

Financial Planning

Dedicating time to financial planning can help you protect the assets you have now and increase your wealth in the future. This module covers the basic elements of financial planning, including:

- Examining Your Current Financial Situation and Setting Goal
- Investing
- Tax Planning
- Insurance and Estate Planning
- Choosing a Financial Advisor

Chapter 1: Examining Your Current Financial Situation and Setting Goals

Examining Your Current Financial Situation

The first step toward planning your financial future is understanding where you are today.

- **Cash flow:** Paying bills on time, saving, and avoiding reliance on credit is only possible if you spend less than you earn. (Okay, spending a little more one month won't kill you, but if it happens on a regular basis, it will be hard to avoid financial problems.) Use the Cash Flow Worksheet to list your income and expenses. (Don't forget to include savings.) To get as accurate figures as possible, you may want to use the Tracking Worksheet to track your daily spending. (If your income is irregular, it is a good idea to track that too.) To determine a monthly amount for periodic income and expenses, such as vacation, figure out the per year amount and divide it by 12.

(Complete the Cash Flow worksheet on pages 8-10.)

(Complete the Tracking worksheet on pages 11-12.)

If you have a negative cash flow (i.e., your expenses exceed your income) or you would like to save more than you are currently able to, take a close look at the Cash Flow Worksheet and determine what you can change. Can you get a part-time job? Rent out a room in your house? Cut back on dining out? Skip the daily \$4 mocha latte? Get a cheaper cable package or cut your land-line phone? Increasing income can be difficult, but most people have some expenses they can trim. Honestly assess what is a necessity and what isn't.

- **Net Worth:** Your net worth is the value of your assets (things you own, like a house or car) minus your liabilities (monetary obligations to others, such as a mortgage or car loan). Complete the Net Worth Worksheet to see where you currently stand.

(Complete the Net Worth worksheet on page 13.)

Your net worth should be positive (meaning you own more than you owe) and increase over time. One simple way to increase your net worth is to pay down your debt. You can also build your net worth by putting your money in assets that typically increase over time (or at the very least hold their value) and minimizing spending and borrowing for assets that decrease in value. If you put \$5,000 in a savings account, at the end of the year, you will have more than that because you are paid interest. On the other hand, if you buy a \$20,000 car, it will probably be worth less at the end of the year because most cars depreciate in value as soon as you leave the lot. If you borrowed money to purchase the car, the amount owed on the loan could be greater than the car's value. (Of course, you may need a car to get around, but does it have to be a top-of-the-line new car or will a used or basic new car do the trick?)

Setting Goals

Identifying clear, achievable goals is a crucial part of anyone's financial plan. A financial goal is the amount of money needed for a specific purchase or service at a definite date. Making goals precise allows you to determine how much you need to set aside each month and track your progress.

There are three types of goals: short-term, mid-term, and long-term. Short-term goals are achieved in under a year, mid-term in one to five years, and long-term in five years or more. Emergency savings, vacations, and electronics are typical short-term goals. A down payment for a house is a common mid-term goal. Long-term goals may include saving for retirement and your child's higher education.

The Financial Goals Chart can help you determine the timeline for your goals and the amount of money you'll need to regularly set aside in order to reach them. You may find the numbers daunting or not realistic based on your current financial situation. As mentioned above, you may be able to make adjustments to your income and/or expenses to free up cash for savings. If not, determine your priorities and save for the most important goals first. If your roof is leaking and your house is overrun with termites, saving for home repairs is probably more important than saving for a new television.

(Complete the Financial Goals worksheet on page 14.)

Chapter 2: Investing

Now that you have determined what you want to save for, you may be wondering where you should put your money. There are three basic types of investment classes:

- **Stocks:** A share of stock represents a percentage of ownership in a corporation. In other words, if a company is divided into a million shares and you buy one share, you would own one millionth of that company. You can make money from receiving dividend payments and selling the stock for more than you bought it for. Historically, stocks have provided the greatest return (earnings) long term. However, there are no guarantees – one day your stock may be worth more than what you paid for it, the next, less.
- **Bonds:** A bond is a loan to a company or government, with you, the bondholder, as the lender. Generally, you receive the principal, called the par value, at maturity of the bond and interest periodically while you are holding the bond. Depending on the market, you may purchase a bond below, at, or above its par value. In general, bonds are between stocks and cash equivalents in regard to risk and return.

