4-3 Personal Financial Planning

GOALS

- Explain the purpose and steps of financial planning.
- List reliable sources of financial advice.
- Describe ways you can protect your financial resources.

KEY TERMS

- financial plan, p. 134
- personal goals, p. 136
- financial goals, p. 136
- short-term goals, p. 136
- medium-term goals, p. 136
- long-term goals, p. 136
- timeline, p. 136
- benchmarks, p. 137
- financial planner, p. 138
- phishing, p. 140
- identity theft, p. 140

What Is Financial Planning?

Financial planning is a formal process that involves looking carefully at your current financial situation and thinking about your future. It requires a long-term commitment. As part of the financial planning process, you will create a financial plan. A **financial plan** contains personal and financial goals you want to accomplish along with steps and a timeline for reaching these goals. Getting a college education, owning a car, and owning a home are examples of personal goals. For each personal goal, you will have a related financial goal. Paying for living expenses, tuition, books, and other related expenses while in college is a financial goal. Saving for a down payment on a house or a car and having a job that provides enough income to make monthly payments are financial goals.

financial plan a plan listing personal and financial goals along with steps and a timeline for reaching them

A financial plan is more than a budget. Its purpose is to plan for earning, spending, saving, and investing that will allow you to achieve your personal goals in the present and the future. You must put your financial plan into action and monitor it periodically. At least once a year, you should review and update the plan. Your plan should contain details, but it should not be too complex to review and follow.

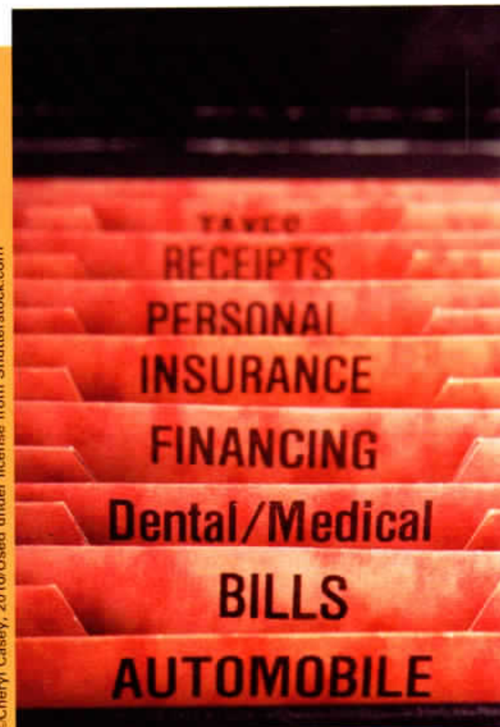
Some people create a plan by themselves because their finances are not complex enough to require assistance. Other people get advice from experts who can help manage resources and plan for retirement. Whether you do planning by yourself or get help, you will need to complete the five steps of financial planning.

STEP 1 GATHER INFORMATION

The first step in financial planning is gathering information. Everything related to your finances should be considered. The purpose of gathering information is to look at the state of your finances now—your starting point. The following list shows examples of *financial records*, or documents that are used to assess your finances. You may not have all the items listed at this time in your life. However, you can gather or prepare the first three items. Other items may become part of your plan later in life.

- personal cash flow statement
- personal net worth statement
- personal budget
- checkbook
- current bank statements
- investment account statements
- insurance policies
- current paycheck stub
- tax returns
- will
- trusts
- financial contracts for items purchased on credit
- any other legal documents related to your finances

At some point when you review your plan, you will need to think about how to finance your retirement. You may want to gather data about your medical history and the medical history of family members. This data may help you estimate your life span, which affects the amount of income you will need over your lifetime. For example, many people may live until age 85 or 90 and should plan how to meet financial needs through that age.



How can you get started with your own financial plan?

STEP 2 ANALYZE INFORMATION

Take a careful look at the documents and information you have gathered. Find out if any data are missing and take steps to get the data. Carefully look at each document and make notes about what you see. Review your personal cash flow statement to see what your current sources of income (cash inflows) are. Look at your expenses (cash outflows). Do you have enough income to pay for your expenses and save for the future? If not, try to find ways to increase income and decrease expenses.

Review your personal net worth statement. What are your assets? What liabilities do you have? What is your net worth? Review a current monthly or yearly budget. Look at the items for which you spend money. Is there a way you can spend less and save more to meet long-term goals?

As you review your financial plan each year, consider the following questions. Some of them may apply now. Others may not apply to you for a few years or for many years.

- *Is your income steadily growing over time?* If so, by what amount and percentage? For example, you may have $2,000 more in income this year than last year. This is a favorable trend that will help you reach your goals.
- *Is your net worth growing over time?* When you compare the current personal cash flow statement to previous ones, do you see growth? If so, by what amount and percentage?
- *How are your spending habits changing?* What types of things are you buying (needs versus wants), and what are your purchasing plans over time?
- *Who else depends on your income?* Do you have a spouse or children that will be affected by your financial plan? What will they contribute? What needs will they have?

