Lifestyle is in the Eyes of the Beholder

Much attention, some would say excessive attention, has been given to the matter of determining the lifestyle "enjoyed" during the marriage. In theory, it almost sounds rather simple – but as we all know, in practice this has become anything but simple, and is often an expensive exercise. The purpose of this article is to attempt to address, from the perspective of litigation oriented accountants, some of the issues involved in developing a truly reliable/accurate lifestyle analysis (LSA).

Number of Years – Probably the first issue to address in doing an LSA is the timeframe, the number of years we are to include. The putative need is to determine the lifestyle during the marriage. However, there has been no definitive statement as to exactly what that means – and indeed, since there are many situations that are not the norm, there may not be an easy way to define such. Are we talking about the lifestyle during the last year of the marriage, the last three years, the last five years, or the entirety of the marriage? There seems to be a default to using the last three full years of the viable marriage. Even then, perhaps there was a separation of a couple of years prior to the filing of the divorce complaint, or dramatic (and often not even dramatic) changes or fluctuations in the income/fortunes of the marital estate, of the different agendas of the litigants, etc. – by no means can three years be considered inviolate. By way of example, our firm and the author of this article handled the accounting part of the remand on *Crews*. We used as many years of the entirety of the marriage for which we had support – which was eight years prior to the filing of the complaint.

One possibility to consider – in order to shorten the time span necessary, facilitate the job and save on costs – would be to take one year and assume that one year was fairly representative of the lifestyle for whatever period you might otherwise analyze. Obviously, this is something that has to be thought through carefully by counsel and client, and probably would be best if it were agreed to by both sides so as to avoid a battle between dissimilar analyses. For most families, as long as income has been fairly constant over the past few or several years, and as long as the spending habits haven't changed dramatically, using one year (most likely the year prior to the filing of the complaint or perhaps the year before that) would probably provide a fairly reliable conclusion.

Discovery/Access to Records – From the perspective of a forensic accountant who has done many LSA's, the matter of access to records is our biggest problem with this type of work and the biggest obstacle for our doing it in a timely, complete, efficient and cost effective manner. It is all well and good to decide that we need to do an LSA that covers the last three years of the marriage. However, all too often, we are faced with significant discovery problems - the records are simply not readily available. Many times, after several items of correspondence back and forth, and finger pointing, it is finally agreed by all that authorizations need to be sent to various financial institutions so as to secure needed documents. This brings in a whole slew of additional problems – such as who signs for what, coordinating signing between the parties and counsel; determining to which institutions authorizations have to be sent. Even when we know the institution, we need to find out where to send the authorization. Then there's following up with these institutions when they inevitably take their time, dealing with institutions that have merged, no longer exist or did not retain the records the way you want them; the cost of securing this type of information; dealing with problems such as we are provided with bank statements but no cancelled checks so that it is literally impossible to determine how the money was spent…. If our charge is indeed to provide a detailed and complete LSA, these types of issues may present insurmountable obstacles. The way to address this is to get practical, and accept the need for certain agreed to shortcuts or limitations. Unfortunately, all too often, one side or the other has a problem with that type of approach – whether the problem is reasonably or unreasonably expressed.

Non-Recurring Items - What do we do about aberrations, unusual or non-recurring items? We had a case not long ago where the couple bought a car every two years. Since we were doing a several year LSA, we felt that using the car purchases as such (the family carried no debt) was reasonable, and we simply averaged them over the several year LSA. The other side (in what was clearly a ridiculous and unreasonable position) suggested that the purchase of the cars were non-recurring aberrations which should not be factored into the LSA at all. It took quite a bit of arguing to get them to simply agree that, at the least, a reasonable lease expense proxy should be used. Perhaps that was reasonable, though frankly the reality of how this family lived was a more reliable barometer of the LSA than concocting a hypothetical lease expense. In a similar vein, are items such as paying for a wedding, a once-in-a-lifetime family vacation, covering a large uninsured loss, etc. It would probably be reasonable to either do some form of averaging or leveling of these expenses, or perhaps to recognize (again depending very much on the financial wherewithal of this family unit) that these non-recurring type expenses were in lieu of what otherwise would have been savings. After all, savings are a component of lifestyle – aren't they? In addition, at some point, a slew of non-recurring expenses makes them (at least in the big picture) recurring.

