

Constructing a Lifestyle Analysis

A Multipurpose Analytical Tool in Marital Dissolution Engagements

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A lifestyle analysis is a multifaceted analytical tool that includes several detailed analyses and can be very helpful in marital dissolution engagements. It involves a more in-depth analysis than the financial affidavits typically required in the divorce process.

A lifestyle analysis provides an overview of each party's sources of income and expenses, historically and into the anticipated future, using the facts and circumstances unique to each particular case. The analysis pulls together all considerations and provides a visual representation of disposable cash and estimated expenses over the remaining life expectancy. Through illustration of the aggregate sources of income and expenses over time, one can discern which funds are actually required, and whether these funds are available to cover expenses, i.e., to maintain standard of living. The details in the analysis serve as verification of net worth (assets and liabilities), historical earnings, historical standard of living, and reasonable expenses going forward.

The process also yields relative analyses, such as percentage comparisons and trend analyses, historically and into the anticipated future. Ultimately, the lifestyle analysis provides an illustration of net worth at a point in time, as well as accumulation over time—an informative tool when assessing alternative settlements. The conclusions provide valuable financial analytics, as well as charts, graphs, and demonstratives.

A lifestyle analysis assists the marital dissolution process in many ways, including assessing division scenarios and settlement alternatives (such as different alimony proposals), assisting with negotiations during mediation, and supporting the trier of fact in determining the equitable distribution of marital assets and alimony needs. These analyses can be quite complex and should be performed by a competent financial expert or forensic accountant who will be able to define and analyze

the financial aspects of a case as well as effectively communicate the findings and conclusions.

Factors Considered for Spousal Support

Careful consideration must be given to the factors listed in a specific state statute when determining historical lifestyle (standard of living) and reasonable need into the future. Spousal support statutes vary state by state and certain factors impact the process, such as length of marriage and ages of the divorcing parties. Nonetheless, if spousal support is a consideration in the case, the factors most frequently weighed in the determination are each party's earnings ability and need—that is, the disadvantaged spouse's need (for alimony) and the obligor spouse's ability to pay. Hence, the applicability of "lifestyle analysis," also known as a "pay and need analysis."

Sources of Financial Information Used in a Lifestyle Analysis

The following documentation, usually requested for three- to five-year time ranges, provides financial information used in the analysis.

- Tax returns
- Brokerage accounts
- Retirement, pension accounts
- Bank, debit card, credit card statements
- Personal financial statements
- Loan applications
- Insurance policies (especially those with cash surrender value)
- Mortgage statements
- Trusts, wills
- Deeds to homes, vehicles, motorboats, etc.
- Annuities, stock certificates, deposit box
- Business valuations
- Appraisals of tangible items (artwork, collectibles, etc.)

The Process: Building a Lifestyle Analysis, With an Illustrative Example

There are many variables, assumptions, and moving components to consider when constructing the lifestyle analysis, and the underlying facts and circumstances can be quite different from case to case.

Listing of Assets and Liabilities

During the preliminary stages of the lifestyle analysis, the financial expert/forensic accountant obtains pertinent data from the aforementioned documentation in order to assemble the marital balance sheet, which may also be referred to as an inventory listing of assets and liabilities. Depending on the facts and circumstances, this process may

also include denotation or determination of separate versus marital assets and liabilities (examples of separate assets are inherited or premarital assets).

Table 1 is an illustration of a noncomplex marital balance sheet as of May 31, 2020, which is organized by asset type and includes a proposed division for each line item. Note: the client or attorney may request multiple proposed division scenarios in preparation for mediation or trial; thus, the balance sheet may become a fluid analysis during settlement negotiations or the financial expert may choose to save and present multiple versions.