- *What new goals do you need to add and plan for?* Do you need a plan to pay for a college education for your child? Is it time to plan for retirement? Does your will need to be updated to include a new grandchild?

STEP 3 SET GOALS

personal goals things you want to achieve in your life

financial goals plans for how you will pay for your personal goals

short-term goals things you expect to achieve within one week to one year

medium-term goals things you expect to achieve in the next two to five years

long-term goals things you expect to achieve more than five years from now

Two types of goals should be considered when creating a financial plan—personal goals and financial goals. **Personal goals** are the things you want to achieve in your life. Living in your own apartment, owning a car, and taking a two-week vacation are personal goals. Personal goals should be set first because your financial goals will be based on them.

Financial goals describe how you will pay for your personal goals. Financial goals may be short-term, medium-term, or long-term. **Short-term goals** are what you expect to achieve within one week to one year. A financial plan for the short term tells you on a week-to-week or month-to-month basis what you would like to achieve. Perhaps you would like to save $40 by the end of the month. Perhaps you want to add $200 to your savings account by the end of the year. Using monthly and yearly budgets can help you achieve short-term goals and save for long-term goals.

Medium-term goals are those you wish to achieve in the next two to five years. You may wish to save money for college or for a future purchase or need. You may want to increase your yearly income within three years. These goals take longer to achieve and also require more planning.

Short-term and medium-term goals are often stepping stones to long-term goals. **Long-term goals** typically include what you want to achieve more than five years from now. You may wish to save enough money to buy a car or go on an expensive vacation. You may want to repay loans for money you borrowed to complete college. When you begin working full time, you may contribute to a 401(k) to save money for your retirement.

Achieving long-term goals may require you to save money for a long time. Online financial calculators are available to help you determine the costs of achieving long-term goals. For example, they can calculate how much you should save yearly based on when you want to retire, or how much you should save monthly to pay for college tuition and expenses. Financial calculators can make planning easier.

As part of the goal-setting process, you may experience delayed gratification. Doing without an item you would like to buy now in order to save money to fulfill a medium-term or long-term goal is an example of *delayed gratification.* For instance, you may have a goal of saving $30 per month to help pay for your college education. This month, you would like to buy some music CDs. However, if you do so, you will not be able to make your savings goal. Doing without the CDs now in order to be able to pay for college later is an example of delayed gratification.

STEP 4 DEVELOP A TIMELINE AND BENCHMARKS

timeline a visual display of how long it will take to achieve each phase of a plan

Goals must be measurable. Plan a timeline for putting your goals into action. A **timeline** is a visual display of how long it will take to achieve each phase of your plan. Before creating a timeline, be sure your goals are prioritized based on how soon you need or want to achieve them.

Figure 4-3.1 Financial Plan (One Goal)

BILL FONG
FINANCIAL PLAN
Updated April 1, 20--

Net worth on April 1, 20--: $525.56

Personal Goal	Financial Goal	Benchmarks	Timeline
Live in my own house in the country.	Buy a house in the country.	1. Save money for a down payment ($12,000)	5 years
		• Set aside $200 per month	Once per month
		• Open a separate account for money saved	April 8 (next week)
		• Talk to a mortgage broker to get prepared	Make an appointment for April 15
		2. Get a job that provides enough income to make monthly payments	2 years

For each personal goal, there may be a financial goal you must first achieve. Financial goals can further be divided into parts or steps. For each step, consider how long it will take to complete. Then set a target date for completion.

In addition to establishing a timeline, goals should include **benchmarks**, which are standards against which progress is measured. Benchmarks may consist of steps or specific actions to take. As you hit each benchmark, you will be another step closer to achieving the overall plan. The record showing the goals you intend to accomplish with timelines and benchmarks is your financial plan. A sample financial plan for one goal is shown in Figure 4-3.1.

benchmarks standards against which progress is measured

STEP 5 IMPLEMENT AND EVALUATE THE PLAN

Once you have decided on your personal and financial goals, begin working toward achieving them. Check off the items on your timeline as they are completed. Set new benchmarks if you learn about other ways to meet your goals. Most importantly, take a look at your financial plan often. At least once each year, you should evaluate the financial plan and update or revise it as needed.

Your financial plan represents your personal and financial goals at one point in time. Those goals are likely to change over time. For example, you may inherit money, or you may have children. You may have a job opportunity overseas, or you may wish to spend more time on a hobby or a side business. As your personal and family goals change, your financial plan should be updated to reflect new goals.

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Why is financial planning important?

Where Can You Get Good Financial Advice?

There are many types and sources of financial advice. Some are better than others. Some may appear to be good, but ultimately you could lose your money. Choosing the right source of advice is important. When you seek outside advice, you should consult someone who is knowledgeable and has a proven track record.

FINANCIAL PLANNERS

financial planner a professional consultant who provides financial advice for a fee or commission

financial adviser

A **financial planner** is a professional consultant who provides financial advice to individuals for some type of fee or commission. A CFP (certified financial planner) has completed an educational program for providing financial planning services. Financial planners are also known as *financial advisers*. Financial planners help people develop financial plans to meet their financial goals. They review every aspect of their client's financial life, including savings, investments, insurance, taxes, and retirement.