The Savings Component - That brings us to what we candidly believe is one of the least understood and least respected elements of what nevertheless is stated as a component of lifestyle – savings. We have seen, both explicitly stated by judges and implicitly factored in decisions, as well as how handled by attorneys, the disrespect (or perhaps more accurately the lesser respect) given to savings as compared to spending. The system typically more readily accepts spending as a lifestyle component than it does saving. The hypothetical two identical families, each with a $200,000 lifestyle – but one that spends $150,000 and saves $50,000, and the other that spends the entire $200,000 – tend to be treated very differently when it comes to the determination of alimony/support. More often than not, the family that spends it all will have that fully reflected in the alimony/support calculation. On the other hand, with a family that saves a significant portion of its income, the alimony/support decision tends to be less, sometimes considerably less, basically ignoring or reducing the savings element.

The savings component issue is one of the more complex issues that need to be addressed in an LSA. Part of it is kind of simple - how much of the salary went into the bank/brokerage account. But, from there it gets much more complicated. For instance, what if money went in and out of a brokerage account during the year? It is important to know what the net change was. Let's add to the confusion and complexity. One or both of the spouses has a 401(k) plan from the employer, as well as other exotic type benefits – perhaps a Flexible Spending Account, stock options, deferred compensation, awards, thrift savings plan, etc. In addition, some of these (typically the 401(k) if not others) have matching contribution components paid for by the employer, and not reflected on any W-2 or tax return.

It is fair to say that the elective type savings (i.e. the 401(k) plan and thrift savings plan) are part of the disposition of the income for the year – that part being in the form savings. What makes this a little more complex is that the cash flow never went into the hands of the marital unit, but was directly deducted from the payroll before it every reached the family's bank account. Nevertheless, it is earned cash income which was intentionally set aside – invested, saved. Now add to the complexity an employer match. That is additional compensation, over which neither party has any direct immediate control. If it is considered additional earnings, is it also additional savings?

It gets far more complex when we deal with things like options, and deferred compensation. It gets even more complicated when the employee (one of the litigants) has the ability to elect how much is going to be received in cash versus how much is going to be deferred or received in an option or otherwise. Are these options additional income which are therefore savings? We believe that the majority thinking in this area is that options are additional compensation, and thus would be additional savings. Clearly, the area of the savings component – including what is in the savings component and how it was handled – can be an extremely complex area. The presentation of same can be a critical element in arriving at the appropriate level of alimony/support.

Inflation - Another element to consider, particularly if developing a multi-year LSA, is the matter of inflation. If only doing one, two or even three years, an inflation adjustment is probably not all that important – especially in recent years when inflation has been quite modest. However, if doing a five or ten year or more LSA, inflation may be something that needs to be considered. Once we consider inflation, we have to address whether we should be looking at some broad based across the board CPI adjustment – or whether we should zero in on specific items. The latter, while perhaps more accurate, is certainly more difficult, more time consuming and therefore more expensive.

By way of example, for the last several years, the cost of telephone service has come down dramatically. Some people have even dropped their land-based phones in favor of only using cell phones. That brings in another factor – while the absolute cost of telephone service has declined significantly over the last several years, almost everyone now has a cell phone. Thus, while the cost of telephone service has come down (negative inflation, or deflation), usage has expanded to where a cell phone is now almost a necessity.

Or, consider the cost of housing. Mortgages (putting aside the matter of real estate taxes) typically are a long-term constant. However, over the last few years interest rates have declined. Therefore, carrying even the same principal balance on a mortgage is now less expensive than it was ten years ago. Should that be taken into account, and if so to what extent? Would it be relevant to assume that there should be a refinancing at today's lower rates even if that refinancing has not happened as yet.

To the other side, in general real estate taxes, health insurance premiums and private schooling costs have increased faster than has inflation. To what extent should such specific adjustments be made rather than taking a broad based CPI. Clearly, depending on the extent this approach is taken, inflation adjustments, or adjustments based on the change in the costs of how people live, might result in dramatically different results/conclusions.

The proper completion of an LSA can be far more difficult, time consuming and complex than it might seem at first glance. Whether it be the sheer volume of transactions/statements that have to be reviewed, the complexity of the pay structure, the complexity of how these people lived, and what was normal or not in their spending habits – all of these combine to make this area potentially very complex, and at the same time extremely important in the eventual proper and fair conclusion of a divorce action.