- **Cash equivalents:** Cash equivalents are assets that can be readily converted into cash, such as savings and checking accounts, certificates of deposit, money market deposit accounts, and U.S. Treasury bills. They tend to be low-risk, so there is little or no danger that you will lose the money you deposit. As a result, cash equivalents provide a low return.

It is best to keep money for short-term goals in cash equivalents. Because you will be using the money soon, your primary concern is that you not lose any of your principal investment. If you put your money that you need in six months in stocks, there is a decent chance the stocks will be worth less when you sell. For emergency savings in particular, you want to make sure you can immediately access the money when you need it.

For long-term goals, the value of your investment in six months is less of a concern than inflation, which is the general rise in the price of goods and services over time. The return on cash equivalents is very often less than the rate of inflation, meaning if you keep your money there, its value will be essentially decreasing over time. That is why it is a good idea to put a large chunk of the money you are saving for long-term goals in stocks and bonds, which, on average, have a higher return than cash equivalents. There is a risk that the value of your investments will decrease, but the risk is lower the longer your investment period is. Inflation can be a concern for mid-term goals, but since the timeframe is shorter, you may want to be more conservative with your investment choices.

A good way to reduce the risk of losing money when you invest is to diversify. A well-balanced portfolio has a mixture of stocks, bonds, and cash equivalents. (What the exact percentages should be depends on how far away you are from your goals and your risk tolerance.) It is also a good idea to diversify within each type of investment class. For example, you can purchase stocks from manufacturing companies, technology-oriented companies, and financial services companies. A simple way to get diversity is to purchase shares in a mutual fund. In a mutual fund, money from several investors is pooled to buy different stocks, bonds, and/or cash equivalents.

Chapter 3: Tax Planning

Smart tax planning is not just claiming all the deductions and credits you are entitled to on your tax return so you can get a bigger refund. It also involves thinking about and engaging in legal methods to lower your tax burden throughout the year. The following are vehicles that can give you a break on your taxes:

- **Employer-sponsored retirement plan:** Most employers offer a defined-contribution retirement plan (typically a 401(k) or 403(b)). It is called a defined-contribution plan because the contributions to the plan are defined, but the benefits you receive in retirement are not. That is dependent on how much is put into the plan and how well your investments perform. The money that you contribute to a defined-contribution plan is deducted from your paycheck pre-tax, meaning you don't have to pay income taxes on it. While your money is invested in the plan, you don't have to pay taxes on the earnings either. You only have to pay taxes on the withdrawals you make.
- **Individual Retirement Account (IRA):** IRAs are not tied to the employer – you can open one at a variety of financial institutions, such as a credit union, bank, or mutual fund company. In order to contribute to an IRA, you or your spouse must have earned income. The annual

contribution limit is higher for employer-sponsored retirement plans, but the investment choices are typically greater for IRAs (and you don't have to worry about what to do with the plan when you leave your job). With a Traditional IRA, your contributions are tax-deductible, and your earnings while in the plan are untaxed as well. With a Roth IRA, your contributions are not tax-deductible, but your earnings and withdrawals are not taxed.

- **Coverdell Education Savings Account (ESA):** The Coverdell ESA is a tax-deferred account for education costs. It works just like a Roth IRA – contributions aren't tax-deductible, but the investment earnings accumulate tax-free, and qualified distributions are exempt from income tax. It can be used to pay for tuition, fees, books, and equipment for primary, secondary, and postsecondary education (kindergarten – graduate school). Contributions can only be made until the beneficiary turns 18 and must be used by the time he or she is 30. Coverdell ESAs can be opened at many financial institutions, and unlike with 529 Plans (discussed more below) your investment options are virtually unlimited. As the plan's owner, you choose what stocks, bonds, mutual funds, or other opportunities to invest in.
- **529 Plan:** The 529 Plan is a tax-advantaged savings vehicle that can be used for college and graduate school expenses. It comes in two basic varieties: the college savings plan and the prepaid tuition plan. College savings plans are investment accounts offered by individual states. (The money is typically put in mutual funds.) Prepaid tuition plans allow you to buy all or part of a future public in-state education at today's prices. Unlike with college savings plans, you can generally only invest in your state's plan (if they have one). It may be possible to use the plan at a private or out-of-state public school, but the coverage will likely be less. With both college savings and prepaid tuition plans, you don't have to pay taxes on the earnings or withdrawals as long as you use the funds for qualified education expenses. Contributions are not deductible on your federal income tax return, but they may be deductible on your state return if you use your state's plan.
- **Medical Expense Flexible Spending Account:** Offered through employers, a medical expense flexible spending account is a savings plan that allows you to contribute earnings pre-tax to pay for qualified unreimbursed medical and dental costs, such as co-pays and over-the-counter medication. (It can even be used to purchase Band-Aids!) You can sign up for a flexible spending account during your employer's open enrollment period.
- **Dependent Care Flexible Spending Account:** While the medical expense flexible spending account allows you to use pre-tax dollars to pay for medical expenses, the dependent care flexible spending account allows you to use pre-tax dollars to pay for – what else? – dependent care. In order to take advantage of this account, you and your spouse (if applicable) must work, and the funds can only be used to pay for dependent care expenses while you are working.
- **Transportation Savings Account:** A transportation savings account is a benefit offered by many employers that allows you to use your pre-tax dollars to pay for qualified transportation expenses, such as parking (near your place of work or commute site, not near your home), public transportation, and vanpooling.