Table 1: Marital Balance Sheet

#	Description	As of Date	Value	Debt	Equity	Child or Separate Account	Proposed Division			Notes
							Marital	Husband	Wife	
Real Estate										
1	House - Memphis Drive	5/31/20	750,000	(100,000)	650,000		650,000	0	650,000	0/100
2	Condo - Memphis High Rise	5/31/20	500,000	(100,000)	400,000		400,000	400,000	0	100/0
	Real Estate Split						1,050,000	400,000	650,000	
Cash and Investments										
3	Bank Checking Acct ending xxxx	5/31/20	10,000		10,000		10,000	5,000	5,000	50/50
4	Savings Checking Acct ending xxxx	5/31/20	50,000		50,000		50,000	25,000	25,000	50/50
5	Brokerage Acct ending xxx	5/31/20	250,000		250,000		250,000	125,000	125,000	50/50
	Cash and Investments Split						310,000	155,000	155,000	
Retirement Plans										
6	Wife's 401k	5/31/20	1,000,000		1,000,000		1,000,000	0	1,000,000	0/100
7	Husband's 401k	5/31/20	1,000,000		1,000,000		1,000,000	1,000,000	0	100/0
	Retirement Split						2,000,000	1,000,000	1,000,000	
Automobiles & Other										
8	Car- wife	5/31/20	35,000		35,000		35,000	0	35,000	0/100
9	Car- husband	5/31/20	35,000		35,000		35,000	35,000	0	100/0
10	Household Goods	5/31/20	50,000		50,000		50,000	25,000	25,000	50/50
	Automobiles & Other Split						120,000	60,000	60,000	
Totals - Assets			3,680,000	(200,000)	3,480,000		3,480,000	1,615,000	1,865,000	
								46%	54%	
Separate Assets										
11	Wife's inherited parent's checking account	5/31/20	50,000		50,000	50,000				
12	Wife's jewelry	5/31/20	40,000		40,000	40,000				
13	Husband's gun & watch collection	5/31/20	75,000		75,000	75,000				
Liabilities - credit cards										
14	American Express ending xxxx	5/31/20		(4,500)						
15	Master Card ending xxxx	5/31/20		(3,000)						
	Subtotal			(7,500)						<i>Agree to split 50/50, accustomed to paying off debt/bills each month.</i>

The financial expert will usually assess historical and current earnings to estimate ongoing earnings.

The balance sheet, just like a business financial statement, is but a reflection of a point in time. At first glance, the sample balance sheet appears to represent an equitable division of the marital estate (the 46 percent to 54 percent division is actually slightly advantageous to the wife). However, there are many more facts and circumstances present in this case that are not fully captured by the listing of assets and liabilities. Thus, the next steps in the lifestyle analysis will assist the divorce settlement process by considering and analyzing additional details.

Example Fact Pattern

For purposes of our example, assume the following facts:

- 30-year marriage
- Each spouse is 55 years old
- No children under 18
- An accustomed “nice” standard of living
- No business ownership interests
- Both spouses are employed and compensated with salary (one spouse’s salary is much higher than the other) and have retirement benefits, but no fringe benefits
- No alimony is offered in the proposed settlement

Wife is not sure whether the proposed division of assets will accommodate her into the future, as alimony has not been offered in the proposed settlement. Per her counsel’s recommendation, she has retained a financial expert to assist in determining spousal support using historical lifestyle and the need for alimony, and the obligor’s ability to pay.

Review of Historical Earnings, Determination of “True Income,” and Estimate of Ongoing Earnings Level

At this point, the financial expert will usually assess historical and current earnings to estimate ongoing

earnings. Following the abovementioned fact pattern, Table 2 presents a comparison of individual gross earnings of the divorcing parties, as well as selected trend metrics. Gross earnings can be reviewed as-is, or net of retirement deductions. Also, many couples file tax returns as married filing jointly; however, for this exercise, it can be meaningful to analyze each spouse’s historical earnings, based on the facts and circumstances of the case.

During this part of the analysis, it is critical to consider perquisites; if present, they may affect the determination of “true income.” Our example’s fact pattern assumes no business interest and no fringe benefits, so further analysis is not necessary. Perquisites may be more common for private business owners or individuals who receive additional compensation in the form of benefits, such as non-business-related expenses, personal life insurance (not key person business insurance), country club dues, vehicle allowances, children’s private school tuition payments, and the like. These types of fringe benefits would otherwise be paid with after-tax dollars, but if paid by a business as a benefit, they ought to be considered a form of compensation.

The expert must then review the trend in earnings. Is salary static? Does salary fluctuate? Does a salary increase potentially reflect a promotion or raise during the observed period? Is salary dependent on sales or company profit? Answering these types of questions may require insight from the client. Average earnings may be more relevant if an individual has a fluctuating salary history, while current or most recent earnings may be more relevant for an individual with a steady salary history. The financial expert will then make an informed selection of salary that reflects ongoing earnings.

