Prenuptial Agreements and Postnuptial Agreements –
Two Forensic Accounting Issues – Let the Lawyer Beware

Prior to marriage or during a marriage, the two future spouses or married spouses may choose to execute a prenuptial agreement, a postnuptial agreement or neither of these two agreements.

A **prenuptial agreement** is an agreement made before marriage, usually to resolve issues of support and property division if the marriage ends in divorce or by the death of a spouse.

A **postnuptial agreement** is an agreement entered into during marriage to define each spouse's property rights in the event of death or divorce. The term commonly refers to an agreement between spouses during the marriage at a time when separation or divorce is not imminent.

Marital property is property that is acquired during the marriage and that is subject to distribution or division at the time of marital dissolution. Generally, it is property, except gifts and inheritances, acquired after the date of marriage and before a spouse files for divorce. A prenuptial agreement or a postnuptial agreement can alter the general treatment of designated assets and liabilities at divorce.

Notwithstanding the social interpretation that prenuptial agreements and postnuptial agreements are unromantic, these agreements attempt to deal with the financial issues in the marriage. Marriage is, among, hopefully, many other things, an economic partnership between the spouses. In the writing and execution of prenuptial agreements and postnuptial agreements, a myriad of legal issues are involved. Both parties need to be represented by family law attorneys. A sizable number of financial, accounting, and tax issues are also involved. Both parties need to be represented by accountants who are well versed in those non-legal issues.

This article discusses two such non-legal issues that should be addressed before either a prenuptial agreement or a postnuptial agreement is signed. Issue number one is identifying and accounting for <u>all</u> the assets and liabilities to be designated as either separate to each party or earmarked according to the agreement of the parties. Issue number two is determining the fair market value of all assets and liabilities either as of the inception of the marriage in the case of prenuptial agreements or at a designated time during the marriage in the case of a postnuptial agreement.

Identifying and Listing Assets and Liabilities

All assets and liabilities for which each propertied spouse (or future propertied spouse) is responsible must be delineated. The details are to be listed as of a certain date. For those assets where the propertied spouse (or future propertied spouse) is a partial owner, the percentage of ownership should be established.

ASSETS

1 – Cash on hand – Count the cash, if significant, and sign off on the amount.
2 - Bank accounts – Named owner(s), name of financial institution, account number, and balance of each account
3 - Securities accounts – Named owner(s), name of financial institution, account number, and balance of each account
4 – Collectibles – Itemized description, quantity of each identifiable item, and original cost
5 - Loans receivable – Named creditor(s), name of debtor(s), terms including interest rate, payment frequency, and repayment schedule
6 - Real estate – For each parcel: Title holder(s), date of purchase, and original cost
7 - Other valuable personal possessions – Detailed listing, owner(s), dates of purchase, original cost
8 - Equity in privately owned businesses – List of equity owners and their percentage ownership, future spouse's date of acquisition, and acquisition cost
9 - Educational degrees and licenses – Narrative of educational history and career history
10 - Patents, trademarks, literary works, and other intellectual property – Details of each item such as acquisition costs and the acquisition process
11 - Celebrity goodwill – Brief narrative as to history of development of this asset

LIABILITIES

Prepare a detailed list of all relevant liabilities, such as unpaid bills, unsecured loans, mortgages, contingent liabilities (pending litigation, loan guaranties, etc.) The details will include date the party became indebted, payment terms, and all other pertinent details.

Calculating the <u>Inception</u> Fair Market Value of Assets and Liabilities

The fair market value of each asset and liability as of a certain beginning date for purposes of the prenuptial or postnuptial agreement forms the base for future calculations of marital value. These values will enable an expert at a future date, if necessary, to assist attorneys in establishing the value of the components of the marital estate. That is, the "down-the-road" values of the components of the marital estate will be affected by the beginning values as originally established by the expert pursuant to the prenuptial or postnuptial agreement.

ASSETS

1 – Cash on hand – The fair market value equals the actual counted amount.
2 - Bank accounts – The fair market value equals the actual balances in the accounts.

3 - Securities accounts – In most cases, the financial institutions will provide the market value of publicly traded securities. In those cases where the fair market value of one or more securities or investments is not readily available, the forensic accountant in his/her role of professional valuation expert will be available to estimate that value.
4 – Collectibles – Specific appraisers may need to be hired to estimate the value of each collectible. In some cases, reference books or Internet data are available.
5 - Loans receivable – The forensic accountant as valuation expert should be engaged to estimate the value of these assets. The expert must utilize appropriate methodology, which includes, among other things, comparing the stated interest rates to comparable market interest rates as well as ascertaining the extent of bad debts or doubtful collectibility.
6 - Real estate – Real estate appraisers should be engaged to estimate the value of each parcel of real estate.
7 - Other valuable personal possessions – Other appraisers, such as fine arts appraisers, may be needed. The forensic accountant may be needed to estimate the value if specific appraisers cannot be located.
8 - Equity in privately owned businesses – The forensic accountant, as business valuator, must be engaged to estimate the fair market value of these assets. The methodology to be utilized will vary from entity to entity depending upon the industry, the availability of data, the accuracy of data, and the availability of market comparable data. Sometimes the expert will discover hidden assets, including other businesses, during the performance of analytical procedures as part of the methodology in estimating the fair market value of a privately owned business.
9 - Educational degrees and licenses – In New York State, enhanced earning capacity is still a marital asset. The forensic accountant will provide a viable estimate of fair market value.
10 - Patents, trademarks, literary works, and other intellectual property – These intangible assets present valuation challenges. It is important to engage the services of a valuator, such as the writer of this article, who has specific experience estimating the value of intellectual property. Some of the most challenging assignments will be to value these assets.
11 - Celebrity goodwill – This asset was defined by Justice David B. Saxe in the Mann v. Mann case in 1995. "As applied to an individual, it is frequently understood to mean the good reputation of the individual in that business or profession so that future business will probably continue to be generated by that individual." Once it is established that the individual is a celebrity, it is important to address the value at the outset. The valuation methodology will vary from case to case. Several of our firm's professionals are equipped to estimate the fair market value of this asset.

LIABILITIES

The fair market value of the liabilities must be determined. The fair market value of current liabilities, those that will be paid in full generally within twelve months, will be their book value adjusted for accuracy. Regarding long-term debt, it would be a mistake to accept the book value as the fair market value. Adjustments need to be made to book value of long-term loans based upon the loans' actual interest rates in comparison with current market interest rates. The forensic accountant as valuator will utilize market data and analytical procedures in order to make the appropriate adjustments and render an opinion as to the fair market value of each liability.

As has been briefly narrated, identifying each of the assets and liabilities in a particular case and establishing their individual fair market value should not be undertaken without the assistance of accounting experts who are trained and experienced in identifying, locating, and valuing all varieties of assets and liabilities, both tangible and intangible.