FIRST COMMAND
EDUCATIONAL
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FINANCIAL READINESS FOR LIFE

DEVELOPING A FINANCIAL PLAN

WHY DO WE NEED A FINANCIAL PLAN AND WHAT DOES IT DO?

Life is complicated! We need to be able to take care of the expected—and unexpected—events of life, especially those that affect our finances.

We need a plan to:

- Help us achieve our long-term goals and dreams such as a home, car, travel, own a business, retirement, etc.
- Plan for accumulating wealth
- Protect our savings, investments, and other assets from loss
- Provide for our family's income in case of death or disability
- Handle unexpected events—medical bills, repair bills, etc.
- Fund our child's college education or other expenses, e.g., wedding, etc.
- Ease financial transition from current career to new one, or to retirement
- Ensure proper transfer of our assets to our survivors and beneficiaries

In other words, we need a plan to tell us how we are doing financially, provide a strategy to achieve our financial goals to become financially stable and secure, and provide us with information to make sound, informed decisions about our finances. This is a financial plan.

Despite the importance of personal financial plans, many people fail to plan for their financial future or to even understand what financial planning is. Why is this? There are many reasons such as fear of the unknown, don't know how to start, don't know the steps to take, fear of looking foolish, etc. Some specific reasons people have given as to why they don't need a financial plan are:

- I'll wait until I have more money to invest
- I don't need to worry about it until I get married and start a family
- I need to pay off my debts first
- I don't make enough money
- The market is too risky now
- I'll start next week…next month…next year…
- It's too late…I should have started before now

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However, the problem with waiting to develop a plan to manage your finances is that, as life progresses, it generally gets more complicated, not less, with events like marriage, birth of children, illness, college expenses, buying a home, retirement, and other things.

When do we need to develop a financial plan? You should start financial planning early in your working life. Financial planning can help when you are getting started in your career and trying to pay your bills, get out of debt, and save for the future. It can help you set your financial priorities when you have limited funds and competing needs, e.g., should you save for your children's college education or for your retirement. Your financial plan can grow with you as you get older and your financial life becomes more complicated.

A financial plan is a **written** document that includes a review of a person's current financial situation (including income, value of assets, liabilities, and investment) and financial goals, as well as strategies to achieve those goals. The plan plays a vital role in helping evaluate whether you are currently in position to achieve your financial goals and to identify actions that must be taken toward achieving those goals. It acts as a source of motivation and keeps you accountable for your expenses. A financial plan acts as a guide to measure your financial progress and in making financial decisions.

DEVELOPING A FINANCIAL PLAN

A good financial plan should be written, personal, practical, flexible, and comprehensive. It should be easily modified and adapted to account for changes in your life or in your goals. Also, it should include strategies to address multiple stages of your financial journey. Specifically, a financial plan should address your savings, investments, tax strategies, risk strategies, and how your assets will be handled when you die or become incapacitated.

Generally, a financial plan should include:

- Evaluation of Current Financial Status and Net Worth
- Setting Financial Goals
- Developing a Budget
- Management of Credit and Debt
- Saving
- Investing/Retirement Planning
- Tax Strategy/Planning
- Insurance Planning
- College Planning
- Estate Planning

EVALUATION OF CURRENT FINANCIAL STATUS AND NET WORTH

You need to know where you are financially to set your future course. Consequently, the first step in developing a financial plan is to evaluate your current situation by creating a

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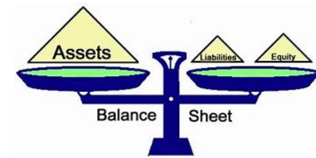
comprehensive list of all your assets and liabilities to determine your current net worth. This will provide a benchmark to measure your financial progress. It is a starting point in working toward your goals.

Assets can be defined as anything that we own that has monetary value, such as savings accounts, real estate, stock investments, IRAs, employer retirement savings accounts, home and car equity, cash, including anything with convertible value, i.e., can be sold for cash. Liabilities are obligations that you must pay or obligations for which you owe money, such as an auto loan, credit card debt, student debt, mortgage, etc.



After identifying and calculating your total assets and total liabilities, subtract your liabilities from your assets. The difference is your net worth. If the value of your assets exceeds the value of your liabilities, you have a positive net worth. If your liabilities exceed your assets, your financial status or net worth is negative, which means you need to save more and spend less. A negative net worth may not be of concern in some cases since many people, especially students, usually have loans and other debts to pay off as they begin their quest for financial security.