Table 2: Comparison of Earnings

Wife's Earnings					Husband's Earnings				
Year	Gross Salary	Pre-tax Deductions-401k	Implied Gross Earnings after Deductions	Gross Monthly	Year	Gross Salary	Pre-tax Deductions-401k	Implied Gross Earnings after Deductions	Gross Monthly
2015	\$75,000	\$23,000	\$52,000	\$4,333	2015	\$450,000	\$23,000	\$427,000	\$35,583
2016	76,500	23,000	53,500	4,458	2016	500,000	23,000	477,000	39,750
2017	78,030	23,000	55,030	4,586	2017	875,000	23,000	852,000	71,000
2018	79,591	24,000	55,591	4,633	2018	505,000	24,000	481,000	40,083
2019	81,182	24,500	56,682	4,724	2019	525,000	24,500	500,500	41,708
<i>Average 2015-2019</i>	\$78,061	\$23,500	\$54,561	\$4,547	<i>Average 2015-2019</i>	\$571,000	\$23,500	\$547,500	\$45,625
<i>Most recent (2019)</i>	\$81,182	\$24,500	\$56,682	\$4,724	<i>Most recent (2019)</i>	\$525,000	\$24,500	\$500,500	\$41,708
Selected	\$81,182	\$24,500	\$56,682	\$4,724	Selected	\$525,000	\$24,500	\$500,500	\$41,708

Source: Tax Returns Prepared by ABC CPAs

Wife's Gross Monthly Earnings as a % of Husband's Gross Monthly Earnings 11% Using selected values from above
 Wife's Earnings as a % of Total (Wife's & Husband's) 10% "
 Husband's Earnings as a % of Total (Wife's & Husband's) 90% "

The financial expert may also provide analytics on percentages of total earnings. In the above example, wife's earnings represent 10 percent of total selected earnings and husband's earnings represent 90 percent of total selected earnings. This is a critical analysis that leads to the next steps of the lifestyle analysis, as it illustrates the ability to pay and potentially a need for alimony.

Note the breakdown of annual figures by month in Table 2. Counsel, clients, and the trier of fact commonly review monthly expenses (historical and budgeted), so it can be helpful to show a column for the monthly figures.

The next phase relates to the marital status quo, i.e., the historical standard of living, and assessing a realistic forward budget. The financial expert may be asked to assist with the budgeting process or the budget may be created independently of the financial expert.

Potential for Further Investigation

The process of determining the "true income"—assessing earnings and historical lifestyle and estimating forward expenses—may lead to further avenues of investigation. As the financial expert begins to assemble the variables (facts and circumstances unique to the case), this stage of the process may reveal fraudulent activities, such as hidden assets or dissipation of marital assets. Thus, the expert must be prudent and wary of facts that reflect possible

arrangements in anticipation of marital dissolution, such as changes in compensation and trends in expenses.

Assembling the Sources and Uses of Cash

The expert will then conduct a pay and need analysis for each spouse, assembling and calculating the sources of income, estimated taxes, disposable cash, and uses of cash over the remaining life expectancy of each divorcing party.

While assembling cash inflows and outflows in connection with the lifestyle analysis, the expert should review retirement plans and annual contributions, brokerage accounts, cash and savings accounts, annuities, insurance plans, and the like, to estimate respective average rates of return as well as varying estimated tax obligations. The expert might even consider the individual's risk tolerance in relation to future rates of return. For example, a person with ample disposable cash may be willing to invest in riskier ventures with a higher expected return on investment, and a person with limited disposable cash may choose to invest more conservatively.

For each spouse's analysis, income less deductions and estimated taxes will yield net disposable cash. The next output will deduct estimated expenses from disposable cash and yield either a deficit or surplus. This analysis is then extrapolated over the remaining life expectancy of wife and husband (the expert may choose to rely on the life

expectancy tables provided by the Social Security Administration or another reliable source).

In the next steps, the financial expert, upon determining that there is a need for alimony and an ability to pay, will add alimony to the recipient (not taxed) and subtract it from the obligor (not deductible), to review the impact on the final deficit or surplus for each party.

Following our fact pattern, the pay and need analysis supported alimony of \$5,000 per month for approximately 12 years, assuming both husband and wife retire at age 67. Without alimony, wife would have been in a deficit each year, quickly reducing her cash and investments balance, while husband would have enjoyed an even higher surplus and hefty wealth accumulation. Although statutory law and judicial precedent varies from state to state, the analysis supports the various factors typically considered—such as length of marriage, marital lifestyle, and each party’s earnings ability and need—in determining the disadvantaged spouse’s need (for alimony) and the obligor spouse’s ability to pay.

Results and Illustrations from the Lifestyle Analysis

Ultimately, the lifestyle analysis illustrates—collectively and on an annual basis for the couple’s remaining expected life—sources of income, tax obligations, and net disposable cash before and after expected (estimated) expenses. Another common output illustrated is the deficit or surplus based on the aforementioned inputs.

The financial expert may build scenarios for the client based on varying inputs, including different potential settlements of assets, varying alimony payouts (both amounts and duration), and even one-off life events, such as a future payoff of a home or a drop-off in children’s tuition expenses. Keep in mind, however, that the analytical model is highly sensitive to any variable changes, so extreme caution is advised, including limiting the sharing of work product to printed versions (electronic or physical) and not sharing the Excel working files.

