Lifestyle Analysis
A Stepping Stone to the Future
Part Two of a Two-Part Article
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Last month, we discussed the fact that a lifestyle analysis provides a great deal of useful information to clients and their counsel, the court or other users, and also serves well as a stepping stone to the development of a realistic personal living expense budget for post-divorce years. We provided an in-depth look at planning. We conclude herein by addressing:

1) data gathering;
2) processing;
3) analysis;
4) adjustment; and
5) reporting phases of a lifestyle analysis job.

DATA GATHERING
Data gathering, although boring, is a condition precedent to the development of a properly documented lifestyle analysis engagement. An early, if not first step of the data-gathering process, should be a client interview to determine those accounts from which the majority of living expenses were paid by each of the spouses, as well as those accounts from which no living expenses were paid, such as investment or brokerage accounts with no check-writing privileges, or business accounts that are being considered separately as part of a business valuation or other professional service. Account statements, checkbook/ account registers, copies of deposit slips and deposited items, and copies of cancelled checks, receipts and invoices (to the extent available) should be gathered for each of these accounts and/or requested from banks or other financial institutions, which cover the entire period of the decided-upon analysis.

After the primary bank and credit card accounts have been identified and the associated data gathering set in motion, the client should be questioned about smaller, i.e., less frequently used, credit cards or other accounts where additional living expenses, if any, could possibly have been paid during the relevant time period. This will help ensure the analysis is complete for each selected time period. Reviewing the client's Statement of Net Worth and/ or credit report in conjunction with this line of inquiry will help you and the client to remain focused on the objective of ensuring that all the relevant data that exists is collected. If any additional accounts are identified as a result of this process the account statements, account registers, cancelled checks, receipts and invoices (to the extent available), etc. should also be gathered and/or requested from the bank or other financial institution.

PROCESSING
Many tools, e.g., software programs, are available to the CPA or other financial expert who will be performing the detailed analysis. Some techniques are more efficient and more flexible than others, allow for better utilization of staff, and make it much easier to

understand the details underlying each line item or component of the analysis that is summarized in the lifestyle report.

Certain techniques allow the user to drill down to more and more detailed levels with ease, and make it easy to reclassify items from one category to another, prove completeness over the period analyzed through reconciliation of account balances to account statements, and allow for the creation of adjusting entries to account for items paid for by means other than a bank account or credit card, for example payments for medical and dental insurance withheld from an employee's paycheck, or adjustments to properly reflect items such as employee business expenses, which are paid for by the employee for convenience purposes but subsequently reimbursed by the employer.

Before you hire a CPA or other practitioner to perform the work, I recommend asking how he or she has performed such analyses in the past, and what they recommend, given the facts and circumstances they will be confronting in the matter at hand. Doing so will allow you to quickly ascertain whether you are dealing with a savvy professional who uses appropriately sophisticated tools suitable for the task.

ANALYSIS

After the underlying financial data has been gathered and processed, the results are reviewed for reasonableness and to identify items where additional information is required. For example, the processing of the data initially provided may reveal that there are a certain number of checks that cleared the bank for which copies of canceled checks or other supporting information was not provided. At this juncture, follow-up requests are made to investigate whether or not any additional relevant information pertaining to these items can be obtained. Another example would be a payment or payments made against a credit card for which no credit card statements were provided. Once identified, the additional account statements are requested, and when obtained, the charges thereon are recorded to correct for the previously missing information. In addition, assignment (i.e., categorization) decisions are reviewed and reclassifications are made when necessary to better reflect the purpose of an expenditure — e.g., payments to Wal-Mart may have been assigned to a general merchandise category when upon inquiry of the client, or review of register receipts the client has retained, it turns out the purchases were predominately for groceries from a Super Center.

As a practical matter, no person keeps every receipt from every purchase, which would allow for a more or less perfect classification of expenses in the format laid out in the NYS Statement of Net Worth, but reasonable classifications can be made based on the evidence produced. It is not practical, for example, to break down every grocery store purchase or every drugstore, Costco or Wal-Mart charge into the categories of groceries, prescriptions, cleaning supplies, laundry supplies, school supplies, tapes, CDs, beauty aids, cosmetics, cigarettes, beer, books, newspapers, pet supplies, party supplies, etc., nor is it necessarily worth the cost of attempting to do so, but classification by vendor name and placement into the most appropriate expense category given the clients' representations as to what they generally purchase from the vendor is usually sufficient for the user to make a reasoned and informed decision.

The costs v. benefit, and feasibility of providing more and more detailed item by item specific classifications is something that always must be considered from a cost and reasonableness perspective. There is often little to be gained, for example, by segregating grocery store purchases into foods, beverages, cleaning supplies, pet supplies, beauty supplies, etc., and even less to be gained by separating soap from toothpaste purchases or Ivory from Dial, Colgate from Crest, or Dawn from Palmolive. The expense analysis should generally be organized to as closely match the expense reporting section of the NYS Statement of Net Worth as possible, with reasonable alterations given the specific facts and circumstances of each matter and bearing in mind the many "other" and "miscellaneous" categories included therein.

Cash withdrawals from ATM machines or tellers are easy to identify and quantify over any given time period, but it is generally not feasible to determine exactly how such monies were spent. A client may represent and testify that such amounts were used for grocery, drug store, and convenience store purchases, and at gas stations, dry cleaners and for take-out food, restaurants, and movies, and the amounts may appear reasonable based on the information obtained from the review of other banking and credit card records. If you are dealing with a client that is a bit of a hoarder, like many accountants tend to be, he or she may actually have most of their receipts for at least a period of time, which could allow for a sampling if such evidence is deemed helpful.