Net worth fluctuates and changes over time. For example, if you pay off a loan or the market value of your home increases and everything else stays the same, your net worth will increase. However, if you incur new debt or use up some of your savings on a new car, your net worth will decrease.

It is important to know how your net worth changes over time. If you assess your assets and liabilities regularly you will be aware of adjustments that must be made and will be able to make them in a timely manner.

SETTING FINANCIAL GOALS

Setting financial goals is the next step in developing a financial plan. In fact, you could describe financial planning as the process of establishing financial goals and identifying actions needed to reach those goals. Goals are critical to a financial plan and establish the reasons the plan is being created. Specific financial goals are necessary to make sure you end up where you want to be in the future.

Possible goals that might be included in a financial plan include:

- Paying off your credit card debts
- Creating a budget you can live with
- Saving an emergency fund of three to six months' worth of your income
- Spending less than you earn
- Saving for your retirement
- Saving for a down payment for a home or second home
- Saving for college

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- Paying off your student loans
- Increasing your income

You start this process by identifying, writing down, and prioritizing your goals. Be sure they are realistic and can be measured to determine how you are progressing in their achievement. Finally, keep yourself accountable by making them time-bound, i.e., assign a completion date to each goal. In other words, make them SMART—Specific, Measurable, Achievable, Relevant, and Time-bound.

Once you have an idea of your goals and how much money you will need to accomplish them, the next step will be to identify steps you will need to meet each goal.

DEVELOPING A BUDGET

A budget is the foundation of a financial plan. It is what will make your goals achievable. A good budget will help you to decrease expenses and indebtedness and increase savings.

Very simply, a budget is a plan in which you project future expenditures, and then you track and record them when they are made. Afterward, you compare your projected expenditures with your actual expenditures. The difference between the two will help you fine tune and adjust your budget or your expenditures.

Tracking your spending regularly can help you avoid overspending. By looking at exactly where your money is going you will ensure that your spending habits align with your priorities and goals. As you track your spending from month to month, revisit your budget to see if adjustments are needed. Reducing spending in one area, for instance, can free up money that you can apply to a financial goal. It is also helpful to conduct an annual budget review to see how your spending has changed year by year. You can then use that as a guide for making your next year's budget.

MANAGEMENT OF CREDIT AND DEBT

Your budget won't do you any good unless you keep credit and debt under control. Debt is often the obstacle holding you back from financial security. Debt, such as credit cards, student loans, or a mortgage, needs to be addressed in your financial plan with a timeline for repaying it.

Very few people have enough cash on hand to buy a car or a house outright, so we borrow money, at a price, to buy them today. Credit cards allow us to buy smaller items without carrying a pocketful of dollars around. We can buy things now that we might not have the cash for, but we incur an obligation to pay the debt, plus more money in the form of interest, later. It is hard to keep aside money to pay back loans. However, the quicker you pay off your debt, the better it is for your finances in the long run. Try to follow the 28/36 guideline, which

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suggests you limit about 28% of your pre-tax income for home debt (mortgage, rent, etc.) and about 36% for all debt.

Paying off high-interest rate debt is one of the best investment moves. The 17% to 20%+ interest rates imposed on many unpaid credit card balances can be a significant barrier to financial security. When you have many debts, you need to prioritize them and decide which ones to pay off first. Credit card debt, for example, with its high interest rates, might have higher priority than your mortgage with a lower interest rate.

When incorporating debt repayment into your financial plan, consider ways to reduce your debt. Refinancing a student loan or mortgage at a lower interest rate, for example, could provide you with extra funds from the lower payments you can use to pay down the principal.

SAVING

All good financial plans should include a savings plan. A savings plan will help you determine how much you must set aside from your income every paycheck or each month to reach your goals. As a general rule it is a good idea to try to save at least 20 percent of your income each month. If you have a 401(k), 403(b), or TSP account with employer matching, try to save at least the percentage that your employer will match. You should also try to save at least three to six months of your income in an emergency fund so that you can prepare for the unexpected. If you are older, you will need to figure out how much money you will need to set aside for retirement.

Some suggestions to help with your savings goals are:

- Automate your savings. Have a set amount deducted from each paycheck and deposited in your bank account.
- Save any "extra" income. Be sure to treat any extra income such as tax refunds, bonuses, monetary gifts, overtime pay, etc., as sources for savings.
- Reduce expenses. Consider reducing monthly expenses that add up such as your cellphone plan, cable service, streaming service, etc.