Another type of financial planner is the *investment adviser*. The investment adviser may not delve as deeply into the client's financial life. They may only give advice on investing in stocks, bonds, and mutual funds (a professionally managed collection of stocks and bonds). Your bank or credit union may have investment advisers who can work with you.

In working with financial planners, you should be aware that they often make money from the investment products you purchase from them. Some financial planners work for a commission, meaning they are paid a percentage of the sale amount. To earn higher commissions, some planners might push the most expensive products instead of the products that best suit the needs of their clients. This is an unethical practice. For consumers, it can be difficult to tell whether or not they are buying the best product at the lowest price. To avoid this kind of dilemma, hire a financial planner who does not work on commission. Instead, pay for the financial advice separately from buying any financial products.

You will need to share personal information about your income, assets, liabilities, and net worth with your financial planner. As with any professional, the financial planner should keep your information confidential and should not use it for personal benefit. You must be able to trust the planner with your most sensitive personal data. Find out if the planner has been in business long, whether any complaints have been filed, and if he or she has a criminal background. Ask what measures the planner will take to keep your data secure. The time and energy you spend carefully selecting your financial planner will be well worth it.

FINANCIAL EXPERTS

A *financial expert* gives advice based on superior knowledge and experience. Many financial experts publish self-help materials in the form of books, videos, and other media. You can purchase them at bookstores and online. You can also listen to financial experts on television, radio, or special news programs.

FINANCIAL SECTIONS AND ARTICLES

If you are willing to do some research, you can learn about almost any type of financial product you would consider including as part of your financial plan. Newspapers have financial sections that list stocks and securities. Newspapers and magazines also publish articles explaining how to make good financial choices.

Internet articles can also give you good information, but you must be careful of the source. Generally, websites ending in .edu, .gov, and .org are less likely to be biased, or to show a preference toward a certain product, than those ending in .com, .net, or .biz. Whenever a website is selling a product as well as providing information about it, you are more likely to get biased information.

SEMINARS AND WORKSHOPS

Companies that provide financial products such as mutual funds or retirement accounts often provide free seminars and workshops. These events will give you information about how products work. You can also get new investment ideas and learn how financial markets work. Be careful to avoid any sales pressure. Sometimes these events charge fees for attendance. Other times they are free, but you must listen to their entire presentation. Be sure to avoid giving personal information that could be used to defraud you.

Why might you want to attend a financial seminar?

FINANCIAL WEBSITES

There are many free websites on the Internet to help consumers get started with their financial planning. Most of these sites are legitimate and offer good advice. They do not charge for their services, and they are good resources for young adults starting out on their own. Many of these sites are sponsored by organizations or foundations that seek to help consumers do a better job of managing their assets. Others are available through mutual fund companies, government and educational programs, and other groups that offer free advice, information, and support. As always, avoid providing personal information over the Internet unless you are sure the website is authentic and secure.

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How does an investment adviser differ from a financial planner?

NET Bookmark

The Federal Trade Commission provides information to consumers regarding identity theft. Access **www.cengage.com/school/pfinance/pfl** and click on the link for Chapter 4. Answer the following questions: How can thieves use your trash to steal your identity? What are some things thieves do with a stolen identity? What are some things you can do to prevent identity theft?

www.cengage.com/school/pfinance/pfl

How Can You Protect Financial Resources?

You must protect your financial wealth. Deal only with financial advisers and financial institutions that you know and trust. Keep good records and verify account balances regularly. Guard your passwords. If you suspect your account or identity has been compromised, call or visit your bank or financial adviser. Keep your monthly statements in a safe place, such as a locked drawer, strongbox, or safe.

phishing a scam in which an e-mail is sent from someone posing as your bank or other legitimate business asking for personal information

Be very careful when communicating with providers of financial products online. **Phishing** is a common Internet scam in which an e-mail is sent from someone posing as your bank or other legitimate business asking for personal information. For example, an e-mail may indicate that there is a problem with your bank account and request your social security number or account number. The bank's logo may appear in the e-mail. However, the message is not from the bank; it is from a *phisher* who wants to use the person's information illegally. Do not respond to such an attempt to get personal information. Instead, call your bank directly and ask if there is a problem with your account.

identity theft the use of your personal information by someone else to commit fraud or other crimes

When you use the Internet, your computer is subject to attacks by hackers. *Hackers* try to break into your computer remotely to steal personal information, such as social security numbers. **Identity theft** occurs when someone uses your personal information without permission to commit fraud or other crimes. Those who get your personal information may be able to apply for credit in your name, withdraw money from your accounts, or take possession of other financial assets. You can buy software to help prevent this type of theft. For example, a *firewall* is software or a hardware device that filters information coming in to your computer. You might also choose to store your financial information on a separate storage device, such as a flash drive or CD.

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List two ways you can protect your personal financial information.