

The Preparation of a Preliminary Financial Affidavit in a Collaborative Divorce

By Patricia L. Young CFE, FRP and Edward S. Sachs CPA/ABV CFF CrFA

Though not required, preparing a preliminary financial affidavit in a Collaborative Divorce matter can be helpful to both the client and the attorney and becomes the footprint for the initial session with the Neutral Financial Professional. This financial affidavit becomes the ground work for future financial affidavits prepared by the financial expert which will contain more detailed information and have documentary support and analysis. It also serves to provide the client and attorney with a better understanding of the need for a Neutral Financial Professional and an early picture of how the financial issues may be settled. Completeness of the preliminary financial affidavit is very important to getting the collaborative process off to a good start and helps to build trust with the opposing side. Identification of assets and liabilities is the most important issue, not their values. The use of “To Be Determined” or “To Be Valued” for the value of assets is preferable when the values are subject to opinion. This article will provide many helpful hints to the attorney and their client.

When you are attempting to prepare a preliminary financial affidavit without the benefit of reviewing the client’s records beforehand, many of the income and expense amounts may have to be estimated. In order to minimize the number of estimated amounts you should ask the client to bring certain records with them to the initial meeting. Though not required in a collaborative divorce, the list of documents that are normally required by Mandatory Disclosure should be given to the client prior to the meeting, as these financial records will be needed to prepare the financial affidavit and serve as an excellent beginning to unraveling the financial situation of the parties. In addition, there are other records that are necessary to calculate monthly expenses and they will be identified throughout the article as they are needed.

As you go through the sections of the financial affidavit, you need to ask the Client about each income and expense item. Specific items requiring your attention will be discussed in detail.

Some general items to keep in mind as you prepare a financial affidavit are:

It is extremely helpful for review and recognition purposes to document how you arrive at the numbers or what your sources are. This may be done by adding notes directly to the financial affidavit. Income sources may include “2009 W-2”, “2010 Paystubs”, or the “2009 Form 1040”. Calculated amounts might be documented as “1/2 the total Interest and Dividends earned in 2010” for income line 10, or “Average electricity expense for April – June, 2010” for monthly electricity expense.

Remember that the income and expense amounts on the financial affidavit are monthly amounts. If the client provides you with a weekly amount, multiply it by 4.33, which is the multiplier used to account for the actual number of weeks in a month ($52/12 = 4.33$).

LAST YEAR’S INCOME:

You should be able to determine this amount using the prior year’s W-2 and tax return provided by the Client. This is the one annual amount that is entered on the financial affidavit. For many individuals, you may use their individual income (salary, pension, social security), plus half of the other shared income shown on the tax return (if a joint return was filed). You should review all lines in the Income section of the tax return (lines 7-22), but do not include any gains or losses from lines 13 and 14. Document how the amount was calculated, such as “2009 salary plus half of the interest, dividends and rental income shown on the 2009 joint tax return.”

PRESENT MONTHLY GROSS INCOME AND DEDUCTIONS:

You must ask the client how they earn income – do they receive a salary that does not change, do they receive bonuses or commissions, do they receive distributions from business interests? All income must be included in this section and you will need records that document it.

Current paystubs or the W-2 are the best sources for determining salary. On the W-2, use the amount shown in the Medicare Wages box. Using the Taxable Wages or Social Security Wages amounts could be incorrect. If the client has any pre-tax deductions (retirement plan contributions and insurance premiums are common), the deducted amounts will not be included in the Taxable Wages box, but they are still part of their gross wages. Social Security deductions end at a certain wage level, which changes annually, so that amount may or may not reflect their entire gross wages for the year. The Wages and Salary found on the tax return is the individual’s taxable wages from the W-2, and does not include any pre-tax deductions, so it should only be used if the W-2 or paystubs are not available and it should be documented if it is your source.

