Beginning the Estate Planning Process

How Are You Doing? A Financial Checkup

A financial checkup is as important as a physical checkup. A regular check of financial health can identify problems, chart progress, and outline action steps to achieve goals. It can also provide motivation to change.

There is no "one size fits all" answer in financial planning. What might be workable for one individual or family may not be for another. This fact sheet will help determine how you are progressing toward your financial goals and whether or not you have acted to improve your finances.

Think of this as you would an annual physical with a health professional — a checkup to improve your financial health and screen for potential problems.

Financial Fitness Quiz

Take this quiz to get an idea of how you are managing your money. Choose the score that best describes your current financial management practices:

5 = always (or yes) 4 = usually 3 = sometimes
2 = seldom 1 = never (or no, or don't know)

Financial Management

___ I have a checking account (or credit union share draft account) with which to pay bills.
___ I have enough money to pay my rent/mortgage and other monthly expenses.
___ I have enough money for an emergency, such as an unexpected vehicle repair bill.
___ I have written financial goals with a date and dollar cost, for example: $10,000 for a car by October.
___ I have a written plan or budget for spending/saving.
___ I keep financial records organized and can find important documents easily.
___ I know the effective percentage rate of my federal marginal tax bracket.
___ I calculate my net worth (assets minus debts) at least annually.

Saving/Investing

___ I save regularly for long-term financial goals (education for my children, a house, or retirement).
___ I have at least three months' expenses set aside in a readily accessible account.
___ I increase savings when I receive a salary increase.
___ I have a personal investment account for retirement (in addition to an employer-sponsored pension, if one is provided).
___ I have money in more than one type of investment (bonds, mutual funds, CD's).
___ The after-tax yield of my savings and investments is greater than the rate of inflation.

Insurance and Estate Planning

___ I have insurance to cover large, unexpected expenses, such as a hospital bill or disability.
___ I have a current will.
___ I review insurance coverage annually.

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Credit

___ Less than half of one week's pay goes to my credit cards, student loans, and car payments.

___ I pay off credit card bills to avoid interest charges.

___ I check my credit report annually.

Shopping

___ I comparison-shop for major purchases by checking at least three sources.

___ I avoid impulse purchases and don't use shopping as a form of recreation.

Scoring: Financial Fitness Quiz

0-20 points: You need to make some changes, but don't despair. It's never too late to improve your finances.

21-40 points: You could be headed for financial difficulty. Now is the time to reverse the trend.

41-60 points: You are doing a fair job of managing your finances and have taken some steps in the right direction.

61-80 points: You are doing a good job and are above average in managing your finances.

81 or more points: You are in excellent financial shape!

Note: Items scored 1, 2, or 3 indicate areas for focus to improve finances.[1]

Financial Goals

Financial goals should be SMART:

- Specific (amount and time to achieve),
- Measurable (show progress),
- Attainable (be realistic),
- Relevant (be important for your needs),
- Time-related (deadline for attaining).

Consider time frames when making investment goal decisions.

- Short-term goals: less than a year
- Intermediate goals: 1 to 5 years
- Long-term goals: more than 5 years

Write down your goals to measure progress. Then, for each goal, develop an action plan that includes the amount needed and number of months available to achieve it. For each goal, divide number of months available into the amount you want to save or pay down debt. Try to automate savings by having part of each paycheck automatically deposited into a designated account.

Most people probably haven't considered the idea of spending $1,500 to $2,000 to have a comprehensive individual or family financial plan written. While that may seem like a lot of money, it may be worth the investment. This publication provides tools to assess financial strengths and weaknesses, provide links to electronic worksheets that can help with goal-setting, and suggest ways to improve your financial health. You can use the results on your own or take them to a financial professional.

Net Worth

An important step in gaining financial control is to take an accounting of your total financial worth. Net worth is calculated by subtracting debts from assets. Assets include everything that you own. Debts (or liabilities) include everything that you owe. Figure your net worth annually to review your progress. Compare each year's figure with your financial goals. Ideally, net worth increases by 5 percent or more each year as a result of increased savings and reduced debt. In addition, a net-worth statement is a valuable aid in planning your estate and establishing a record for loan and insurance purposes. (See chart, next page.)

Income and Expense Statement

You can also check your financial health with an income and expense statement. It will show how much money you earn and spend. When calculating income, be sure to include not just wages, but tax refunds, interest earnings, child support, and any other seasonal or nonwage income.

There are three categories of expenses: fixed (rent or mortgage payment), variable (groceries, clothing), and periodic or irregular (vacation, school expenses). The difference between your income and expenses is your cash flow, or the amount that is available for savings and to reduce debt. (Forms to track your income and expenses can be found in the K-State Research and Extension publication "Essential Living Skills: Money Management," S134G, pages 28–33, at: *bookstore.ksre.ksu.edu/pubs/S134G.pdf*)

Financial Ratios

Financial ratios can be used as another kind of checkup tool. Liquid assets should be equal to three or more months of expenses and always be available for emergencies. Total debt should be less than total assets, or a household is technically insolvent. A common guideline is that annual debt payments, including mortgage, should be 36 percent or less of annual gross income.

