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Rosenberg v. Rosenberg

Personal vs. enterprise goodwill in a multimember professional practice

In many jurisdictions, the distinction between personal and enterprise goodwill in divorce cases is critical. That's because most states treat enterprise (or business) goodwill as a marital asset subject to division but consider personal (or professional) goodwill nonmarital. The typical rationale for the distinction is that personal goodwill represents the business-owner spouse's future earnings capacity (and future earnings generally aren't considered a marital asset).

In a 2024 case of first impression — *Rosenberg v. Rosenberg* — a Florida appellate court addressed whether nonmarital personal goodwill includes the personal goodwill of *all* the medical practitioners in a multimember practice. This decision may have significant implications for divorce cases involving the values of closely held businesses.

2 types of goodwill

Goodwill is an intangible asset that represents the value derived from a business's name, reputation, customer loyalty, location, products and other factors that attract customers but aren't separately identified. *Enterprise* goodwill is goodwill associated with the business as a standalone entity.

> Instead of excluding the personal goodwill of all the practice's physicians, the wife's expert excluded only the husband's personal goodwill.

Conversely, *personal* goodwill reflects an individual owner's reputation, skills, education and experience. It's usually not easily transferrable to a buyer if the business is sold.

Dueling experts

In *Rosenberg*, the husband, an anesthesiologist, was a shareholder in a 35-shareholder corporate anesthesiology practice. The wife successfully moved to vacate a consent judgment in the couple's divorce proceedings after discovering that the husband had concealed a multimillion-dollar sale of the practice to another corporation. At trial, the parties' valuation experts took different approaches to calculating personal and enterprise goodwill.

The husband's expert estimated the practice's net sales price was $71.66 million, consisting solely of personal and enterprise goodwill. He also estimated that about half of the practice's revenue was derived from non-exclusive contracts with surgery facilities that requested specific anesthesiologists from the practice or elsewhere. He reasoned that this revenue was attributable to the personal goodwill of the preferred physicians and that the remaining revenue (from exclusive contracts that required surgery facilities to use the practice's physicians) was attributable to enterprise goodwill.

Based on this analysis, the husband's expert concluded that half of the total goodwill ($35.83 million) was personal goodwill, which is excluded from the marital estate under applicable legal precedent. The remainder represented enterprise goodwill, a marital asset, and the husband's portion was worth approximately $1 million.

The wife's expert used a similar approach. However, instead of excluding the personal goodwill of all the practice's physicians, he excluded only the husband's personal goodwill. The expert estimated this amount at 3.55% of the business's value, reasoning that the husband was more productive than other physicians. So, he concluded that the value of personal goodwill to exclude from the marital estate was approximately $2.544 million ($71.66 million times 3.55%).

Therefore, the expert estimated that the value of the enterprise goodwill was $69.116 million ($71.66 million minus $2.544 million). The husband's pro rata share of that amount was about $1.97 million, nearly double the opposing expert's estimate.

Appellate court decision

The appellate court upheld the trial court's adoption of the husband's expert's methodology. The appellate court reasoned that the principle that personal goodwill is a nonmarital asset "requires that the personal goodwill of the 35 physicians must be excluded; it is collectively a [nonmarital] asset of each of the respective physicians."

The court explained, if all 35 physicians divorced their spouses simultaneously and each attributed $1.97 million to business goodwill, roughly $69 million would be treated as marital property — nearly the entire value of the practice. This result would be contrary to the principle that personal goodwill is nonmarital property.

2 methods for allocating goodwill

Dividing a business's goodwill into personal and enterprise goodwill is complex. The husband's expert in *Rosenberg* (see main article) devised a simple, commonsense approach for distinguishing between the two. However, not all cases lend themselves to this approach.

Some situations may call for a more structured, scientific technique to allocate goodwill into its components. Two common methodologies are:

1. The multi-attribute utility model (MUM). This model involves examining various attributes that indicate personal or enterprise goodwill and weighting them based on their presence and relative importance. Examples of attributes that indicate personal goodwill are the owner's abilities, skills and judgment, reputation, and personal referrals. Enterprise goodwill might be indicated by the business's staff, reputation, marketing and branding.

2. With-and-without method. This approach estimates the value of personal goodwill as the difference between the business's current value with the individual in question and its value without that individual. To determine the "without" value, an expert might estimate the business's reduced cash flows without the benefit of the individual's talents. Alternatively, the expert might estimate the cost of replacing the individual with someone who has comparable qualifications.