In most cases, simply classifying a reasonable amount of ATM and teller withdrawals under the heading of "other expense" is reasonable. The exception is where large amounts of cash are withdrawn or relatively large amounts are very frequently withdrawn and the explanation appears unreasonable. Where that occurs there is always the possibility that a significant amount of cash may have been stashed away in a shoe box or coffee can or sent to a relative overseas, for example.

Outside of an admission it may be difficult to determine exactly what happened to such monies. The analysis, however, will identify the time frames and quantify the amounts involved. Expenditures associated with non-recurring or special events that were paid for during the period being analyzed should be identified and segregated for reporting purposes. This may include expenditures associated with once-in-a-lifetime events associated with a child such as a religious ceremonies or educational attainments, for example a confirmation or bar mitzvah, or a graduation party or presents (assuming they are considered large enough to warrant such treatment). This may also include special events such as expenses associated with a wedding, or a casualty loss or other catastrophe.

ADJUSTMENT

The analysis process described above may identify gaps or otherwise reveal that certain adjustments must be made in order for the presentation to be complete and/or fair to the parties. Health insurance, for example, may have been deducted from one or both of the parties' paychecks rather than paid by check. When this occurs, an adjustment reflecting the cost of such coverage needs to be separately recorded. It is always a good idea to inspect W-2 forms and year-end paystubs for withholdings other than those associated with income or Social Security taxes, and make sure they have been given due consideration. My preference, as noted earlier, is to present taxes paid and/or withheld as a separate line item since I believe it is easier to understand and helps the end user to more readily interpret the findings. Business-related expenditures that an employee made for the convenience of his or her employer is another area, which, if substantial, may be identified as requiring adjustment as a result of the previously described analysis process. It is common for employees to sometimes pay business expenses for their employer, which are subsequently reimbursed. In order to be fair and avoid overstating the amount of personal living expenses incurred, the payments made by the employee must be offset by the reimbursements received from the employer. Such reimbursements may or may not be shown on the employee's paystub. The employer may write a check to the employee separate and apart from payroll, or in rare instances, could even repay the employee from a petty cash fund. The specific details of such arrangements should be explored with your client. The preceding examples identify adjustments commonly encountered, but is not intended to be an all-inclusive list.

REPORTING

Reporting the results of the lifestyle analysis work can be done in many ways. A formal written narrative may not be required unless the matter is headed to trial and you believe such a narrative will help the judge make a well-informed decision by highlighting and explaining some of the nuances that may not be as apparent to an end-user as they are to those who have been intimately involved with the process for months.

Preparing numerical schedules (statements or reports) that quantify annual living expenses other than income taxes, which can be shown as a separate line item, is an effective means of delivering the information in a clear, concise, and easy-to understand manner. I have found that communicating the information on three levels is usually most effective, as it allows the user to make a quick, broad-based assessment and also to investigate the underlying details with as much scrutiny as he or she desires. I refer to these three levels as: 1) the high-level summary; 2) the summary level; and 3) the detailed-level reports or schedules.

The high-level summary provides a one-page snapshot of annual living expenses by major category — e.g., automotive expenditures, charitable contributions, educational expenditures, food and beverage, housing, household maintenance, insurance, merchandise (including clothing), recreational expenditures, transportation and travel, utilities, unreimbursed medical and dental expenditures, miscellaneous, and other.
The summary level breaks down each category further by showing the total annual amounts incurred for each vendor assigned to each of the high-level categories. For example, "automotive" would show the total annual amounts charged to Exxon-Mobil, Shell Oil, Dealership A, Dealership B, Ford Credit, EZ-Pass, Parking Garage A, Parking Garage B; etc.

The detail level provides that same higher level subtotals and totals, but also shows each particular payment or charge that was assigned to each vendor. In other words the date and amount of each EZ-Pass replenishment that occurred during the year would be shown and would sum to the amount appearing at the summary level. Likewise, the date and amount of each car loan or lease payment made during a year, the date and amount of each fill-up charged on a credit card, the date and amount of each payment made to a dealership for service and repairs, etc., would be shown and sum to the amount appearing at the summary level.

The user is able to quickly understand what has occurred, and identify differences in spending behavior during each period of time presented in the analysis. The reports provide a judge or arbitrator with a thorough understanding of the normal and reasonable living expenses and standard of living established during the marriage, the amount and time period over which any spending behavior the judge may consider wasteful occurred, and other information the judge may find helpful for purposes of making his or her maintenance and equitable distribution decisions in the matter.

THE FUTURE

The lifestyle analysis report provides an excellent framework for your client to begin a budgeting and financial planning process that will help them to optimize their new freedom and new happiness and build a sound and secure financial future. The client will have a good idea of what expenses are required to maintain a happy and healthy life-style, and will be able to adjust them to reasonably reflect child care and other children-related costs in comparison to those existing during the marriage; remove expenses related solely to his or her former spouse; and substitute new expenses for an apartment or home in place of those existing during the marriage. By monitoring their cash flow as they chart their new course in life, build a new career or business, rededicate themselves to an existing one, or otherwise move forward in their post-divorce years, they can take corrective measures when necessary to keep their plan on track or adjust it for changes that occur as nothing in life remains static.

It is also an opportune time to reassess their current needs for insurance, investments and an emergency fund, college planning, and commit to begin developing longer range goals associated with retirement planning and estate planning. Life is dynamic and circumstances change, but now is the perfect time for your client to dedicate themself to an ongoing financial planning process that continually monitors and assesses their means and financial needs and obligations, and the tax consequences of their decisions, so that they can develop peace of mind and serenity, and be as happy, healthy, secure, and wealthy in their new life as they possibly can he.

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