Farmington Observer

Business

Marilyn Fitchett editor/591-2300

Develop financial savvy with 5-part plan

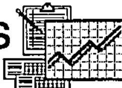
Five Financial Pitfalls

1. Lack of a financial plan
2. No spending controls
3. Inadequate insurance
4. Failure to plan an investment portfolio
5. Poor estate planning

Actions for Financial Success

1. CREATE A FINANCIAL PLAN
   - Organize your financial goals
   - Set clear, specific goals
   - Follow through - be persistent
2. PRIORITIZE EXPENDITURES
   - Track where money is spent at least monthly
   - Save a portion of your pre-retirement income
3. REVIEW YOUR INSURANCE COVERAGES
   - Be sure disability coverage is adequate
   - Periodically review life insurance needs
   - Check liability coverage
   - Update amounts of property coverages regularly
4. PLAN YOUR INVESTMENT PORTFOLIO
   - "Pay yourself first" each month
   - Diversify and balance your portfolio
   - Focus on long-term results
5. UPDATE YOUR ESTATE PLAN
   - Create a will
   - Consider trust arrangements as appropriate
   - Review and update beneficiary designations

FAMILY FINANCES



By Dan Boyce and Alan Ferrara
staff writers

"A danger foreseen is half avoided."

This month's column discusses common financial problems gleaned from the responses we have received from readers of this column. This departure from our normal financial profile format is part of our continuing effort to provide readers with insight into actions that can improve their financial lives. Marking the second anniversary of writing this column, we believe that by noting these common pitfalls our readership would be able to make better financial decisions.

One of the most common shortcomings we see is a lack of any financial plan whatsoever — much less one that is broad in scope and comprehensive in nature. Frequently, people will spend more time planning a two-week vacation than they will spend planning their entire financial lives. A plan can become the foundation for financial success. Without one, chances for reaching financial goals are considerably diminished.

In creating a plan, financial organization is important. Readers request and are sent a data questionnaire if they are interested in being profiled in this column. Many that are returned are incomplete or inaccurate. To make good financial decisions, it is important to have an accurate picture of your current financial condition.

Another common problem is lack of clear goals. Almost everybody has both short-term financial goals and long-term goals. Most people overemphasize one or the other. They are either restricting their standard of living unnecessarily to provide for the unknowns of the future (the hoarders) or else they spend every dollar that passes through their hands, making no provision for their long-term financial security (the spendthrifts).

TO HELP develop goals, think of them in three categories: short term (*under two years*), *medium term* (two to five years), and long term (five years and longer). Then develop a financial wish list and place the items on the list into the time frames. Finally, prioritize the items on a scale of one to five.

After goals are set and a plan formulated, another common pitfall is failure to follow through with the plan established. It takes persistence to reach many long-term goals. In our society, we have become so used to the idea of immediate results — we have instant tea, instant replay, instant gratification — that we have frequently lost sight of the time and patience needed to reach a meaningful goal. Although winning the lottery or receiving a significant inheritance may provide financial security for a few, most of us must build our financial futures through diligence and consistence of effort.

A second major problem area frequently mentioned is one of controlling expenditures. This is probably the single most common reason people fail to reach long-term financial goals. Note that the emphasis here is on expenditures, not on income. There is almost no limit to what one can spend. But it is how the available income is handled that determines financial success.

Most people have no real idea of where their money goes each month. Only if some dollars just happen to be left over at the end of the month is money put away for the future. Even if modest savings are achieved, frequently they are depleted when a major purchase such as a car or a vacation is made.

It is important to put away a portion of your income each month for long term — to provide for the old man or old woman you will hopefully become one day. As a general rule, 10 percent of gross income is a good target. Start modestly and build up to that target.

A THIRD MAJOR area where oversight occurs is in the insurance coverages. Perhaps surprisingly, the most frequent shortcoming here is in *long-term disability area. Many* people are unsure whether they have any coverage, or mistakenly assume that their employers have provided them with this coverage. Statistically, only about one-third of employees have any long-term disability coverage, and frequently this coverage is inadequate. Coverage should provide between half and two-thirds of predisability income and should last until age 65. The monthly premium on a policy that provides a $2,000 monthly benefit for a 40-year-old would be approximately $65.