This analytical tool is valuable because it can illustrate pre- and post-alimony scenarios, as well as various alimony scenarios, and lead to further analyses, such as comparisons of relative gross earnings or after-tax disposable cash. See Figure 1 for an illustration of wife and husband’s net disposable cash (after-tax and including alimony) using our fact pattern. These percentages and illustrations allow comparison on relative terms, not just dollar amounts, which can be particularly valuable in high net-worth cases, and assist the settlement process or the trier of fact.

The financial expert may build scenarios for the client based on varying inputs, including different potential settlements of assets, varying alimony payouts (both amounts and duration), and even one-off life events.

Figure 1: Comparison of Disposable Cash

<i>After-Tax Measures: Include Alimony, Before Expenses</i>			
Years Beyond Divorce	W Net Disposable Cash	H Net Disposable Cash	% W to %H
1	\$105,845	\$280,115	38%
2	107,010	286,631	37%
3	108,198	293,257	37%
4	109,410	300,015	36%
5	110,647	306,908	36%
6	111,908	313,939	36%
7	113,194	321,111	35%
8	114,506	328,426	35%
9	115,844	335,887	34%
10	117,209	343,498	34%
11	118,602	351,261	34%
12	120,022	359,179	33%

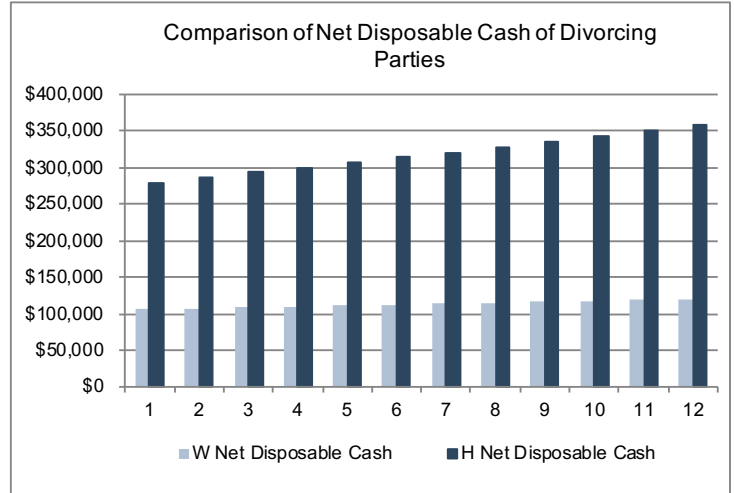
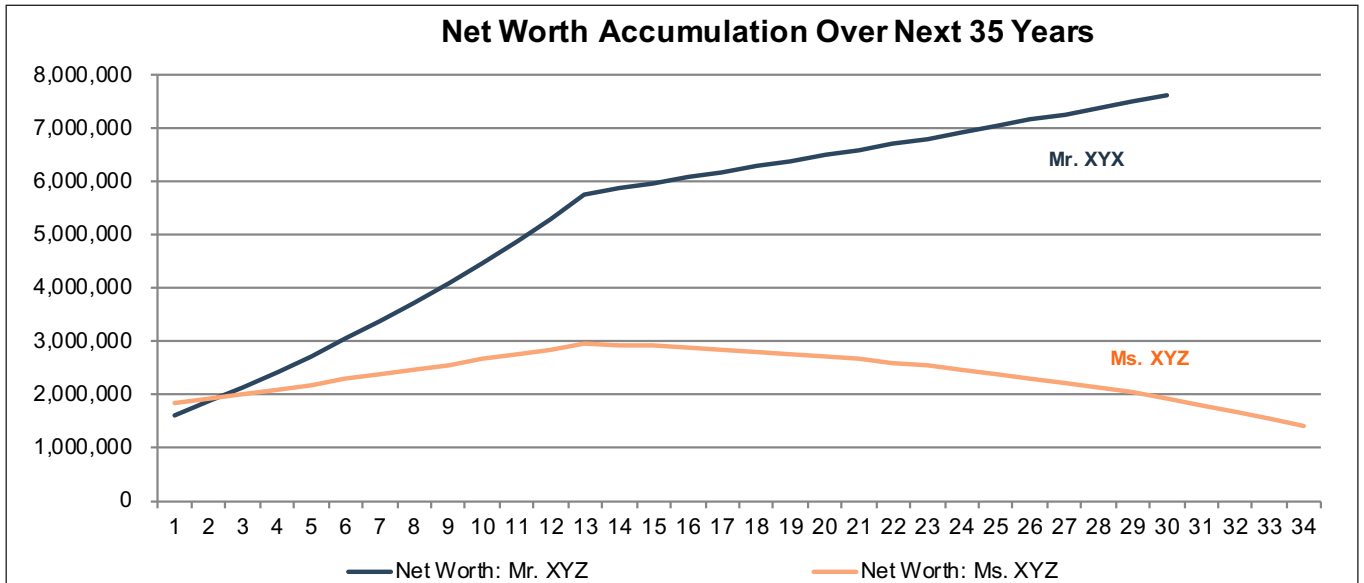