- Liquidity Ratio: Liquid assets divided by monthly expenses. (Guideline: equal to three months' expenses or more.)
- Debt-to-Asset Ratio: Total liabilities divided by total assets. (Guideline: less than 1.0, which indicates insolvency.)
- Debt Payment to Income Ratio: Annual debt payments divided by gross income. (Guideline: 0.36 or less.)

Net Worth Statement

Assets – What You Own

Cash: On hand	$__________
Checking Account	$__________
Savings Accounts	$__________
Money Markets	$__________
Other	$__________
Cash Value Life Insurance	$__________

Real Estate/Property (Fair market value):

Home	$__________
Land	$__________
Other	$__________

Investments (Market value):

Certificates of Deposit	$__________
Stocks	$__________
Bonds	$__________
Mutual Funds	$__________
Annuities	$__________
IRAs	$__________
401(k) or 403(b) Plans	$__________
Pension Plans	$__________
Other	$__________

Loans Receivable	$__________

Personal Property (Current value)

Automobiles	$__________
Recreational Vehicle/Boat	$__________
Home Furnishings	$__________
Appliances / Furniture	$__________
Collections	$__________
Jewelry and Furs	$__________
Other	$__________

TOTAL ASSETS $__________

Liabilities – What You Owe

Current Debts:

Household	$__________
Medical	$__________
Credit Cards	$__________
Department Store Cards	$__________
Back Taxes	$__________
Legal	$__________
Other	$__________

Mortgages:

Home	$__________
Land	$__________
Other	$__________

Loans:

Bank/Finance Company	$__________
Bank/Finance Company	$__________
Automobiles	$__________
Recreational Vehicle/Boat	$__________
Education	$__________
Life Insurance	$__________
Personal (from family / friends)	$__________
Other	$__________

TOTAL LIABILITIES $__________

Subtract liability total from asset total to figure net worth.

Total Assets	-	*Total Liabilities*	=	*Net Worth*

Spending Plan/Budget

A spending plan includes projected amounts for income and expenses. Ideally, income should equal expenses plus money placed in savings.

Steps to make a spending plan:

- List anticipated sources of income
- List expenses
  - Fixed (include savings)
  - Variable
  - Periodic
- Compare budgeted amount with actual amount
- Adjust as necessary

A spending plan template can be found in the K-State Research and Extension publication "Essential Living Skills: Money Management," S134G, page 33, at: *bookstore.ksre.ksu.edu/pubs/S134G.pdf*

Tax Checkup

1. Pay necessary taxes but no more. Ideally you should owe nothing and get no refund when your taxes are figured. Why give the government a short-term loan without interest? If you do get a large refund, increase the number of deductions on your W-4 form to reduce the amount of money withheld from your paycheck. Then you can use the money from each paycheck to pay down debt or to increase savings.

2. Itemize deductions when appropriate and keep adequate records to justify those deductions.

3. Use tax credits (Earned Income Tax Credit or Dependent Care Credit, for example) if eligible.

4. Know your marginal tax bracket. Use the information to guide decisions about whether to utilize taxable or tax-exempt investments. Check your bracket each year for changes.

For updated tax bracket information, see:
dinkytown.net/java/TaxMargin.html, or
irs.gov/formspubs/article/0,,id=150856,00.html.

Credit Checkup

Your credit cards also need a checkup. Here are five questions to get you started.

1. Do you have a credit card that you don't use? If so, cancel it with a written request to close the account, noting that the account was closed by the account holder.

2. Can you get a better interest rate? Call the credit card company and ask for a lower rate.

3. Have you checked your credit report? Check periodically for errors.

4. Do you keep a list of credit card contact information (e.g., 800 numbers)?

5. Would refinancing/consolidation help?

Consumers are eligible to receive one free report a year from each of the three major credit bureaus (Equifax, TransUnion and Experian). They can be ordered at *annualcreditreport.com* or by calling 1-877-322-8228. To get a new report every four months, rotate among the bureaus, using each annually.

Your credit score is a three-digit number that affects how much you pay for credit, insurance and other necessities. This number helps lenders identify the level of risk their business assumes when lending or providing insurance. To learn your credit score, you will have to pay a fee, or it may be available from a lender who recently denied you credit.

To stop receiving credit card offers in the mail, tell credit reporting agencies that you want to opt out of the sale of your credit information. (You can opt out for five years by calling 1-888-567-8688 or visit *optoutprescreen.com*.)