Chapter 4: Insurance and Estate Planning

Insurance

Unexpected events, such as a severe illness, car accident, or house fire, can put a serious cramp in your financial health, even if you have savings. Having the right amount of insurance will help protect you from the financial consequences associated with many of life's adversities.

- **Life Insurance:** If you have a spouse, child, parent, or anyone else who relies on your support, this is something you should consider having. Life insurance is not just intended to replace the wages you provide but services as well. (For example, a stay-at-home mother may want to purchase life insurance to pay for child care if she dies.) There are two basic types of life insurance: term and cash-value. Term insurance is pure life insurance. You pay the premiums for a specific period of time, and the only way the policy will pay out is if you die. With cash-value life insurance, part of your premium pays for the policy and part of it goes into a savings plan. You can keep the policy as long as you pay the premiums. You can also borrow against the money in the savings plan or cancel the plan and get the cash back. However, the premiums are generally higher for cash-value life insurance, and it may not be worth the extra cost if you don't anticipate needing life insurance for the rest of your life.
- **Disability Insurance:** If you are employed, it is a good idea to have disability insurance, which replaces a portion of your income if you are unable to work. There are two types of disability policies: short-term, which only provides coverage for a limited period of time (usually up to six months to two years), and long-term, which provides benefits until retirement age. Long-term insurance is the most important insurance to have. If you are only out of work for a few weeks, you should be able to pay for your expenses with savings. However, if putting aside money in savings is a struggle, a short-term disability policy could be a helpful thing to have. Check to see what coverage you have through work before purchasing a policy on your own.
- **Auto Insurance:** In most states, drivers are required by law to have at least liability auto insurance, which covers your legal costs (up to a limit) if you injure a person or damage property with your car. If your car is several years old and worth little, liability coverage may be adequate. However, if your car is newer, you may want full coverage insurance. (This will likely be required by your lender if you have a car loan.) In addition to liability coverage, it typically includes medical expenses coverage, uninsured motorist protection coverage, collision coverage (which pays for repair costs or replacement due to accidents), and comprehensive coverage (which covers repairs costs and replacement due to damage resulting from other causes, such as theft or fire).
- **Homeowners Insurance:** If there is a mortgage on your property, you are required to have homeowner's insurance, but is your coverage sufficient? It is a good idea to consider if you should increase your coverage when you make improvements to the house. Also, if your policy only pays you the actual cash value for stolen or damaged property, you may want to switch to replacement cost coverage (which pays you what it actually costs to replace the property). Furthermore, if you have expensive jewelry, antiques, artwork, or other possessions whose value exceeds the coverage provided by a standard policy, you can supplement it with a personal article floater.

- **Renters Insurance:** Renters insurance covers personal property loss and liability for renters. This insurance is relatively inexpensive, especially compared with what it would cost you to replace all your clothing, furniture, electronics, and other property if they were stolen or damaged. Don't assume that your landlord's policy will cover your losses – in most circumstances, it won't.

Estate Planning

Do you want to leave money to your favorite charity? To friends? Do you not want people to fight over who gets your beloved plaid lounge chair? Planning your estate allows you to determine what happens to your hard-earned cash and other assets when you pass away.

- **Will:** A will is basically a set of instructions that specifies who gets what assets. You can also stipulate guardianship for a dependent. If you die without a will or other declaration, state law determines how your property is distributed. While the law may be in line with a person's wishes, often it is not. Even if it is, with a will, probate (the legal process of distributing a person's estate) is typically a lot easier and cheaper.