Figure 2: Net Worth Accumulation Analysis



Another valuable result of the analysis is the ability to assess the parties' net worth at multiple points in time. The net worth accumulation analysis (Figure 2) demonstrates the differences or similarities in the division of net worth at the date of divorce and at the date of death. Additionally, it illustrates the net worth accumulation between those two points in time. This may highlight that what appears to be reasonable at a point in time may or may not be reasonable when extracted over time. When used as trial demonstratives, these illustrations can assist the trier of fact in determining the disadvantaged spouse's need and the obligor spouse's ability to pay.

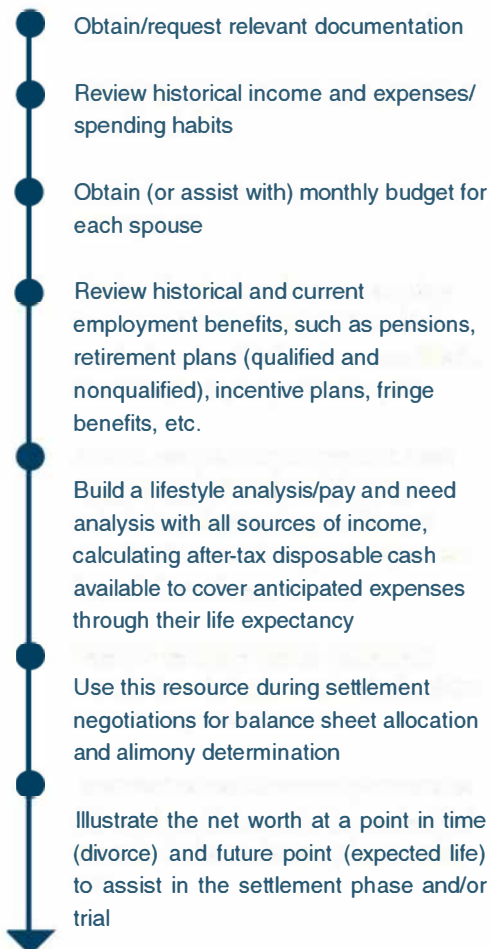
Concluding Thoughts

Because no two cases are alike, with facts and circumstances varying from case to case, all components of a lifestyle analysis must be carefully assessed. In many

cases, complexities beyond those presented in the above example require further investigation. For example, in some cases it may be necessary to involve a vocational expert, value business ownership interests, assess personal versus enterprise goodwill, distinguish between marital and separate assets, value vested and nonvested stock options and restricted stock, or review deferred and incentive compensation.

In financial situations that may be scrutinized by regulators, courts, tax collectors, and other potential adversaries, an expert's financial, economic, and accounting experience and skills are invaluable. The details in the lifestyle analysis can help determine the equitable distribution of marital assets as well as alimony needs. These complex analyses are best performed by a competent financial expert who will be able to define and quantify the financial aspects of a case and effectively communicate the conclusion. **VE**

Sample Timeline of Events



Karolina Calhoun is a vice president at Mercer Capital and a member of the firm's litigation group. She provides valuation and forensics services for family law, gift and estate planning, commercial litigation, transactions (M&A), and other matters related to privately held businesses, dissenting shareholders, intellectual property, and personal goodwill. Ms. Calhoun also provides financial reporting and valuation analyses related to mergers and acquisitions, intangible assets, private equity portfolio companies, contractual agreements, and complex capital structures. These engagements have been conducted for the purposes of mergers and acquisitions, buyouts, financial reporting, estate and gift taxes, allocation of purchase price, litigation support, shareholder dissent, buy-sell agreements, dissolutions, financing, and business planning. Prior to joining Mercer Capital, Ms. Calhoun was a senior auditor at Ernst & Young in its Audit and Assurance Services practice. She is the valuation chair of the AICPA's Forensic and Valuation Services Conference Committee and a member of the AICPA's CFF Task Force. In 2018, Ms. Calhoun received the Forensic and Valuation Services (FVS) Standing Ovation award. She served as the president of the Memphis chapter of TSCPAs in 2019 and 2020. Email: Calhounk@mercercapital.com.