INVESTING/RETIREMENT PLANNING

A financial plan must also include an investment plan. Investments provide assets for long-term goals. Investing money into stocks, bonds, and mutual funds can be a great way to put your existing income to work, grow your wealth, and fund your long-term goals.

Before you start investing, you will need an investment strategy that can help you select your investments. The appropriate mix of stocks, bonds, and mutual funds for your personal situation will depend on your own goals, tolerance for risk, and the number of years you expect to invest. During the early years of your life or career you may need your investments to

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concentrate on growth, thereby acquiring stock in companies expected to grow over the years. As you approach or enter retirement you would likely focus on an investment strategy of generating current income, consequently concentrating on bonds and stocks that pay reliable dividends. Some investors seek preservation of capital, which attempts to protect money they have by investing in insured or fixed-income investments such as Treasury securities, high-yield savings accounts, money market accounts, or certificates of deposit that promise to return the principal. However, while this may sound like a smart strategy, over time the constant avoidance of investment risk could lead to returns that may not keep up with inflation. Try not to be too conservative in your investments.

If you are not well informed or comfortable with investing, you should become familiar with the basics before investing some hard-earned money. There are many free educational resources available on the subject, or consider consulting with a financial professional.

TAX STRATEGY/PLANNING

Creating a tax plan and strategy is important for your overall financial plan. Your financial plan should be structured to maximize your tax savings.

The three basic types of investment accounts are taxable accounts, tax-deferred accounts, and tax-free accounts. When you invest in taxable accounts, the amount of money you invest is not tax-deductible, nor does it grow tax deferred. Instead, the investor is taxed on any dividends received during the year. When an investment is sold at a price higher than it was purchased, the capital gains will also be taxed. In tax-deferred accounts such as Traditional IRAs and 401(k)s, the invested money grows tax-deferred until it is withdrawn. When withdrawn it is taxed at your current income tax rate. In tax-free accounts such as Roth IRAs and 401(k)s, the money invested grows tax-free and is tax free when withdrawn, because you paid the tax on your contributions before investing them.

One strategy for minimizing tax liability is diversification. Diversification is the process by which you strategically spread investment dollars among various account types with different tax requirements and risk. Tax diversification can help you choose between using a Roth IRA, a Traditional IRA, a Traditional or Roth employer-sponsored retirement plan, or a regular brokerage account. In most cases, you may need all types of accounts. Your allocation of assets and investment dollars will change with time (age), your personal tax situation, and changes in tax rules.

The order in which you withdraw income from different types of accounts in retirement can also affect your taxes. Tax diversification can help you structure withdrawals to potentially reduce taxes and increase your after-tax spendable income.

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Other tax minimization strategies that can be considered include tax-loss harvesting (using capital losses on some investments to offset capital gains on other investments), investing in municipal bonds or dividend-paying stocks, converting traditional retirement accounts to a Roth account, using tax-advantaged educational savings programs such as a 529 Educational Savings Plan, or using a Health Savings Account (HSA) if eligible to have one. As mentioned above, your decisions will be based on your personal tax situation.

Along with your overall financial plan, your tax plan and strategy should be reviewed at least annually since tax laws and regulations change every year. Using the services of a knowledgeable tax professional is recommended.

INSURANCE PLANNING

Another important component of a personal financial plan is an insurance plan. Risks need to be identified as well as the type and amount of insurance needed to offset those risks. An understanding of the various types of insurance and how they help manage risk is critical to making these decisions.

Personal assets exposed to loss include:

- Income
- Savings/checking accounts
- Retirement savings/pension
- Home
- Personal vehicle
- Investments
- Other personal property

There are various types of insurance to protect different types of assets. Some of the most common and essential types include:

- **Life insurance**: After the insured's death, funds can be provided to beneficiaries for income or other expenses such as funeral expenses, mortgage/rent, etc.
- **Health insurance**: Your health is the greatest asset. Health insurance can cover high medical costs that could negatively affect your financial situation.
- **Renters'/homeowners' insurance**: Provides coverage for damages or other losses due to disasters or crime.
- **Automobile insurance:** Provides protection from costs incurred due to vehicle accidents or theft.
- **Disability insurance:** Protects a person from loss of income if he or she is unable to work due to illness, injury, or accident.
- **Long Term Care Insurance:** Pays for care for persons with a chronic or disabling condition that requires constant supervision.

