# Identifying Corporate Aspects of Family Law

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# IDENTIFYING CORPORATE ASPECTS OF FAMILY LAW

It is easy to dismiss the area of family law as a practice that any lawyer can do. However, when one stops to consider all of the various elements that touch family law, it is not nearly so simple as it may appear at first blush. The family law practitioner is expected to understand and apply principles of not only support, parenting, and matrimonial property, but also real estate, wills and estates, income tax law, and corporate law. For a junior practitioner, this can be both overwhelming and a wonderful opportunity to develop a broad base of understanding and application of various legal principles.

Corporate law encompasses many aspects of public and private business, including sole proprietorships, partnerships, and incorporated companies. This paper does not attempt to address the implications of public corporations, including valuing shares in publicly traded corporations, or stock options and key employee compensation as it relates to support and property issues. Instead, the focus of this paper is the privately-held corporation which is more often encountered in smaller centres outside Edmonton and Calgary, and the impact of those corporations on matrimonial property division and support issues.

## ANATOMY OF FINANCIAL STATEMENTS

It is essential that a family law practitioner be able to understand the key elements of a corporate financial statement. The following is intended to be a very brief overview, rather than an in-depth analysis presented by an accountant.

Firstly, there is a difference between a Notice to Reader financial statement, a Review Engagement financial statement, and an Audited financial statement. In the first, the accountant who has prepared the financial statement is relying solely on the information provided by the business owner or bookkeeper for the Corporation. Therefore, it is only as good as the information that underlies the statement. The accountant has no way of verifying whether the records provided to him/her are actually correct and accurate. However, given the cost factor, this is the most common type of financial statement amongst small businesses. The Review Engagement financial statement provides negative assurance. The accountant performs sufficient analysis, inquiry and discussion with management to issue a statement that the financial statements are not material misstated. An audit opinion is not given. These types of financial statements are often required by banks if there is outstanding debt, and although more expensive than a Notice to Reader, they are less expensive than a full audit. The Audited financial statement provides an opinion on the financial statements, and the auditor will perform enough test procedures to obtain reasonable assurance about whether

the financial statements are free from material misstatement. While inherently more reliable, these types of statements are also more expensive, and therefore less common.

Financial statements are prepared in accordance with Accounting Standards for Private Enterprises (ASPE) or International Financial Reporting Standards (IFRS). In general, IFRS is required for publicly accountable enterprises, which eliminates most of the privately owned companies discussed in this paper. The old accounting standards, Generally Accepted Accounting Principles ("GAAP"), reported on historical cost basis, not value or worth. The conversion from GAAP to ASPE did allow for fair value adjustments to certain assets at the time of conversion to the new accounting standards. This is not something that was implemented by many corporations. Therefore, it is necessary to keep this in mind when using financial statements to assist in determining the value of a corporation.

***BALANCE SHEET***

The balance sheet of a financial statement is a snapshot of the assets and liabilities of the corporation as at the year-end date of that corporation. The information contained on the balance sheet is necessary to assist in determining the value of the Corporation for matrimonial property division purposes. Depending on the year-end date for the Corporation, it may be necessary to obtain updated values from the general ledger and other supporting documents, such as bank statements.

Within the category of Assets are usually the subcategories of current assets and capital assets. Current assets include cash, investments, inventory, and accounts receivable. Capital assets include the land, buildings, and equipment of the corporation at book value. Book value is the original cost less accumulated depreciation of the asset. Different categories, or classes, of assets are depreciated at different rates to reflect the lifespan of those assets.

Liabilities of a corporation should include both the short-term and long-term liabilities owing by the Corporation. Any amounts owing to the shareholder, usually referred to as a shareholder loan, will also appear as a liability on the balance sheet. The shareholder loan balance reflects money that is owed to the shareholder tax-free. Therefore, assuming the Corporation has liquid assets to pay to the shareholder, these funds are available to the shareholder without triggering further income tax implications.

The shareholder equity is a function of the Assets minus Liabilities, and includes share capital and retained earnings. Most corporations will only have common shares issued, and the share capital

work will reflect the adjusted cost base when no shares were issued. Common shares fluctuate in value, based on the changing equity in the Corporation.

In some circumstances, however, preferred shares may have been issued to one or more of the shareholders. Preferred shares typically have a face, or par, value for which they can be redeemed by the shareholder or retracted by the Corporation. While they are equity shares, they may have features more similar to debt, in that there is usually a predictable cash flow stream. If the preferred shares have dividend rights, which they usually do, dividends must be paid on the preferred shares before any dividends can be issued on the classes of common shares. There is usually a specified rate of return or mount of dividends to be issued, time frame for payment of the dividends, and date after which the shares can be redeemed or retracted.

Due to the similarity between preferred shares and debt, the easiest way to value preferred shares is the same as determining fair market value of a loan: present value is a function of future cash flows using a discount rate that reflects an accurate rate of return on investment, considering the risks involved with the preferred shares. If the preferred shares are convertible to common shares, that feature needs to be valued separately. Preferred shares are typically higher risk than debt, and therefore usually have a higher rate of return. Generally, preferred shares are valued using a discounted cash flow method (see below).

***INCOME AND EXPENSE STATEMENT***

The income and expense statement may also factor into a corporate valuation for matrimonial property division purposes; however, a Chartered Business Valuator or corporate accountant would be the qualified person to utilize this information for matrimonial property purposes. This part of the financial statement is more relevant to the family law practitioner when attempting to determine support issues under the *Family Law Act* or *Divorce Act*.

The gross revenue of a business reflects all money coming in from all sources to the business. In some types of businesses, there may also be information relating to inventory or cost of goods sold.

However, the gross revenue of a business is merely a reflection of the work generated by the business. There are always costs associated with running a business, which are reflected in the Expense portion of the statement. In some closely held corporations, there may be a blurring of personal and corporate expenses. These situations are the most difficult for support purposes, as it is necessary to untangle the personal and corporate finances to determine what amounts are