Insurance Checkup

The purpose of insurance is to cover major losses. Many people would not consider a television, a vehicle windshield, or a microwave oven to be a "major" loss, so if you have savings, choose policies with higher deductible amounts to reduce the premium. For more information, see: *iii.org*.

Homeowners Insurance

- Is your home insured for at least 80 percent of its replacement cost?
- Do you have "replacement cost" riders on the contents of your home?

If your home is not insured for at least 80 percent of replacement value, insurance will not cover the full cost of rebuilding after an insured loss. Financial professionals often encourage purchase of "inflation guard" coverage to keep home insurance from falling below the 80 percent level. (The "guard" automatically increases the coverage with the rate of inflation.) Make sure insurance on your home and contents is for full replacement coverage – not depreciated value.

It is important to have a written inventory of your home's contents. Store the inventory and supporting photos or videos in a safe deposit box or another secure location away from the home.

Auto Insurance

- Do you have at least $300,000 of auto liability insurance?
- Required Kansas minimum auto insurance is $25,000/$50,000/$25,000; recommended is $100,000/$300,000/$100,000.

What do those figures mean? The minimum liability limit is $25,000 for bodily injury for one person injured in an accident, but $100,000 is recommended.

In Kansas the minimum liability requirement is $50,000 for all injuries in one accident, but $300,000 is recommended. The minimum liability requirement for property damage in an accident is $25,000, but $100,000 is recommended.

Umbrella Liability Policy

- Umbrella liability insurance is so named because it acts as an umbrella over your homeowner's and auto insurance policies to provide extra protection. Purchase an umbrella policy if liability coverage on auto and homeowner/renter policies is less than net worth.

Disability Insurance

When a worker dies, his income stops, but so does consumption of goods and services. When a person becomes disabled and can't work, income stops but expenses continue. From that standpoint, disability insurance is just as important – maybe even more important – than life insurance.

Disability insurance should replace 60 to 70 percent of monthly income until the worker is eligible for retirement. There are two types of coverage: "own occupation" versus "any occupation." It is important to understand the way your policy defines a disability and covers your ability to work.

If an employee pays for disability coverage, distributions are received tax-free. If your employer pays for disability coverage, distributions are taxable to the recipient because it is considered an employee benefit. An example of a disability calculator can be found at *lifehappens.org*.

Life Insurance

Financial planners generally estimate most workers need 75 percent of current household income in the event of the wage earner's death. Take that number times the number of years that income is needed, add additional expenses (such as repayment of debts) and subtract existing assets and a survivor's income, if any. The total equals the approximate amount of life insurance coverage needed. Life insurance should be reviewed as family needs change through life stages.

Life insurance calculators are available on the web to help figure individual need. An example of a life insurance calculator can be found at *lifelifehappens.org*. Or use the formula below :

Current & Future Financial Obligations	-	Existing Resources (survivor's earnings)	=	Life Insurance Need

Health Insurance

Does your health insurance have high coverage limits and few exclusions? Stay current on insurance premiums, and save an emergency reserve to meet deductible, co-insurance amounts and uninsured medical costs. Build your knowledge of risk, costs, and financing options for health care, and develop a plan for managing long-term health-care needs. Consider health savings plans that may be available for use with high-deductible health insurance policies. Consider participating in your company's cafeteria plan, such as a health reimbursement account or a flexible spending account.

Long Term Care Insurance (LTC)

If you are generally in good health and have assets that you'd like to protect and pass on to your heirs, consider long term care insurance. Information on LTC policies can be requested from the office of the Kansas Insurance Commissioner at 1-800-432-2484 or online at: *ksinsurance.org*.

Social Security and Pension Checkup

As you consider the state of your retirement plans, be sure to check on your expected Social Security and/or pension benefit. Also be alert to pension plan changes – a switch from a traditional defined benefit plan to a cash balance (defined contribution) plan, for example – and determine which is in your best interest.

Review your annual Social Security benefit report. This is available online at *ssa.gov* through the *My Social Security portal*.

- Review retirement benefits at age 62 versus full retirement age, depending on date of birth.
- Note disability benefit amount.
- Check accuracy of annual earning amounts.
- Request a defined benefit pension estimate or check the balance of your defined contribution plan.

Retirement Checkup

Assessing progress toward retirement goals is also important. First, estimate the amount of income you'll need annually. Then:

- Subtract anticipated Social Security benefits, pension (if any), earnings from work or investments, etc.
- Estimate retirement age and life expectancy.
- Determine total required to cover the estimated number of retirement years.
- Add up the value of existing retirement savings accounts (IRA, 401(k), etc.)
- Subtract future value of savings (See *arkansasrunner.com/calculators/futureval.htm*)

- Calculate total savings needed and annual (or per-paycheck) savings amount.

