Unit 1: Personal Financial Planning Overview and Spending Review

Topics:

- Personal financial planning techniques
- The personal financial planning process
- The life cycle of financial plans and the role they play
- The use of professional financial planners
- The economic environment's influence on personal financial planning
- Career choices

Personal financial planning techniques

What is a Financial Plan?

A financial plan is a comprehensive approach to managing your financial life. It is used to aid you in preparing for your short-term and long-term goals. A financial plan includes income, expenses, investments, and debt. It is a road map that shows where you are now and how you plan to get to where you want to be in the future financially. A financial plan is not written in stone. As you go through life, circumstances, income and expenses change, and when they do, you should review and edit your financial plan.

Planning for your financial security is important at any age. It is never too early or too late to start saving for your retirement, your children’s college education, or that vacation home you have always wanted to own.

The personal financial planning process

Personal financial planning is the process of developing and implementing an approach to meet goals, to prepare for any financial emergency which may arise, and to build a more secure financial future. People who develop financial plans often have less stress because they do not spend time worrying about their financial situation. They know where they stand and the actions they are taking. Money is a key stressor in personal and family relationships.

Many people think that a financial plan is only for the people who have wealth. This is not true; everyone needs to plot the best strategies for their future. Financial planning is not a one-time event. It is a continuous process. Your plan needs to be re-examined periodically as changes take place in your life. Life events such as marriage, divorce, the birth of a child, college education, and retirement can affect the flow of money coming in and your expenses.

The steps to complete a financial plan:

1. Determine your current financial position
2. Develop your financial goals, both short-term and long-term

3. Identify strategies to achieve your goals

4. Create and implement your financial plan.

5. Review and revise your plan

Figure 1.1

Determine your current financial position

In order to know where you are going, you must first know where you are now. As a starting point for your financial plan, you will need to determine your current income and expenses. You should collect all of your financial information, including bank statements, credit bills, pay-stubs, and references for any other financial responsibility you may have. It is essential for you to understand where your money is coming from and where it is going.
Where does your money go?

Tracking your finances is very important not only during good economic times, but is especially important during bad economic times. One of the first steps in planning your financial future is to figure out where your money is going each and every day. Think about it; how many times a week do you stop for coffee? How about going out to lunch? These are just two examples of how the “little” expenditures can add up over time. You must learn wise spending habits.

You will be amazed at how those little costs can add up and end up costing you large amounts of money each month. By tracking your expenditures you will know where to limit your spending. Sometimes we spend money and do not realize the impact. Using a daily spending log will assist you in finding the areas where improvement is possible.

Cash Flow Plan

A cash flow plan is a tool to map your monthly income so that every penny is designated for some category. Every dollar you make must be allocated somewhere. With a cash flow plan you must be very specific and put every cent in the right category. Your list of categories should be very detailed and align itself with your personal situation. The cash flow plan breaks down your money to areas where it will be spent. For example, let’s say you allocate $200 of your income for gasoline for the car. This is an estimate. At the end of the month you will record your actual expense and figure out what percentage of your income is allocated to gasoline. The money which did not get used can be designated to a savings account. When there is an excess of funds at the end of the month, you would be able to designate more money to your savings or pay down your credit card bills. When you have spent too much money there is a short-fall. In this situation you will need to look for ways to cut your unnecessary expenses.
You will need to track your actual expenses so that you can then track your projected expenses for future months. With this information you can calculate the percentage of your monthly income that goes toward each expense.

With the premise that all money needs to be accounted for, your income minus expenses should equal zero. If it does not equal zero then you must adjust (an expense or savings) until the balance is zero.

To protect your future a very important category would be an “emergency” account. It is important to allocate funds each month to the emergency savings account until you reach a level of comfort. As a rule of thumb, reserve three months worth of income to cover expenses in case of an emergency. The current economic outlook seems to suggest that a reserve of six months might be a better goal to reach for additional security.

**Personal Financial Goals**

Once you have restricted any excessive spending, it is time to set personal financial goals. Where do you see yourself in the future? Are there items you would like to purchase such as a new car, vacation home, or a new house? Do you have a dream of paying off all your credit cards? If you have children, what are you doing to save for their college education? How close are you towards retirement? You must look at the lifestyle you plan to have once you are retired.

All of the above mentioned items will become part of your plan to secure your financial future. Putting all these things in perspective will help you to determine how much money you must set aside each month to reach your goals. Remember, planning your financial future is not just for the wealthy. It is important to remember that every little bit helps, so it is necessary to start early to save for your future. For example, if you want to save for your child’s college education but you feel you just cannot afford it, consider that, even if you put away $25 or $50 a month, eventually small amounts of savings will add up.

