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Lifestyle Analysis: Guide to an Accurate and Defensible Net Worth Statement

MICHELLE M. SMITH, CFP, CDEA

A net worth statement (or case information statement depending on its name in your state) is *the* operative document in a divorce. Whether aggressively trying to settle or preparing your client for court, an accurate statement of net worth is the vehicle in which all parties involved must drive. All too often this document is prepared in a rushed fashion, is fraught with mistakes and inaccuracies, and as a result, harmful to case credibility. The net worth statement should be like the foundation of a house—well designed and solid with structural integrity. The time and care initially invested in the preparation of this document will yield exponential dividends as the case progresses and builds.

For example, a critical component of many cases is support related and lifestyle issues. An accurate accounting and reconstruction of expenses strengthens your position and can be crucial for determining and substantiating support. This requires more than giving the client the budget section and saying “Go home, complete this and bring it back in a week”. Clients are overwhelmed by reconstructing their financial lives and organizing and collating the data. Many law offices have no system in place to cross check and reconcile the data even if the client does manage to produce everything. Both the monied and non-monied spouse has their own reasons for the ensuing paralysis and procrastination in gathering this data. It is overwhelming, time consuming, involving hard to obtain documents if you are not in control of the family finances, and in general, a seemingly ‘useless’ and annoying thing to do.

This article will set forth my Rules of Thumb and Tips in guiding your clients and your office through an accurate, detailed, defensible lifestyle analysis.

DETERMINE THE TIME PERIOD MOST REFLECTIVE OF THE MARITAL STANDARD

Do not assume the past 12 months is accurate. Before or during separation, some clients elevate or, severely cut back depending on the ‘advice’ they get from friends and family (or counsel) early on. Some elevation or cut backs are legitimate. Some are not. It is our job to determine the normalized standard. Two or three years of look-back and analysis may be necessary; sometimes 12 months is sufficient. Every case is different; therefore, determine for each case the appropriate time period for analysis.

DOCUMENTS TO REQUEST (THE ‘RAW DATA’)

Start asking questions such as: “What are all your sources of spending? What credit cards do you use? What checkbooks do you have? Do you have brokerage accounts that have check-writing privileges? Where do you take your cash advances? What debit card do you use?”

Michelle M. Smith, CFP, CDEA, is President of Smith Divorce Financial Solutions, LLC in New York City and the Co-Founder and Senior Managing Director of Family Wealth Management for Alexandra & James Co., also in New York City, serving investors with between \$2 million and \$30 million. She is a Regional Director for The Institute for Divorce Financial Analysts™ and has 18 years of extensive expertise in financial planning and investments. She has been featured on CNBC, ABC’s ‘Good Morning, America’, Fox’s ‘Good Day, New York’, and has been quoted frequently in many newspapers and magazines. She has also created a Practice Management paper for the American Bar Association’s Family Law Section titled Lifestyle Analysis Preparation.

People often forget accounts they use, and in this day and age of bonus miles and points depending on the card, you will need a comprehensive list of their particular sources of spending and how each is used.

Clients may also have one or two primary 'operating accounts' where they pay most of their bills, and then there are the 'sometimes used' accounts. You need them all, but more important, understand the uses of each account. For example, I have clients who have two joint accounts that are linked through the same bank. Perhaps the wife is in control of joint checking account #1, and the husband is in control of joint checking account #2. Understand how and who uses what.

Tip: Many banks provide a summary statement where the first page lists all accounts and balances. I make a copy and write next to each account "Husband uses; Wife uses; jointly used; Vacation Home Account," etc. This way, as the analysis progresses, I have this information right next to each account number. This becomes particularly relevant if any tracing is necessary.

Credit Card Year-End Summary Statements

These are easier to work with than individual statements but if no year-end summary is provided for certain cards, monthly statements are necessary.

Tip: Make three copies. One for you, one for client and one for back up folder. I have the client sit in my office and write down the purpose of the expense right next to the entry directly on the copy of the statement for proper allocation. Codes are helpful as well. For example, if there is an expense to Bed Bath & Beyond, a code could be "VH" for Vacation Home and I know that expense was to purchase house wares for a second residence. Other useful, easy codes are, 'W' for Wife's expense; 'H' for Husband's expense, 'K' for Kids.

Checking Account Statements with Copies of Scanned Checks

Tip: As stated above, have the client write down the purpose of the expense directly on top of the copy of any scanned check or automatic debit in checking account statements.

Explanation of Benefits Statements from Insurance Companies

These statements help to pin down this elusive category as these forms always list 'Patient

Responsibility' amounts. They are usually easy to download from the insurer's Web site.

Tip: Ask the client if they submit insurance reimbursement claims regularly and on time. These EOB statements may not contain the whole picture if claims are erratically submitted. In that case, have the client call all doctors and request the time period's invoices/statements for exact costs.