Ramifications for other proceedings

The appropriate treatment of goodwill varies based on jurisdiction, state law, legal precedent and case facts. Given the significance of *Rosenberg* and its ramifications for other divorce proceedings, the appellate court certified the issue for consideration by the Florida Supreme Court. As of this publication date, it's uncertain whether or when the state's high court will take up the issue. ■

M&A accounting: How valuators can help with purchase price allocations

A company's in-house accounting personnel may not be familiar with current accounting rules for allocating the purchase price in mergers and acquisitions (M&As). Here are four questions to help report these transactions properly under U.S. Generally Accepted Accounting Principles (GAAP).

1. What's the purchase price?

The purchase price (also called the fair value of consideration transferred) is obvious when the buyer pays with cash. But the following types of consideration complicate matters:

- Stock and stock options,
- Replacement awards, and
- Contingent payments.

A business valuation professional can help management convert these payment terms into a current cash-equivalent price. For example, a discounted cash flow analysis may be used to value earnouts, which are payable only if the acquired company achieves predetermined financial benchmarks. Using this technique, expected earnout payments are discounted to present value using a rate that reflects risks related to achieving financial benchmarks.

It's also important to determine whether the terms of any deal include arrangements to compensate the seller (or existing employees) for future services. Under GAAP, these payments aren't included in the purchase price.

2. Which assets and liabilities were transferred?

The next step involves identifying all tangible and intangible assets and liabilities transferred in the deal. Examples of *tangible* assets are accounts receivable, equipment and inventory. However, *intangible* assets

may be harder to identify because they're generally not reported on financial statements unless acquired from a third party. Unreported intangibles might include internally developed brands, patents, customer lists and other intellectual property.

The buyer also may be liable for contingent liabilities, such as environmental claims and pending lawsuits. Overlooking identifiable assets and liabilities often results in inaccurate financial reporting.

3. What's the fair value of acquired assets and liabilities?

The heart of M&A accounting is allocating the purchase price to acquired assets and liabilities based on their fair values. Fair value is the price an entity would receive to sell an asset (or pay to transfer a liability) in an orderly transaction between market participants at the acquisition date. Book value may be a reasonable proxy for many tangible assets and liabilities. A real estate or machinery appraiser can help with fixed assets.

Valuing intangibles is more difficult. Although GAAP rules recommend using market-based inputs to estimate the fair value of intangible assets, comparable transaction data is often lacking. So valuators usually turn to the cost approach or the income approach.

Under the cost approach, fair value equals the cost to reproduce or replace the asset. This method is most relevant for internally generated intangibles, such as software or proprietary formulas.

The income approach derives value from an asset's future economic benefits. For example, using the relief-from-royalty method, value is based on the cost savings of not having to pay a royalty to use the intangible asset. Alternatively, valuators sometimes perform discounted cash flow analyses, in which an asset's cash flows are projected and discounted to their net present value.

4. What's the value of goodwill?

Goodwill is the amount of the purchase price remaining after fair value has been assigned to all identifiable assets and liabilities. In subsequent accounting periods, most companies that follow GAAP must test goodwill for impairment annually. Goodwill becomes impaired if its fair value declines below the amount reported on the balance sheet.

In lieu of annual impairment testing, private companies that follow GAAP may elect to amortize goodwill over 10 or fewer years. However, a company that elects this practical expedient must test for impairment if a triggering event (such as the loss of a major customer or an economic downturn) happens.

Get it right

Do-it-yourself purchase price allocations can be perilous. It's important to work with a valuation professional to ensure fair value measurements are supported by market data and other reliable valuation techniques. This can help minimize subsequent write-offs and potential lawsuits from stakeholders. ■

Does your expert use AI?

Court's damages ruling suggests caution

Everyone seems to be jumping on the artificial intelligence (AI) bandwagon these days. Much like the internet back in the 1990s, AI has the potential to improve efficiency and lead to more robust research and analyses. Although AI has many practical applications, the technology needs humans to guide it and verify its output.

This lesson was reinforced in the recent case of *Matter of Weber*. The court ruled that an expert's AI-generated output was unreliable and, therefore, his opinion was inadmissible as evidence.

Case facts

In *Matter of Weber*, a trust beneficiary objected to the trust's accounting. He alleged that the trustee breached her fiduciary duty by retaining certain real estate in the trust and using it for her personal benefit. The beneficiary claimed that the trustee should have sold the real estate, which would have allowed the trust to enjoy significant profits and invest the proceeds in the Vanguard Balanced Index Fund.

The beneficiary hired a financial expert to support his breach claim and alleged damages. However, the Saratoga County Surrogate's Court found that the beneficiary failed to prove that the trustee breached her fiduciary duties. It also rejected the expert's damages calculations, including a supplemental damages report.