You must arrive at a monthly salary amount for line 1 of the Income section. Salaries are paid at varying intervals which are commonly weekly, bi-weekly, semi-monthly, and monthly. A client will usually be certain if they are paid weekly or monthly, but the bi-weekly and semi-monthly distinction may not be so clear. Semi-monthly payroll is typically paid on the 1st and 16th of each month, for a total of 24 pay periods per year. Bi-weekly payroll is paid every two weeks regardless of the date and has a total of 26 pay periods per year.

The detail on the paystub may indicate if any income in addition to salary is being paid, such as bonuses or commissions. You may use a recent paystub to calculate an average monthly bonus being paid this year, or use the year-end paystub from the prior year to calculate an average monthly bonus. You should also look at the history of bonuses paid in past years to determine if it has been paid consistently. You should document how you arrived at the amount you use. If your client is paid commissions make sure that you report what is earned, not what is received. Voluntary holdback of commissions is common.

You may use the tax return to determine monthly interest and dividends. For a preliminary financial affidavit, you may use half of the total interest and dividends

(unless the accounts are non-marital and specific to one party) reported on the tax return for your client and document this calculation.

If the client filed their tax return separately, any income in addition to salary would be attributed to them in full.

If the parties have any rental properties, you need to obtain details about the properties – the address, mortgage and rental information. You may use their tax return to find the rental income and expense information (on Schedule E) and prepare a schedule of such to be attached to the financial affidavit. Be careful not to include depreciation in your schedule. While this is a valid expense to enter on the tax return, it is not a true outlay of cash each month and should not be included in the net rental income calculation for the financial affidavit. If the net rental income is being received by both parties (if you found your information on a joint tax return), half of the calculated amount would be attributed to your client. Likewise, if the net rental income belongs to only one party, it is included in that party's income only.

Clients frequently have expenses paid by their employer that reduce their personal living expenses, which must be indicated on the financial affidavit in the Income section. An example of this is a car provided by the business. While this is an acceptable business expense to the IRS and not taxable as income to the individual, your client is receiving the use of an automobile that they do not have to pay for themselves. Normally, the actual amount paid by the business for the automobile is used. However, if the amount is beyond what is commensurate to the person's normal spending, a reasonable amount may be estimated. A salesman may drive an expensive car to fit in with their clientele, but would not drive this type of car otherwise. You must also ask the client if they have their own automobile to use when they are not working. If they do, the car provided by the business would not be included as in-kind income.

Another benefit that may be received from an employer is a meal allowance. If the client takes business associates or clients out to lunch or dinner on a regular basis, they do not have to pay for some of their own meals and that reduces their personal living expenses. If you are told that on the average, the client dines with two other people on four nights per week at an average of \$150 per meal, the client is receiving a weekly benefit of \$200 ($1/3$ of $4 \times \$150$), or a monthly benefit of \$866.

Make a note in the income section that breaks down the total reimbursed expenses and in-kind payments into individual monthly amounts. These amounts should also be included in the Expense sections with notes indicating that they are paid by the business and are included on Income line 13.

You need to ask about any income deductions taken from their pay other than taxes. Some jobs, such as firefighters and police officers, have mandatory union dues or retirement contributions, and these amounts should be included in the Monthly Deductions section. For most people though, contributions to retirement plans are not mandatory and would not be included in this section. The amount the client pays for

health insurance for themselves may also be included in the Deductions section even if it is not a pre-tax deduction taken from payroll. Note that the client's health insurance should only be included in one place – either as a deduction to income or in the expense section, but not both.

After all monthly income and deductions are determined; you will need to calculate the monthly income tax, Social Security, and Medicare taxes to enter on the financial affidavit. There is software available to do this. It is not accurate to use the deductions found on a paystub as those deductions are for the salary only and do not take into account any other income factors. In addition, some individuals may have either too much or too little withholding tax deducted from their pay based on the number of exemptions they specify on their W-4.