**The life cycle of financial plans and the role they play**

Life events can affect your finances and this can also affect how money is spent and saved. If you are single your expenses are probably less than a person who has two children. Adjusting your financial plan is necessary each time there is a change in your personal status. Deciding to attend college, getting married, having children, becoming ill, losing your job, getting promoted or retiring all affect your circumstances. Each can affect your income and, of course, your expenses.

Each time there is a new life event, there is a need to review your financial plan to determine if previous financial choices still pertain to your life situation and current values or if there are changes that must be made. Events can and will change your standard of living, which is the lifestyle to which you are accustomed. Standard of living includes the necessities, comforts, and luxuries enjoyed or desired by an individual or family.
Figure 1.2 shows at which points your financial plan should be reviewed and evaluated to reflect the change. Your financial plan is not something you do once and forget; it is something that must be continuously updated to secure your financial future.

The use of professional financial planners

The process of assessing your financial future can be intimidating for you. There is nothing wrong with hiring a professional to assist you with this task. But, before you hire someone to help you out, make sure you do some research on financial planners. You need someone who understands your goals and, more importantly, you must be able to trust the person whom you are relying on to control your money.

The economic environment's influence on personal financial planning

The economy pays an important role in your finances. Inflation is a state of the economy in which the general price level is increasing. Higher inflation means that the dollar buys less, and does not stretch as far as it did previously. If you are spending more for your daily needs, this results in less money to save. When prices go up your purchasing power is reduced. To measure the rate of inflation, the consumer price index (CPI) is used. The CPI is based on the cost of a fixed basket of consumer goods and services and is published monthly. This is also referred to as the cost-of-living index. A depression occurs when the levels of employment and production are low. When people are not working it means they are also not purchasing goods. This can result in low or no production of the goods you may need.

The cost of living in the area in which you live will also influence your financial wealth. If daily expenditures for convenience items, gasoline, food, and maintenance goods and services are high in
your community, extra money for savings will be less available because you will need it just to pay for the necessities of everyday life.

**Career choices**

Your career choice has everything to do with your earning power. We all must live within our means. The career you choose is critical in determining your earnings. Education (the level you have completed), your life style preferences, and the economic outlook are all factors that are affected by career choices. Your personal values come into play as far as how you spend your money, and what is important to you. For example, some people are happy to drive a ten year old car, while others have to have the newest model.

It is not only important to have a financial plan, but it is important to plan for career changes. The average person will change jobs at least seven times in his/her life. The career you choose will determine your financial outlook and personal satisfaction. When a person makes a career change, there are opportunities and risks which one must be prepared to handle. Events such as getting married or having children can make a person question their current position in their career. You may value time over money, or vice versa, at different times in your life. It is a good idea to periodically evaluate your career choice and to make sure that it continues to fit your lifestyle and values.

Many young people try to climb the corporate ladder by working 40, 50 and sometimes 60 hours a week or more trying to get ahead but find, once they are married or have children, that it does not fit them anymore. They want to spend more time at home and less time at work. This situation could indicate the need for a career change.

**Unit Summary**

This unit has given you an overview of the financial planning process. You must take a good look at your current financial situation and develop your financial plan from there. Start by monitoring your daily spending and look at where your future is going to lead you; it is a step-by-step process which will help in planning your future.

Personal choices play a big part in your life plan. As you go through this course you will need to take a close look at the financial situation that you are in today, and where you want to be in the future.
Resources

http://www.bls.gov/cpi/
Glossary

**Consumer price index (CPI)**
A measure of inflation based on changes in the cost of a fixed basket of consumer goods and services.

**Depression**
The phase of the economic cycle when levels of employment and production are low and economic growth is at a virtual standstill or even negative.

**Expansion**
The phase of the economic cycle when levels of employment and production are high and the economy is growing, generally accompanied by rising prices for goods and services.

**Financial assets**
Intangible assets, such as savings accounts and securities, that are acquired for some promised future return.

**Financial goals**
Results that an individual wants to attain, such as buying a home, building a college fund, or achieving financial independence.

**Inflation**
A state of the economy in which the general price level is increasing

**Personal financial planning**
A systematic process that considers important elements of an individual’s financial affairs in order to fulfill financial goals

**Purchasing power**
The amount of goods and services each dollar buys at a given time.

**Recession**
The phase of the economic cycle when levels of employment and production fall and the growth of the economy slows

**Recovery**
The phase of the economic cycle when levels of employment and production are improving and the economy is growing.

**Standard of living**
The necessities, comforts, and luxuries enjoyed or desired by an individual or family.

**Tangible assets**
Physical assets, such as real estate and automobiles that can be held for either consumption or investment purposes

**Wealth**
The total value of all items owned by an individual, such as savings accounts, stocks, bonds, home, and automobiles