If your estate is relatively simple, you may choose to create your own will with the help of a quality software program or book. Make sure you are familiar with your state laws. If you do not follow certain rules or procedures, such as having the proper number of witnesses, your will may not be valid. If your situation is complex or you do not feel comfortable writing your own will, you can hire an attorney to do it for you.

- **Trust:** A trust is a legal entity in which your property is held for the benefit of another person. While a will has to be validated as part of the probate process, a trust bypasses probate completely. Many people use one to leave assets to a minor or special needs child. Another situation in which it is commonly used is when a person remarries. A trust can allow the spouse to use the assets while he or she is alive and then pass them on to the children after the spouse's death.

A trust can be either living, in which the assets are placed in the trust while you are still alive, or testamentary, which is created by a will and only becomes active after death. A revocable living trust allows you to remain in control of the assets in the trust. (For example, you can remove them from the trust or obtain income from them.) An irrevocable living trust is a permanent arrangement. Once it is established, you lose the title to the property, and the trust cannot be altered.

As with a will, you can create a trust using software or a book. However, trusts are typically more involved than wills are, so having a lawyer set it up for you may be the best way to go. Also, since trusts can be costly and timely to set up and maintain, it may be helpful to discuss with a lawyer if having a trust would even be beneficial in your situation.

Having a trust does not necessarily eliminate the need for a will. Most trusts do not cover all assets in the estate. Having a will can ensure that nothing is neglected.

Chapter 5: Choosing a Financial Advisor

Many aspects of financial planning can be done on your own. However, there may be times when you will find it helpful to use the services of a professional. Financial services professionals include:

- **Certified financial planners (CFPs):** CFPs must complete courses on personal finance and pass a comprehensive board exam. They typically offer advice on a variety of topics, including tax planning, estate planning, investing, and insurance. Some planners earn all of their income from commissions, while others charge a flat fee. (Note: someone who is simply a financial planner, without the certified part, may provide the same services, but they do not have to meet any requirements – anyone can call themselves a financial planner.)
- **Certified public accountants (CPAs):** CPAs are accountants that pass an exam and meet certain educational requirements. While they are often thought of primarily as income tax return preparers, many also provide advice on other aspects of tax planning and financial planning in general.
- **Brokers:** Brokers are registered representatives that buy and sell securities on behalf of their clients for a commission. Many financial planners are also brokers.
- **Credit counselors:** Credit counselors typically offer advice on personal finance topics like budgeting, establishing/using credit, debt repayment, or purchasing a car or home. Agencies that are part of the National Foundation for Credit Counseling require their counselors to go through a comprehensive training process.

Choose an advisor carefully. Most financial professionals are honest and ethical, but some are not. Don't be afraid to ask questions or ask for references before hiring someone. If available, check with the relevant professional organization to see if the person has a history of complaints. And don't be afraid to listen to your gut – if it is giving you a bad feeling about someone, that is a good enough reason to not use him or her.

Cash Flow Worksheet

Source	Gross	Net
Job		
Spouse's job		
Part-time job		
Rental/room & board received		
Commissions/bonuses		
Tax refunds		
Investment income		
Government benefits		
Unemployment insurance		
Child support/alimony		
Support from family/friends		
Other		
Total		

Monthly Expenses

Since many expenses are variable, such as utilities and groceries, it is important to average these expenses. Other expenses are periodic (such as insurance or vehicle registration). Again, calculate the annual amount and divide by 12.

Category	Expense	Average Per Month	Goal Per Month
Housing	Rent/Mortgage		
	2nd Mortgage/Equity Line		
	Homeowner's/Renter's Insurance		
	Condo Fees/HOA Dues		
	Home Maintenance		
	Gas/Electric		
	Water/Sewer/Garbage		
	Telephone		
Food	Groceries/Household Items		
	At Work/School		
Insurance (Exclude Payroll Deducted Amounts)	Health/Dental/Vision		
	Life/Disability		
Medical Care (Exclude Payroll Deducted Amounts)	Doctor/Chiropractor		
	Optometrist/Lenses		
	Dentist/Orthodontist		
	Prescriptions		
Transportation (Exclude Payroll Deducted Amounts)	Car Payment #1		
	Car Payment #2		
	Auto Insurance		
	Registration		
	Gasoline/Oil		
	Maintenance/Repairs		
	Public Transportation/Tolls/Parking		
Child Care (Exclude Payroll Deducted Amounts)	Daycare		
	Child Support/Alimony		
Savings	Emergency		
	Goals		
Income Taxes	Prior Year		
	Estimated Tax Payments (Self-Employed)		
Unsecured Debt	Loan payment		
	Credit Card #1		
	Credit Card #2		
	Credit Card #3		
	Credit Card #4		

