Five Key Areas of a Complete Financial Plan

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By Jim Werner

During my teaching days, some of my students were satisfied with a grade of 80%. While that may be an acceptable result in the classroom, a grade of 80% in your retirement planning is dangerous. Any portion of a retirement plan that is incorrect, unattended, or forgotten about can easily spill over and create uncertainty with profound damaging effects into areas that were well planned.

A comprehensive, high-quality retirement plan must include five key areas of focus:

1. Expense and Income planning
2. Legal planning
3. Tax planning
4. Emergency planning
5. Asset planning

The expected outcome of a complete retirement plan is a feeling of utmost satisfaction, knowing you are on track to be five-for-five into and through retirement. Each area of focus must not be viewed on its own, because as they are interdependent. Being three-for-five or four-for-five is not good enough.

Having a plan that coordinates and creates alignment between your goals and resources will increase the chances of having an increasing retirement income you cannot outlive. The results of a successful plan can have a positive, multi-generational impact.

Expense and Income Planning

The cost of living will increase over time. Budgeting and expense planning helps us be prepared for these unwanted future increases. For the purposes of planning, it is reasonable to suggest that today's lifestyle expenses will double in 20 years. Now, that might not apply to everyone. Some people may see their expenses go down, as a mortgage or other debts are paid off. Other opportunities to lower expenses include downsizing, or moving to a state with lower taxes.

Having a written expense budget in place creates a realistic plan and helps put little things in perspective.

Let's say you were to spend $5 on a meal, for three meals per day. Over a 35-year retirement, the food bill would be a little over $190,000. And since the price of food will not go down over time, let's add 3% inflation. Your food bill is now $331,000, and that's at $5 per meal. Then multiply $331,000 by the number of mouths you plan on feeding. This is a good example to show how little things can quickly add up, and why you need to create a written expense plan.

The value of the expense analysis exercise can help:

- Create an awareness of where you are spending your money
- Help identify ways to maintain control of your expenses
- Provide an accurate estimate for future expenses
- Prioritize your expenses and goals

A good plan starts with expense planning. Once we know what the future expenses will be, we can then match up the income sources, such as pensions, Social Security, investment income, required minimum distributions, part-time work, and rental income, to the expense needs.

Legal Planning

Legal planning is about control. When set up properly, it can help you have control of decisions, assets, and emotions. Legal planning is about having a team of trusted resources in place help you make decisions during a time where you may not be able to make a decision for yourself. Important documents such as a power of attorney and health care proxy should be accessible to your agents (people you designate to make decisions for you). In a time of need, it doesn't help to have these documents in a vault and inaccessible.

Legal planning should also include a review of your beneficiary designations. I recently met with a newly hired professor at the local university. She wanted to name her current husband as the beneficiary for her tax-deferred savings account. During the course of the conversation, she mentioned that she had pensions with other schools where she had previously worked. At her first job, she was not married and had named her mother as a beneficiary. In her second job, she named her husband as the beneficiary. For the third job, she had named her minor son as beneficiary, as she had divorced the first husband.

She now has four accounts with four different beneficiaries - but she told me not to worry, as she has a will that names her second husband as the beneficiary of the accounts. Unfortunately, the beneficiary designations override the will. Should she predecease the named beneficiaries, her mom, first husband, and son would receive the accounts for which they are listed as beneficiaries.

Emergency Planning

Emergency planning is not exciting. You are probably not going to brag to your neighbors about your great emergency plan. The emergency plan is not designed to make you money, but rather put protections in place to prevent you from losing assets, or, if they are lost, provide you with reimbursement. Good planning can help anticipate a favorable result after the occurrence of an unwanted event. The plan helps identify how to minimize or transfer the financial risk that may otherwise have a damaging effect on your plan.

An emergency plan may mean different things to different people. For some, it means having three to six months of expenses in a savings account. For others, it may mean having the right insurance in place: homeowners, umbrella, business continuity, life, disability, or long-term care insurance.

The successful, goal-based plan must anticipate the realistic possibility of risks and include steps to minimize them.

Tax Planning

Tax planning is always a timely topic, and the new tax laws make tax planning more important than ever. How will the new tax law effect your tax liability? Since no two tax filings are the same, it makes sense to speak with your tax professional and ask for a 2018 tax estimate. If your taxes will be increasing, consider making a budget and earmarking money to cover the tax increase.

Taxes are confusing, and no one wants to pay more than their fair share. The complex nature of taxes doesn't help, but a well-constructed plan should consider all taxes: Income, capital gains, state/local, gift/inheritance, sales, and estate taxes. A good plan may not be able to project all future taxes, but some tax planning today could minimize your future tax bill.

Asset Planning

While working, we do our best to save money and accumulate assets. At a point in time when the earned income stops, we become dependent on the assets to provide income.

As you accumulate assets, planning helps coordinate the actions you need to take today to ensure a successful future. While it's always good to encourage people to save, it's equally important to make sure they are saving the right way.

Having all your savings in a tax-deferred retirement account or an illiquid investment, such as real estate, doesn't help if you need money in the short term. And having all your money in a taxable account may not be in your best interest as you may be losing out on tax advantages offered by other types of accounts.

Accounts can be classified in different ways based on the tax nature of the account that holds the assets: tax-deferred, tax-free, and taxable. And for taxable assets, these can be classified again for short term and long term capital gains.

It is important to be aware that assets are the one category that have a direct impact on the four other areas of focus.

The Plan That's Right for You

It's tough to offer advice in writing that is being made to the public as no two plans are the same. However, one thing that is true for most people: Financial advice must be comprehensive. Too often, I hear of advice given that is specific to one topic. I'm sure the advice is well intentioned for that one topic, but can easily have an adverse effect on other areas. It's difficult to give advice without know the big picture and full disclosure of one's assets, budget, emergency plans, taxes, and legal needs. Goal based planning and adviser support helps create a higher probability of success. The plan helps a family coordinate and understand the interdependency between each of the five areas of focus. The result of being 5-for-5 is a sense of confidence, security, and control.

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