there are certain documents which are essential and should be asked and provided as a matter of course. These include the basic documents asked for pursuant to a "**NOTICE TO DISCLOSE**" and include: personal income tax returns, bank accounts and credit card statements, financial statements, and corporate tax returns, bank accounts and credit cards. It is important to request all the schedules to the income tax returns, especially if the individual is operating a business but is not incorporated. Income tax returns can reveal a great deal of information but you need to have the complete return. That is why the computer printout that you can obtain from the CCRA offices is not that helpful, although it is better than nothing. Once you have this information then you can assess whether you need more, with the assistance of your expert if necessary.

If the case warrants it you may need to delve deeper in order to reach the stage where you "know the business". This involves requesting even more information. The objective is to obtain the most accurate picture as to the value of a business or the amount of an income. In either case you need to appreciate the nature of the business. If the individual is operating a sole proprietorship then the income tax returns are