AVERAGE MONTHLY EXPENSES:

The following are some general notes regarding monthly expenses:

The expenses reported on the preliminary financial affidavit are usually those from the intact marriage. Ask the Client who is paying the expenses now. If an expense always incurred during the intact marriage is not being incurred due to a spouse not receiving adequate support, the expense should still be listed and footnoted.

Avoid using N/A on the financial affidavit, give an actual explanation instead.

Encourage clients to give realistic estimates of their expenses, not a “wish list.”

HOUSEHOLD:

There are several household expenses that should be fairly constant: the mortgage or rent payment, and condominium or homeowner's association fees, if they exist. If the property taxes and insurance are included in the mortgage they should not be listed separately. If they are not part of the mortgage, those amounts will need to be determined on a monthly basis.

For utilities, an average for the last three months could be used, using the records the client brings to the meeting. Make a note of the time frame that was used.

Some expenses are better estimated by asking the client to tell you what they spend on a weekly basis. This works well for items like groceries, meals outside the home, and maid service. You can multiply their weekly amount by 4.33 for a monthly average and document the calculations.

Any other recurring household expenses may be written in at the bottom of this section. An example of this might be the monthly payment for a storage unit.

AUTOMOBILE:

Discuss the automobiles and any other vehicles used by members of the family. You need to identify the vehicles and know who uses each. Determine if the vehicles are owned or leased, as all loan or lease payments should be entered in this section. A note should be made to indicate the amount paid for each party's automobile. The automobile insurance should be handled in the same way, by entering a monthly amount and noting the amount that is for each vehicle.

Gasoline is another item that may be estimated by asking the client how much is spent for gas each week and then calculating the monthly amount.

CHILDREN'S EXPENSES:

Only expenses for minor children should be listed in this section. If the parties incur expenses for adult children we suggest those be listed under household or other expenses, clearly identifying to whom the expenses belong.

If the children attend private school you need to enter the monthly tuition in this section. Tuition is frequently based on 10 monthly payments, so divide the total of the 10 payments by 12.

If the children have a nanny, that could be written in as an additional monthly expense at the end of the section.

Enter the children's health insurance premium if it is known. If the children are covered by a family health insurance plan and the client cannot identify their portion of the premium, a note could be made indicating so.

Do the children typically go to summer or holiday camp? Determine the amount paid for the camps and divide it by 12 to get a monthly amount to spread over the entire year.

INSURANCE:

This section is self explanatory. If the client has a family policy for health insurance the individual premiums should be broken down for the client and the children, if possible. Also ask if the client has any other types of insurance that are not listed, such as a personal articles policy for jewelry or disability insurance, and add them here.

OTHER EXPENSES:

These are personal expenses for the individual for whom the affidavit is being prepared.

Many of these expenses will be estimated by the client. To help them, you should go line by line and ask for details of their expenses. For things like sports and hobbies, find out if they regularly attend sporting events, or participate in them. If the client has season tickets for sports, break down an annual amount into a monthly expense. The same should be done for vacations – ask what type of vacations are usually taken during the year, how often, how much is spent, and then calculate a monthly average. If these vacations are taken with the children, you need to separate out an amount for the children

and enter it in their section. Also ask about the cell phones used by the family. If the monthly amount is for a family plan it should be footnoted.

PAYMENTS TO CREDITORS:

This section is used when the client is making monthly payments to creditors for past balances. Those payments should be entered in this section and the average monthly payment for the last three months could be used. Does the client pay the credit card balance in full each month? If so, the payments do not go here. Those expenses will already have been included elsewhere.

When the creditor is listed, include the name and the last four digits of the account number, i.e. Bank of America Visa #1234.

ASSETS:

You must include the assets of both parties in this section. Identifying all assets in the preliminary financial affidavit is the critical issue. Values are not as important. Any values you enter should be as of “Date of Filing”, unless of course there is a significant reason for using a different valuation date.