Category	Expense	Average Per Month	Goal Per Month
Personal	Beauty/Barber		
	Clothing/Jewelry		
	Cosmetics/Manicure		
Entertainment	Cable/Satellite		
	Movies/Concerts/Theater		
	Books/Magazines		
	CD/Tapes/Videos/DVD		
	Dining Out		
	Sports/Hobbies		
	Vacation/Travel		
Miscellaneous	Banking Fees		
	Laundry		
	Union Dues		
	Internet Service		
	Pet Care		
	Gifts for Holidays/Birthdays		
	Cell Phone/Pager		
	Postage		
	Cigarettes/Alcohol		
	Contributions to Church/Charity		
	Other		
	Other		
	Other		
	Other		
Other			
TOTAL (include figures from page 9)			

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Bottom Line

Once you have determined the total of your take-home pay and expenses you are ready to determine your bottom line. Subtract the total of all expenses including debt payments from your net income. If the result is a positive number, you can add the extra money to your savings to reach your goals sooner. If your expenses exceed your income, you'll need to make some adjustments to bring your finances back into balance.

Total Monthly Net Income	Total Monthly Expenses	Monthly Surplus or Deficit
	-	=

Weekly Expense Tracking

If you don't know where your money is going, it's time to start tracking your spending. Different methods of tracking work for different people – some like to save receipts while others prefer to jot down all purchases in a small notebook they carry with them. Remember, tracking is only effective if you count every expense, including the morning newspaper and the change you put in the office vending machine. Use the sheets on the next two pages to record weekly and monthly spending totals. (Make copies of the charts so that you can track for longer than one week.)

Item	Mon	Tue	Wed	Thu	Fri	Sat	Sun	Total Expenses	Weekly Budget	Over / Under
Groceries										
Restaurants										
Laundry/Dry Cleaning										
Medical/Dental										
Auto/Gas/Parking										
Other Transportation										
Child Care										
Personal Care										
Clothing										
Bank Fees/Postage										
Entertainment										
Books/Music/Video										
Cigarettes/Alcohol										
Gifts/Cards										
Home/Garden										
Church/Charity										
Savings										
Other										
Other										
Other										
Weekly Totals										

Monthly Expense Tracking

Item	Week 1	Week 2	Week 3	Week 4	Week 5	Total Expenses	Monthly Budget	Over / Under
Groceries								
Restaurants								
Laundry/Dry Cleaning								
Medical/Dental								
Auto/Gas/Parking								
Other Transportation								
Child Care								
Personal Care								
Clothing								
Bank Fees/Postage								
Entertainment								
Books/Music/Video								
Cigarettes/Alcohol								
Gifts/Cards								
Home/Garden								
Church/Charity								
Savings								
Other								
Other								
Other								
Monthly Totals								

Net Worth

In order to evaluate your progress as you work toward your goals, you must determine what your overall financial picture looks like today. Your net worth is simply the difference between what you own and what you owe. To make sure you are staying on track, it's a good idea to calculate your assets and liabilities annually. If you conscientiously follow your plan you should see a gradual, steady increase in your net worth.

What You Own	Amount
Checking/Saving Accounts	
Certificates of Deposit	
Stocks & Bonds	
IRAs/401(k)	
Home/Real Estate	
Automobiles	
Other Assets	
Total Owned	(A)

What You Owe	Amount
Mortgage	
Credit Cards	
Student Loans	
Auto Loans	
Other Loans	
Income Tax Due	
Other Debts	
Total Owed	(B)

Total Owned (A)	Total Owed (B)	Net Worth
	-	=

Financial Goals

Your financial goals are specific things you want to do with your money within a certain time period. Short-term goals are accomplished within one year, mid-term goals are accomplished within 1 to 5 years and long-term goals generally take more than 5 years to achieve.

	Target Date	Total Needed	Current Savings	Additional Savings Needed	Pay Periods Until Target Date	Savings Needed Per Pay Period	Savings Needed Per Month
Short-term Goals							
Mid-term Goals							
Long-term Goals							