Criticisms of AI tools

To cross-check the calculations for his supplemental damages report, the expert used Microsoft Copilot, a generative-AI chatbot similar to ChatGPT.

However, he couldn’t recall the inputs or prompts provided to Copilot or state the sources Copilot relied on. He also couldn’t explain how Copilot works or arrives at its output.

> The discrepancies “question the reliability and accuracy of Copilot to generate evidence to be relied upon in a court proceeding.”

To test Copilot’s accuracy, the judge entered the following prompt on a court system computer: “Can you calculate the value of $250,000 invested in the Vanguard Balanced Index Fund from December 31, 2004, through January 31, 2021?” Copilot returned a value of $949,070.97, which differed from the expert’s conclusion. The court ran the same query on two different computers that generated values of $948,209.63 and just over $951,000, respectively. Although the discrepancies weren’t significant, they “question the reliability and accuracy of Copilot to generate evidence to be relied upon in a court proceeding.”

When the judge asked Copilot, “Are you accurate?” The chatbot replied, “My accuracy is only as good as my sources so for critical matters, it’s always wise to verify.” When asked whether its calculations are reliable enough for use in court, Copilot responded, “When it comes to legal matters, any calculations or data need to meet strict standards. I can provide accurate info, but it should always be verified by experts and accompanied by professional evaluations.”

The court noted that the use of AI is expanding rapidly across various industries. However, that doesn’t make its results admissible in court. Given the “rapid evolution” of AI and its “inherent reliability issues,” the court held that before AI-generated evidence is introduced, “counsel has an affirmative duty to disclose the use of [AI] and the evidence sought to be admitted should properly be subject to a *Frye* hearing prior to its admission.” (The *Frye* standard is the benchmark used in New York to evaluate the admissibility of expert testimony.)

Not ready for prime time

AI can be a valuable tool, but as the *Weber* case demonstrates, it presents numerous challenges when used in a litigation setting, and its output should always be independently verified. AI currently isn’t — and will likely never be — a substitute for the skills and judgment of experienced professionals. ■

Leverage AI tools to fight fraud

Artificial intelligence (AI) has emerged as a game-changing tool in forensic accounting investigations. With its ability to rapidly analyze vast amounts of data and uncover hidden patterns, AI helps businesses stay ahead of financial crime.

Prevention applications

AI refers to the use of computer systems to perform tasks that typically require human intelligence. It can involve visual perception, speech recognition, decision making and language translation.

AI applications may be well suited for fraud prevention, helping businesses strengthen their internal controls by:

- Identifying vulnerabilities before they're exploited,
- Automating fraud risk assessments and compliance monitoring, and
- Enhancing real-time decision-making, reducing human error in financial oversight.

Moreover, when would-be fraudsters think a company uses AI fraud-detection tools, they may think twice before engaging in dishonest activities.

Smarter investigations

Unlike traditional rule-based detection methods, AI-powered tools continuously learn and refine their fraud-detection capabilities based on real-time data. This means AI can help:

Reveal anomalies faster. AI analyzes transactions, behaviors and financial records at scale, flagging irregularities that may indicate fraud.

Uncover hidden connections. By recognizing subtle patterns and relationships between data points, AI can expose complex fraud schemes that might otherwise go unnoticed.

Reduce false positives. AI minimizes the number of false alarms, allowing forensic accountants to focus on high-risk cases rather than wasting time on legitimate transactions.

When suspicious behavior is identified, AI tools can also improve the speed and accuracy of external forensic accounting investigations.

AI in action

As fraud schemes become more complex, AI-powered detection has evolved beyond traditional methods such as neural networks and rule-based systems. Today, forensic accountants are leveraging advanced tools that improve accuracy and anticipate emerging threats.

For instance, deep learning models enhance neural networks by processing vast datasets to detect subtle fraud patterns. They can analyze structured financial transactions and unstructured data, such as text and images. Similarly, natural language processing enables AI to scan emails, contracts and other communications for suspicious activity, such as phishing attempts or fraudulent invoices.

Another major development is graph analytics, which maps relationships between transactions, accounts and entities. This may be particularly useful for detecting complex money laundering and insurance fraud schemes.

Explainable AI ensures that fraud detection models provide clear, justifiable reasons for flagging transactions, making AI-driven audits more reliable. Some businesses may even use generative AI tools to simulate fraudulent transactions and train detection systems to recognize new fraud tactics before they occur.

Reshaping the fight against fraud

AI tools are rapidly advancing, becoming increasingly reliable and affordable. Although AI streamlines fraud investigations, human expertise remains essential. A forensic accountant can conduct in-depth analysis, interpret data and provide expert testimony in fraud cases. ■

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