



FINANCIAL PLANNING

THE ART OF REALIZING YOUR FINANCIAL GOALS

CANADIAN ASSOCIATION OF FIRE CHIEFS

Financial success means different things to different people. For some it means retiring early, for others being debt free and for others still a life of financial luxury. This chapter is not meant to give you all the answers on how to achieve financial success, rather it is intended to provide you with some useful information to help get you started towards achieving your financial goals. The quiz below is an example of the type of money questions you should be asking yourself.

10 QUESTIONS TO TEST YOUR FINANCIAL FITNESS

	Yes	No
1. Do I have a systematic savings plan in place?	___	___
2. Do I have a cash reserve for emergencies and opportunities?	___	___
3. Do I have a cash reserve for emergencies and opportunities? Are my savings growing faster than inflation?	___	___
4. Am I taking advantage of tax saving opportunities?	___	___
5. Do I have a will?	___	___
6. Will my retirement income enable me to maintain my life-style?	___	___
7. Do I know how much it costs to put a child through university?	___	___
8. Do I have investments in mutual funds?	___	___
9. Do I fully understand the type of investments I have?	___	___
10. Do I know how much my retirement income will be?	___	___

If you answered no to any of the questions, there may be some holes in your financial plan which need filling. So read on and let us help you find some answers.

GETTING A HANDLE ON YOUR SITUATION

There are three main reasons why people fail financially; Lack of a Plan, Procrastination and Bad Advice.

Perhaps the most important element of a good financial plan is to know where you are heading. You must take some time and decide what your objectives are, whether they include paying down the mortgage quicker, retiring early or saving money for a child's education. The greatest shock that most Canadians receive occurs when they realize, all too late, that their dream of financial independence will never become a reality due to the lack of a plan.

Take out a pen and paper, and as fast as you can write down everything you would like to achieve financially. Make sure not to limit yourself but be realistic. Pick the three main goals and list them in order of importance. Once you know what it is that you want, we can create the means of getting you there.

The next thing you must do is take a hard look at your present situation. Make a list of your assets and liabilities. Consider the interest rates and the length of time left to pay off your debts. Are any of your debts tax deductible? Are you paying the debts with the higher interest rates first, i.e. credit cards? The easiest way to increase your net worth is to lower your debt load. So if you have Canada Savings Bonds paying 6% before tax and a car loan at 16% after tax, you're better off to pay the loan. If you have a number of debts such as credit cards and short-term loans, consider consolidating them into one loan. The interest rate will likely be lower so that more of your payment will be going towards the principal. Ultimately, the objective is to increase your cash flow. Therefore, the sooner you can rid yourself of consumer debt the sooner you can start to invest the money.

If you're like most Canadians, one of your concerns is a comfortable retirement. Take a look at your income and make a list of your monthly expenses. Remove those expenses which will no longer be a factor upon retirement but leave those which will still exist after retirement. This is where the planning becomes a bit more complicated. Compare your expenses against your projected pension income, but bear in mind that the further you are from retirement, the more inflation will reduce your buying power.

Example, using an average of 5% inflation per year, a \$50,000 pension today will have a buying power of less than half of that by the year 2010. Therefore, the question that arises is where do we make up the shortfall? Do you have RRSP's? Are you taking

INVESTMENTS

There are a multitude of investments available in the financial marketplace today. Unfortunately, most of us lack the time, skill and knowledge to choose the type of investment vehicle which best suits our needs. One thing that we all understand, its the relationship between risk and reward. Most of us are interested in the greatest reward for the least amount of risk. Therefore, you must consider your comfort zone when choosing your investments. The following is a brief explanation of some of the options available to you and is listed in order from lowest to highest level of variability.

1. Savings Account: Low returns but great for an emergency fund.
2. CSB's, T-Bills's, GIC's: Moderate returns, generally low risk, but may not keep up with inflation.
3. Government Bonds, Mortgage Backed Securities: Competitive returns, extremely low risk.
4. Real Estate: Competitive returns, moderate risk.
5. Preferred Shares: Competitive returns, preferential tax treatment, moderate risk.
6. Common Shares: Potential high returns, preferential tax treatment, some risk involved.
7. Tax Shelters: i.e. films, flow throughs, limited partnerships etc., extremely risky.

While a savings account offers security and is necessary as an emergency fund, in the long term, its returns are not competitive compared to other investments. Over the last few years we have also seen the decline in opportunity in the real estate market as an investment vehicle. Similarly, individual stocks can be highly volatile. Also, there is no doubt that while tax shelters were very popular in the 1980's, very few have produced more than nominal returns.

For these reasons, most of us find ourselves with the bulk of our money in numbers one

and two and a bit of four. However a good financial plan, and long term investment strategy should also incorporate elements of numbers three, four, five and six. To accomplish this and reduce the risk substantially, more and more Canadians are turning to mutual funds. Very simply, a mutual fund is created when thousands of people pool their money and have it professionally invested and managed for them. Mutual funds can invest in everything from treasury bills to gold mines.