Life insurance is another frequently neglected area. Many respondents have the wrong amount of coverage. Sometimes they are overinsured, which wastes premium dollars, or more frequently, they are underinsured because they have neglected to update their coverage in line with current circumstances. This is an area that should be reviewed at least every few years with an insurance agent.

We have also found that auto and homeowners coverages frequently have inadequate liability coverage and insufficient property coverage. Especially as assets grow, one becomes a more attractive target for any lawsuit. Often an umbrella liability policy that provides up to $1 million of liability coverage is a desirable additional coverage that will cost $15-$150 per year.

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Dan Boyce

Alan Ferrara

Deciphering annual reports

practically speaking

If you find annual reports baffling, you're not alone. People try to read them the way they read a book or magazine — and that's a mistake. Annual reports are reference works, according to the Farmington Hills-based Michigan Association of Certified Public Accountants.

You don't read the dictionary the way you read Dickens, and you don't approach an annual report the way you do People magazine.

When you are considering an investment or looking for a job, annual reports can be a valuable source of information if you know how to read between the lines. The first section of an annual report usually contains the chief executive's letter to shareholders and management's discussion of the company's condition. The letter generally highlights the company's financial data, summarizes the year's events and describes the company's goals for the future. While the letter to shareholders makes every attempt to put the company's best foot forward, a good letter will point out both the firm's weaknesses as well as its strengths.

To test a chief executive's credibility and gauge past management predictions, review the annual reports of the past few years. Compare projections made in previous years with subsequent results. How did the CEO's promise to increase company earnings fare? Were research and development projects completed on schedule and within the budget outlines by the chief executive?

If read carefully, the section called "Management's Discussion and Analysis" can provide valuable insight into a company's financial condition and operations. Generally, this section includes information about the company's liquidity, capital resources and operational results.

FOR MANY readers, the biggest mystery of annual reports is the financial statement — also called the "numbers" section. The core of the financial section consists of a balance sheet and an income statement. The balance sheet shows where the company stood as of a particular date and should be viewed as a snapshot rather than a moving picture. The balance sheet describes what the company owns (its assets) as well as what it owes (its liabilities). The difference between these two figures is the company's net worth or shareholder's equity.

While the balance sheet reveals the company's book value, the income statement measures the firm's earnings, costs and profitability. Income statements are also called profit and loss statements, operating statements or income and expense statements. Whatever its name, the purpose is always the same — to detail how much money the company made or lost during the period reported.

The income statement matches the amount the company received from selling its goods and other items of income against all the costs of operating the company. The difference between the two figures is the net income or net profit — the proverbial bottom line. This number represents the amount available to pay shareholder dividends or to be reinvested in the company. Search the income statement for extraordinary items that don't recur each year, such as a large tax credit or the sale of a subsidiary. Keep in mind that such an isolated event may distort the current year's profit statement.

SOME EXPERTS suggest that the fastest way to evaluate a company's financial statement is by reviewing the auditor's opinion, which appears near the end of most annual reports. An independent auditor issues an opinion on the financial statements provided by the company's management. The auditor's primary responsibility is to provide the public with reasonable assurance that the company's financial statements and the related disclosures conform with generally accepted accounting practices.

Last year, the Auditing Standards Board of the American Institute of Certified Public Accountants approved nine new statements on auditing standards. As a result, auditors will now have the increased responsibility for detecting and reporting fraud or illegal acts, for evaluating the system of internal control and for considering and disclosing doubts about a company's ability to continue in existence.

Another useful tool in ferreting out important information is the footnote section, usually found at the end of the annual report. If the footnote section is long, read all the items with special care. Footnotes generally serve one of two purposes — either they explain the company's accounting policies or they provide critical disclosures. The condition of the company's pension plan, heavy use of tax benefits, plans to sell a subsidiary or pending lawsuits are all examples of the type of information tucked into footnotes.

If you need to analyze financial statements for investment purposes, CPAs advise you to consult an expert for help in understanding the facts behind the figures.

WHAT CAN AN ANNUAL REPORT REVEAL?

- Company earnings
- Future plans
- Desirability as a possible employer
- Corporate values
- Social responsibility

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