Every person's insurance needs vary. When purchasing insurance, you must evaluate the risks and their related costs to determine what is appropriate for each situation.

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Individual insurance needs can be affected by factors such as:

- Age
- Profession
- Economic status
- Health
- Family status
- Assets

COLLEGE PLANNING

It is a good idea to start planning for their college education while your children are still young. College planning discussions should cover things like scholarships, grants, financial aid, and student loans. As your kids approach college age, it's also helpful to talk about affordability when it comes to school choices, as well as your expectations about their contributions to their education costs, perhaps with a part-time job.
Opening a 529 college savings account or a Coverdell/ Education savings account are two ways to save money for college on a tax-advantaged basis. Those can be helpful even if you get a late start on saving.

ESTATE PLANNING

A financial plan should include an estate plan to explain how a person's assets will be distributed after their death.

Estate planning is something that many people put off because they either do not want to think about death or because they think that they have plenty of time to do it later. It is important to understand that the unexpected can happen at any time.

An estate plan can:

- Provide for the immediate family by distributing a person's assets in an orderly, timely, and cost-effective manner according to their wishes.
- Provide instructions for managing a person's estate during their lifetime if they are unable to make financial decisions for themselves.
- Appoint guardians for any children.
- Provide instructions for a special purpose such as donating to a charity, caring for an elderly parent or other family member, providing funds for education, etc.
- Help reduce estate taxes.

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Everyone has things that they want to protect. Estate planning is not just for married couples, rich people, or men. It is especially valuable for people:

- in a "non-traditional" relationship
- who have been married more than once
- who own property in more than one state
- with dependents

An estate plan can contain any of these items, in any combination; whatever it takes to accomplish the task:

- Will
- Trust(s)
- Power of attorney
- Living will
- Life insurance
- Gifts to charity
- Taxes

If you do not have an estate plan in place (even a simple one) at the time of your death, the state will decide who will receive your assets and who will care for your minor children. Also, a proper estate plan can reduce the estate taxes paid from your estate, leaving more money for your heirs. In addition, if you are incapacitated your loved ones may have trouble accessing your accounts to pay your bills for you or researching important health care information. Regardless of your age, you should at least have durable financial and health care powers of attorney in place.

If all it takes is a will and naming a beneficiary on an IRA or an insurance policy, then that's your estate plan.

DECIDING ON A FINANCIAL PROFESSIONAL

While anyone may be able to create a basic financial plan, there are benefits to getting help from a financial professional. If you attempt to do everything yourself, over time the process may become more complicated and overwhelming as you acquire more assets and your wealth grows.

A financial professional can provide expertise and knowledge about things like investing or retirement planning you may lack. They can also take a comprehensive view of your financial picture to spot planning gaps you might be overlooking. A financial professional can help guide you through complicated financial decisions so you can have less stress, more confidence, and more time to focus on other things. A financial professional should also hold you accountable to help you attain your goals

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with reviews held at least annually. Above all, your financial professional should be a fiduciary; that is, your interests and well-being are put above the professional's interests.

A financial professional can help you:

- Save money
- Protect against risk
- Manage debt
- Grow your assets
- Reduce tax liabilities
- Plan for retirement
- Identify entitlements to government benefits
- Plan your inheritance for next generation
- Stay on course

If you decide to work with a financial professional, be sure to select one that understands and will accommodate your personal and financial needs. Also, determine whether their compensation is fee-based or fee-only. Fee-based advisors may earn commissions for selling specific products, like insurance and investments products, while fee-only advisors charge only for services rendered. With fee-only services you are left to decide what products and services to purchase.

TAKEAWAY

A financial plan is an extremely valuable financial tool that can help you identify your goals, provide a strategy for achieving those goals, and allow you flexibility to adjust to life's events that may otherwise hamper achieving your and your family's goals.

A personal financial plan is not a static document. Financial planning is an ongoing process that continues throughout a person's life. A financial plan should be reviewed at least annually and adjusted as needed, especially to update changes in beneficiaries. Financial plans should also be reviewed any time there is a life event that may affect your goals such as a promotion, career change, marriage, divorce, birth of a child, death in the family, etc.

Remember—a financial plan that is not implemented, reviewed, or changed as time goes on is merely a document, **not** a plan.

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