

Your Financial Health: Developing a Financial Plan

It takes more than luck to get what you want out of life. It takes careful planning. The most effective tool for your financial well being is a sound plan. Think of a sound plan as a road map to help get where you want to go.

Financial plans help individuals live within their means, identify their financial goals and accumulate the savings needed to meet those goals. A good plan also helps individuals to be prepared for financial emergencies as well as to reduce credit use. Having a financial plan in place can allow an individual a sense of financial security and control over their financial future.

In order for a financial plan to be successful, one must take the time to gather relevant and realistic information, make some crucial decisions and prioritize their financial goals, put the plan into action and continuously evaluate the plan.

The following are steps that can be used when developing an ongoing financial plan.

1. Establish Financial Goals

The first step in designing a financial plan is to identify what it is you want out of life - your goals. Take the time to put your goals in writing; not only will that reinforce the significance of the goals, but it will help you be able to organize them as well.

One way to organize your goals is to group them into short-term and long-term. Short-term goals are those to be reached within a year or less. Examples include an emergency fund, a new sofa, paying off a charge card or building a holiday gift fund. Long-term goals are those to be reached in more than a year, perhaps five or more years. Examples of long-term goals include a new home, children's college education and retirement. (Saving methods may vary for short and long-term goals. This will be addressed in a later feature.)

In establishing goals you also need to ask the following questions: what do I need to do to accomplish each goal? When do I want to accomplish it? What will it cost? What money have I set aside already? How much more money will I need to save each month to reach the goal?

Look at the priority of your goals. How hard are you willing to work and save to achieve a particular goal? Would you work extra hours, for example? How realistic is a goal when compared with other goals? Reorganize their priority if necessary.

2. Determine Net Worth

Determining your net worth is not as difficult as it may seem. Your net worth is simply the total value of what you own (assets) minus what you owe (liabilities). It is a snapshot of your financial health.

To determine your net worth, start by adding up the approximate value of all your assets. Your assets include such items as your home, vehicle(s), checking and saving accounts and the cash value of any life insurance policies you may have, excluding any death benefits. Assets also include the current value of investments, such as stocks, real estate, certificates of deposit, retirement accounts, IRAs, and the current

value of any pensions you have. You may have other assets that are also of value. Use particular caution and realistic market values when evaluating their worth.

Next, add up the approximate value of all your liabilities. Liabilities may include the remaining mortgage on your home, auto loans, student loans, credit card debt, income taxes due, taxes due on the profits of your investments, if you cashed them in, and any other outstanding bills.

Subtract your liabilities from your assets. Do you have more assets than liabilities (a positive net worth)? Or more liabilities than assets (a negative net worth?) The goal is to produce a positive net worth and to build upon it.

Plan to review and update your net worth annually. Your net worth is a way to monitor your financial health since the goal is for it to increase each year. Compare annual net worth statements to determine if you need to modify your financial behavior and/or your goals to meet your changing financial conditions. If you expect significant changes in your liabilities such as college expenses, you may want to project what your conditions will be in the coming year to help prepare and plan.

3. Estimate and Balance Income and Expenses

By estimating your income and expenses you can obtain a picture of your current financial situation. Understanding how your income is being used for expenses can help you develop a realistic plan to reach your financial goals.

Begin the process by totaling all of the income you expect to receive during a given period of time (one month is a good place to start). Include regular income, such as wages, Social Security benefits, public assistance and child support payments, gifts, allowances, interest and dividends.

Next, keep detailed records for one month to record all expenses. Based on this information as well as old records, receipts, bills and cancelled checks estimate future expenses. Calculate estimated expenses for the same time period that you used for your income estimation.

Compare your income to the total estimated expenses. Are income and expenses balanced? Are you paying more in expenses than you have in income? If so, where are you overspending? Which expenditures can be postponed? How can you increase your income? Or does your income exceed your expenses, in which case do you have an established savings plan in place for your goals?

Now is the time to consider which expenses can be cut back or where money should be reallocated. For instance, in order to meet your goals you may decide to cut back on spending (such as golf and dancing) and apply the money towards savings (perhaps for a new car).

4. Review Personal Debt Situation

Credit is a powerful personal finance tool that can make it possible for you to have and enjoy things now and pay for them later. But purchasing on credit costs additional money and can tempt us to overspend. Before purchasing with credit, ask yourself the following questions: do I really need it? Can I really afford it? Why exactly do I want it? What other things will I have to do without? What happens if I can't pay this off?

How much debt can you afford? A general rule of thumb is that no more than ten percent of a household's take-home pay should be committed to consumer installment and credit card debt. If your current personal debt situation exceeds this amount you should seriously considered reducing your financial debt as your top priority.

While paying cash is almost always less expensive than using credit, there are times when using credit is necessary. When you do use credit, it is in your best interest to borrow as little as possible, seek the lowest finance charge, and pay off the loan as soon as possible.

5. Allocate Savings to Reach Goals

If you want to successfully accomplish your goals you need to actively save money. When developing a financial plan many financial advisors will suggest that you pay yourself first. Paying yourself first means establishing a set amount to save each payday and putting that money into savings rather than spending it on current consumption. In developing a habit of regular savings for future goals you are making a commitment to successfully accomplish your goals. For instance, if your place of employment offers a retirement plan by choosing to participate not only will you have a plan to meet your retirement goal, but you may be able to do so with tax advantages and by paying yourself first.

When developing a financial plan you may initially find it difficult to save money because current income is needed for current living expenses, but even a few dollars a month can grow and contribute to financial independence. For instance, saving a mere \$10.00 a week for five years, at an average return of 10%, will give you \$3,327.81. Saving the same \$10.00 a week for 10 years will give you \$8,687.29 (at 10% average rate of return). This is called compounding interest. The money you save is actually making you more money. And the longer the savings have to make money, the more it will make.

6. Implement the Plan

The mistake that most people make is that they fail to implement the financial plan that they have taken the time to create. The implementation of your financial plan is essential to its success. Set a date to implement your plan (the sooner the better) and stick to that date. Plan a schedule to pay the bills, balance the checkbook, review the monthly financial statements, and set up a savings account. Make the success of your financial plan a top priority. By doing so, you will better insure your financial security and the successful accomplishment of your goals.

7. Review and Modify the Financial Plan

And lastly, a financial plan cannot remain the same for the duration of one's life. A financial plan is a tool to help you reach your financial goals. As your financial goals change so should your financial plan. Constant review and modification of your financial plan help to ensure their long-term success.