When selecting a mutual fund, it is important to consider the type of investments involved, the historic performance of the fund and the risk management mentality of the fund managers. Once you find the type of investment which best suits your needs and goals, mutual funds can be a tremendous asset to your financial plan. Once again, it is vitally important to get good advice from a professional.

TAXES

"The more you make, the more they take!"

By now, most Canadians are aware that taxes have consistently increased during the 1980's. Governments appear to be continually searching for new and innovative ways to establish additional taxes and it seems that taxes will continue to increase throughout the 1990's.

As your taxable income increases, the percentage of tax that must be paid on that income also increases. Different tax rates at different income levels result in what is known as marginal tax brackets. This tells us how much is to be paid in taxes from each additional dollar of taxable income we earn.

A tax deduction is an actual deduction from your earned income before calculating your final marginal tax liability. A tax credit, on the other hand, is an amount subtracted from your taxes owing to arrive at the actual tax that is due. Income deferral means delaying taxes payable on income earned currently to future years.

It is important to realize that the real return on your savings is only what you get after paying income tax. The key is to determine the source of your income. For example, a dollar of interest from a Canada Savings Bond, GIC, Term Deposit or savings account in a bank, is taxed at your maximum marginal tax rate, which may be as high as 53%.

A dollar of interest income is also worth less after tax than a dollar paid out as a dividend by a taxable Canadian company. The tax break is created by the Dividend Tax

Credit. Similarly, the dollar of interest income is also worth less, after tax, than a dollar of Capital gains. You pay tax on a maximum of seventy-five cents on every dollar of capital gains earned and you may escape the tax completely.

Once you have set your personal financial goals, it is very important that you recognize taxable income from any transaction and the form which will give you a favourable tax treatment. Details should be discussed with a financial planner, who can also explain the advantages of income-splitting between spouses, such as a spousal RRSP, to reduce taxes further.

RETIREMENT PLANNING

Today, approximately 12% of Canada's population is over 65 years of age. Over the next 10 years the percentage will climb as more and more Canadians live longer and healthier lives. The common questions in the minds of most Canadians over 50 years of age are:

"Will I have enough money to provide the life-style I want when I stop working?"

"Am I looking after my money and other assets in a prudent way?"

"What should I be doing to minimize risks that could jeopardize a comfortable retirement?"

It's been said that financial freedom means different things to different people. Only you can decide what it means to you. A financial planner can assist you by drawing up a plan with you and recommending the most appropriate income stream - from an annuity, a RRIF (Retirement Income Fund) or a LIF (Life Income Fund) or a combination, if these options are available to you.

The planner will analyze all of your assets, liabilities and sources of income. Based on this overall analysis, he or she can then make a sound recommendation as to how these assets should be utilized in order to provide a maximum income with minimum taxes paid.

Some of the oldest, well established financial planning organizations in Canada have developed highly sophisticated computer software which will not only project your income and taxes over a ten year time frame, but will also take into consideration inflation and various investment rates of return, as well as, any shortfalls in your investment

portfolio. A computerized analysis and planning session is a must for anyone preparing to retire within the next five years.

ESTATE PLANNING

The three main reasons why you should consider estate planning are the following:

1. To ensure that you and your family are looked after adequately now and during retirement and that the heirs are provided for after your death.
2. To distribute your assets during your lifetime and on your death according to your wishes.
3. To minimize the erosion of the wealth you have built up, now and in the future.

Your personal objective should be thought out and realistic. The first step is to determine what your assets, liabilities and income are now and project what they will probably be in the future. A financial planner can develop a sound plan based on the information you provide. He or she will probably coordinate the work of other professionals, such as lawyers, insurance agents and accountants.

The two most important documents to establish and review periodically are your will and Power of Attorney.

The most obvious reason for a Will is to ensure that, insofar as possible, after death, your property is distributed in accordance with your wishes. If you don't leave a Will after your death, your property is divided without regard to what your stated wishes might have been during your lifetime. Someone else makes the decisions, not you.

A Power of Attorney is a document by which one person gives to another the right to act on his or her behalf with respect to his or her financial affairs and property. The form is simple but should be drawn up by a lawyer to make sure it covers all the things you want and complies with existing laws. It allows the "Attorney" to deposit and cash cheques, pay bills and taxes, invest money if you fall victim to a debilitating disease, or stroke or accident which impairs your ability to look after your affairs. The Power of Attorney ends when the individual, still being competent, revokes it, or when he or she dies. In other words the Power of Attorney does not replace the Will, but simply delegates authority while the individual is alive.

CONCLUSION

Life for most people is continually becoming faster and more complex and there seems less time to research complicated matters such as taxation. This is why more and more Canadians are turning to the service of a professional planner who is trained to assess needs, understand your financial goals, appreciate your "comfort zone" with respect to investing, and develop a plan and strategy to help you realize your financial goals.

The best time to look into financial planning for yourself is NOW - **before** you retire and **before** you decide to share your assets. In other words, just as prevention is critical in minimizing fire damage and loss of lives, financial preparation minimizes taxes, unnecessary losses and disruption of a comfortable life-style.