Credit Reports

These are a must to verify liabilities, credit score, mistakes and any hidden issues.

Copies of Loan Application Statements (Including Auto Leases)

Passport

Not all destinations stamp passports, but copies of the passport pages can be useful to verify or discover travel.

Tax Returns

I prefer obtaining the actual filed copies from the IRS. This can be done easily with a \$39.00 check payable to the IRS and downloading Form 4506 from www.IRS.gov

Copies of Gift Tax Returns

Frequent Flyer Miles

Obtain balances in all frequent flyer accounts.

Membership Rewards Point Balances for Credit Cards

Include any special incentive program with account balances that can be redeemed for gifts, travel, gift cards.

Tough and Often Inaccurately Represented Categories

Cash Advances: Walk the client through a typical day, a typical week, a typical season of holiday tips for which they may pay in cash, for example.

Gifts: Clients never realize how much they spend on gifts. Have them list all people they buy for, occasions, how much is usually spent on each person/event. Do not forget teachers, gifts if clients have children and children's friends, birthday parties.

The Superstore Category: Long ago, I would query the client and spend wasteful time on exactly what items they purchase in stores like Wal-Mart, Target, etc. I now list these items separately under a Miscellaneous 'Other' category called Superstores. This is for a variety of expenses one cannot remember. It is deserving of its own category due to the impossibility of precise allocations of expenses.

Insurance: In addition to medical insurance, have the client provide you with current policy and annual premium notices which shows coverage, term and annual premiums for insurance on all cars, houses, apartments, boats, etc. It is easier to tabulate this way than to sift through checks and charges since many people forget to pay premiums, pay them late, two may be paid in one month, etc.

Expenses Paid from a Business Account: This requires business checking account records and credit card records with a similar process as outlined above. The goal is to sit with the client to determine and allocate expenses that are personal and part of the marital and family lifestyle that may not be appearing on any records.

TAKING A STEP BACK, OR, THE 30,000 FEET ABOVE THE GROUND VIEW

An easy way to initially get a sense of the marital (or one party's) spending is to take 12 month's worth (or whatever time period you are analyzing) of statements, add all together, and divide by 12. (Be sure to back out actual checks from the checking account paid to the credit card companies as that would be double counting). If there are four credit cards and two bank accounts, and all six sources have \$240,000 worth of expenses that were charged and paid, you know you are dealing with approximately \$20,000 per month in expenses. It isn't exact, it isn't precise, but it is a good initial start to get a 'feel' for the spending. This process will tell you if something seems 'off' and whether the numbers don't make sense compared to the documents and the client's income (expenses that are way beneath income would point to accumulated savings/investments, which should be reflected in the account balances/assets of the marriage, or, if expenses far exceed marital income, this may point to significant debt incurred to maintain lifestyle, or, gifts from family members, or, additional accounts omitted (either purposefully or simply forgotten). This means you need to ask more questions.

ADDITIONAL TIPS

Let the client talk and take a lot of notes. I ask clients many questions and query them on various aspects of their lifestyle. Where do you normally travel? Is there a set vacation you take each year, just the two of you, or annual trips with the kids (skiing in winter, summer rental house in summer)? I ask how they travel. What types of hotels, coach or first class, do you use miles to upgrade, redeem points for upgrades? If there is substantial discussion about using points/miles to upgrade, a current points/frequent flyer statement may not be reflective of this type of history. Have the client call the company and obtain the account's history so you have a fact pattern.

- Be organized; set up a system that works for you. I have binders, labels, color codes and duplicate copies of everything. (Comes in particularly handy when producing the Statement of Net Worth and Lifestyle Analysis with a back up binder containing all copies, fully coded. You've done your homework, your expert has done their homework and you have a document you can count on for accuracy).
- Be consistent and commit chunks of time for continuity.
- Step back at each stage of analysis and ask *if it makes sense*.
- Get contact information of all client advisors/resources and be sure client has authorized you and your office/expert to speak with them as needed (we have an intake sheet allowing for many contacts to be added).
- Always source your information- especially with a comprehensive lifestyle analysis, it is easy to lose track of where you got what information.
- Inventory, Inventory, Inventory- this must happen within two days of receipt of anything, and be sure to note how and when received (example- client produced and mailed it, obtained from opposing counsel/client, obtained from company benefits manager, etc.).

CONCLUSION

A comprehensive lifestyle analysis can be a springboard from which possibilities for its use

are endless. I have seen lawyers and judges use an accurate spending report as a starting point for determining true cash flow from a business minus or pending formal valuations (or, for a business that may be impossible to value).

This can be a four to eight week process. Allocate the time internally or hire a Certified Divorce Analyst or other forensic specialist to assist; you will reap strategic benefits and stay in control of your case and its outcome.