Ask the client to identify all bank accounts, investment accounts, and retirement accounts for both parties. You should note whether the accounts are held jointly or individually. When listing an account, use the name of the institution plus the last four digits of the account number, and indicate the effective date (statement date) of all balances.

Discuss all real property owned by the parties. Do the parties own their home? If so, ask about the mortgage – who is the mortgagee? In this section, list the address of the marital home and all other properties they own. When there is a liability associated with an asset, i.e. a mortgage on a home or a loan on a car, include the liability in this section with the asset. This allows you to easily see the equity in the asset.

Use the appraised value for real property if one exists. If not, you could use the Market Value from the county tax assessor’s office. Document the source of the property value.

Do the parties have any business interests? If so, list the businesses and the percentage of ownership interest. At this time, you may want to indicate that the business is “To Be Valued” rather than estimating the value.

You will have already discussed the vehicles used by the family. The value of a vehicle may be estimated using Kelley Blue Book (www.kbb.com). A leased vehicle should not be included as an asset.

At this time, include all life insurance policies even if they do not have a cash surrender value, to make sure that all are identified. Indicate the face value of the policies as part of the description.

If the client has indicated that they have an insurance policy for their jewelry, there should be jewelry listed in the asset section but you may want to use “To Be Determined” for the value. The amount jewelry is insured for is usually higher than it could be sold for. Therefore, jewelry appraisals may be needed for the purpose of the dissolution.

HIDDEN ASSETS –

A review of the most recently filed tax return may reveal some hidden assets.

If estimated tax payments are being made, the IRS could be holding a significant asset of the parties. Look at the Payments section on page 2 to determine if estimated tax payments have been made in the past. If so, it is likely they are being made now.

An overpayment of taxes that has been applied to the following year is an asset. See the Refund section at the bottom of page 2.

A refund that is being directly deposited will indicate a checking or savings account that should be disclosed.

Also review the following schedules from the tax return:

Schedule A: If the client has itemized real estate taxes or mortgage interest, make sure these assets and liabilities have been disclosed.

Schedule B: All sources of interest and dividends are assets. There are questions at the bottom of Schedule B relating to foreign bank accounts. If YES is checked, confirm that these accounts have been disclosed.

Schedule C: A source for identifying business income as well as business assets.

Schedule D: Capital Gains indicate the sale of securities or other assets which may lead you to other cash, investment accounts or other assets.

Schedule E: Here you will find information on businesses and rental properties.

LIABILITIES:

You must include the liabilities of both parties in this section.

The Client needs to identify and provide statements for all credit cards, whether held jointly or individually. You will need to have the balance closest to the Date of Filing and indicate the effective date (statement date) of the balance.

Determine if there are any loans outstanding, including student loans, and include them in this section with the outstanding balance. Loans, much like assets, obtain their marital/non-marital status based on when they were obtained.

ABOUT THE AUTHORS:

Edward S. Sachs is Director of the Litigation Services Department of Appelrouth Farah & Co. and has spent over 20 years as a forensic accountant building an expertise in litigation and valuation matters. He joined the firm in 1999 and supervises all business valuations, forensic accounting and ad valorem tax appeals. He is Accredited in Business Valuation and is Certified in Financial Forensics by the American Institute of Certified Public Accountants and is a Certified Forensic Accountant. He serves as an expert witness in Federal and Circuit Courts and as a forensic accounting and valuation consultant to legal counsel.

Patricia L. Young is the Senior Case Manager in the Litigation Department of Appelrouth Farah & Co. She has been with the firm for four years and is the case manager on most of the firm's family law matters which includes preparing clients' financial affidavits, mandatory disclosure, preparing and fulfilling requests for production and preparation of income analysis, lifestyle analysis, alimony option worksheets and child support guidelines. Patricia is a Certified Fraud Examiner, a Florida Registered Paralegal, a Certified Legal Assistant and has a Masters of Business Administration from Florida International University.