Spring Cleaning

Spring cleaning should not be limited to garages, basements and closets. You should also do some financial spring cleaning. Hopefully, your tax returns have already been filed. Now, before you put all of your tax data away, evaluate your financial circumstances.

Cash Flow Statement

When you look at your tax return, do you wonder where all the money went? Now is the time to create a personal cash flow statement to find out, and also to determine whether you need to alter your spending habits. Start by determining your income. Usually, you can just take your adjusted gross income amount from your tax return as it will have already considered business and rental expenses. Next, deduct your most substantial expenses, including income taxes, mortgage payments and real estate taxes. Then, deduct other essential expenses such as utilities, insurance, food, and maintenance.

What remains is disposable income. Unless you are already retired, which will be addressed below, you need to commit some portion of your disposable income to savings. The amount of disposable income that should be saved is fact dependent, but at a minimum, you should try to save ten percent of your disposable income. The savings need not be limited to bank accounts and securities though. Purchasing and improving a primary or second home are forms of savings. After you determine a sustainable savings amount, withdraw that amount from your income after all of your essential payments have been made. If you wait until the end, you will save nothing. Budgeting yourself is boring, but it works.

Balance Sheet

In conjunction with the creation of a cash flow statement, you should also prepare a personal balance sheet. List all of your bank and securities accounts as well as their account numbers, locations and balances. (Be sure to note the valuation dates as your statements are not likely to have the same ending dates.) List all parcels of real estate and a rough idea of the fair market value of each. (Also note where the deed to each is located). With respect to life insurance policies, note the type of insurance, cash value, and death benefit of each.

Finally, list retirement plans, annuities and any miscellaneous assets, including tangible personal property. With two exceptions, it is unnecessary to get too detailed with tangible personal property. First, if you have a valuable item of property, be specific in describing it. Second, if you have an item of great sentimental value, be sure to note it.

On the liability side, list mortgages, auto loans, and the like. It is unnecessary to include liabilities such as real estate taxes and income taxes as these will be satisfied from income over the next year. Recall that you did not list your current year's income as an asset.

The balance sheet is helpful for two reasons. First, it helps you to evaluate whether you have enough money to retire at your desired retirement age or, if you are already retired, whether it is likely that you or your money will expire first. Second, it provides a comprehensive list to your loved ones in the case of an accident or survivors in the case of your death.

Retirement Planning

To use your personal balance sheet for retirement planning, you must keep in mind that not all of the assets listed have an immediate retirement value to you of the value listed. Real estate must be sold and expenses incurred (commission, closing costs..,) before you can spend the proceeds. The liquidation of retirement plans generates taxable income; thus, you must reduce the fair market value of those plans by their associated tax liabilities before considering the available proceeds. With certainty, I can state that you will never see the death benefit of your life insurance.

How much one needs to retire is the sixty four thousand dollar question (actually, it is usually much closer to a six hundred forty thousand dollar question). I am continually amazed that web sites can tell you, based solely on your age, how much you need to retire comfortably. What you need to retire is directly related to how much you spend while retired. What you spend is more a factor of your spending habits than your age. I have a married couple that make due with $50,000 per year and another that needs more than $200,000 per year. If they are the same ages, the former couple needs only one fourth what the later couple needs to retire "comfortably".

Estate Planning

As set forth above, the second reason for keeping all of your financial records current (within a year) is in the case of an accident or death. Far too often, I have seen something happen to the family member who handles the family finances and the remaining family members are left with more questions than answers. The cash flow statement allows survivors to survive, because they are aware of the income and liabilities.

The balance sheet identifies the property in which you had an interest. More often than not, assets are identified that survivors had no idea existed. Usually, they are relatively small, but I once had a spouse quite surprised to learn of an additional two homes in Florida. Without the balance sheet, tangible personal property with substantial monetary and/or sentimental value can easily be overlooked.

The first year that you do your financial cleaning is by far the most time consuming. In subsequent years, you can compare your actual cash flow results to those budgeted and see where you may scrape some additional savings. The balance sheets let you compare your net worth year to year. (It is a real eye opener if you move backwards on your net worth.) Financial spring cleaning is cumbersome but it can be more satisfying than cleaning the garage, basement or closet because, it may determine whether you can afford them.

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