When saving for retirement, try to contribute the maximum, but at least contribute the amount required to receive an employer match, if available. Understand your employer-sponsored retirement plan. You need to know about vesting rules (if they apply), when you can retire, and what employer-sponsored benefits will remain after retirement. Understand withdrawal options for your retirement benefits: life, life annuity, joint and survivor, lump-sum payment, or installment options.

In addition to your employer-sponsored retirement plan, contribute to an individual retirement account (IRA). Make sure you compare different plans: traditional IRAs versus Roth. Required minimum distribution begins at age 70 1/2 for traditional IRAs, 401(k) plans, and other pension programs.

It is also important to contribute to a personal savings/investments plan as well. Such a fund may already have been established for other goals, such as children's education, a second home, or other dreams.

Retirement Checkup Tools

- Ballpark Estimate worksheet (available online at *choosetosave.org/ballpark*)
- Planning for a Secure Retirement (from Purdue); 10 modules with online calculators: *ag.purdue.edu/programs/areyouprepared/secureretirement/Pages/default.aspx*

Investment Checkup

Risk Tolerance

A risk tolerance checkup is in order to make sure investments match your tolerance for risk. Complete the Investment Risk Tolerance Assessment at *pfp.missouri.edu/research_IRTA.html* to determine your level of risk-tolerance. The score will indicate appropriate investment tools. Remember that younger workers can usually bear more risk.

Asset Allocation

Be sure to do a regular asset allocation checkup. Increase your earnings by matching your personal investment risk-tolerance level with appropriate savings/investment services and products to achieve an acceptable rate of return. Choose an appropriate asset allocation model to balance growth and income for your age. A traditional guide is that you should not have a higher percentage of money invested in the stock market than 100 minus your age. This may be too conservative given current life expectancies.

If percentages of your portfolio in stocks, bonds, or cash have strayed from original weightings, rebalance to get back on track. Choose appropriate savings/investments to match investment goals. Evaluate your plan regularly to make sure savings and investments are appropriately balanced to achieve maximum earnings consistent with investment risk-tolerance level and goals.

Investment Performance

Review investments to see if they are providing the rate of return you expect. You can do this for each investment or for the total portfolio. A financial advisor or investment professional will be able to help you calculate the current rate of return.

To do the calculation yourself, you need to know your beginning and ending account balance and the amount of money deposited in the account throughout the year. These are the steps:

- Write down the beginning balance and the ending balance.
- Add half of annual contributions to the beginning balance and subtract half of annual contributions from the ending balance.
- Divide the adjusted ending balance by the adjusted beginning balance; convert total into a percentage.

Estate Planning Checkup

Develop an integrated plan for accumulating, protecting, and distributing/transferring assets.

Major Considerations

Do you have a letter of last instruction and will?

Prepare a letter of last instruction including:

- Location of personal documents, financial papers and accounts.
- Names, addresses and phone numbers of family and close friends
- Personal and financial professionals who need to be notified of your death.
- Names of people you wish to receive special things.
- Preferences for services and disposition of the body, as well as any information about prepaid funeral plans or location of cemetery plot you may own.

Considerations for your will

- Have you looked at your will in the last five years or after a major life event, such as death or divorce?
- Name personal and/or financial guardian for dependents, if appropriate.
- Choose executor and trustee for your estate plan.
- Prepare information about financial records so an executor can take over immediately.

- Have you recently reviewed beneficiary designations on insurance and retirement accounts?
- Are there conflicts between your will and the titling of assets? Use appropriate form of ownership: It influences the way your estate is valued and how property is transferred. (For example, payable on death? Or joint tenancy with rights of survivorship?)
- Do you have a living will or medical power of attorney? (A living will expresses your wishes concerning life-sustaining procedures in case of terminal illness and/or imminent death. Durable power of attorney for medical decisions grants power to a person you choose to make health-care decisions if you are unable to do so.)
- Who will handle finances if you are unable to do so? A durable power of attorney for finances grants powers to the person of your choice if you are physically or mentally unable to do so.
- Decide who will get what and when. Who do you want to receive your assets? How much do you want each heir to receive? When do you want them to receive the assets? How should the asset be given?

Final Thoughts

Like a physical health check-up, a financial checkup can help identify problems — such as a high debt load — and evaluate progress toward goals. It can also identify future action steps and provide motivation to form new habits and improve your financial health.

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[1]Financial Fitness Quiz (page 1) was created by Barbara O'Neil, Specialist in Financial Resource Management, Rutgers Cooperative Research and Extension, New Jersey.

The material presented here is not intended to be a substitute for personalized professional advice. There are many types of financial advisors. Learn more about choosing financial advisor at
https://www.smartaboutmoney.org/Topics/Saving-and-Investing/Build-Your-Wealth/Choose-the-Right-Financial-Advisor

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Kansas State University Agricultural Experiment Station and Cooperative Extension Service

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MF2721 rev. | August 2019