

Financial Planning Basics

It's easy to put off taking care of your long-term financial affairs, but it's not smart! Don't let dealing with daily finances and the other activities of everyday life take precedence over the need to create a workable financial plan.

Here are some ideas that will help you come up with a plan that will cover the basics and put you on the road to a more secure financial future.

Develop a financial reserve. Being prepared with a reserve of three-to-six months of living expenses can help relieve some of the financial anxiety. Consider an automatic savings plan with a deposit into a savings account from each paycheck. The fund will grow, and you may not even miss the amount that goes in the account each month.

Get rid of high-interest-rate credit card debt. Interest rates on some credit cards are high. If you are carrying over balances and paying interest, cut down on your card use, pay more than the required monthly minimum, and begin to eliminate this expense. Also, you may want to consider changing to a different credit card with a lower rate.

Develop a household budget. To become more financially responsible, create a "household spending analysis." Seeing your spending patterns on paper will probably help identify areas where you could reduce expenses. Financial management software (Quicken or Microsoft Money) may also be helpful in getting your finances organized and saving time and money.

Save for retirement. Your financial lifestyle during retirement is largely dependent on the financial decisions you make before retiring. Social Security and the traditional company defined benefit plans are becoming less important as the responsibility for preparing for a financially secure retirement is shifting to the individual.

Start with your employer's retirement plan. Many plans, especially 401(k) plans, make it easy to save, offer investment flexibility, and enable you to reduce your taxes. Many plans also have provisions for the employer to make contributions on your behalf. Review your plan details, contribute as much as you can, and contribute at least enough to get the full employer "match."

If you have taken full advantage of company sponsored plans, and can still afford it, consider contributions to an IRA or Roth IRA. The tax deferred compounding aspects of these plans enable your funds to grow faster.

Be sensitive to taxes. No one likes to pay more income taxes than absolutely necessary. Be aware of the opportunity of deducting certain items like mortgage interest, state and local taxes, charitable contributions, and certain medical expenses. Also, consider the preferential tax treatment from capital gains on your investments.

Have a sensible investment strategy. Start with an asset allocation goal that divides your investments into equity, fixed income, and cash investment categories. Your initial asset allocation should be based on your time horizon (age) and how you feel about taking risks. The younger you are and the more comfortable you feel with risk, allocating a larger portion of your funds to equities may help you earn higher returns. However, remember that all investments involve risk and that past performance is no guarantee of future results.

Be adequately protected. Insurance provides protection against the unknown. Make sure your possessions, life, and health are adequately insured. Examine the level of deductibles and the coverage amounts to get the protection you need at the lowest cost.

Take care of estate planning. Your will can ensure that your assets are distributed as you desire on your death and can help reduce any estate taxes. But estate planning is more than reducing taxes. Your estate plan should include documents that designate someone to make financial decisions if you are incapable of making them (durable power of attorney for finances) and that designate someone to make medical decisions if you are incapacitated (durable power of attorney for health care).

Finally, organize your records. Having a system for handling monthly expenses can reduce the stress and time needed to handle your everyday finances. Using a system to keep track of investment and tax records will make every tax season less "taxing." Having to hunt for the name of your insurance agent, an account number, a frequent flyer number, or any other bit of information can be a waste of time.