KNOWLEDGE ORGANISER - LIBF Unit 3 Topic 4 – Monitoring & Adapting Personal Financial Plans

What is a financial plan?

In general usage, a financial plan is a comprehensive evaluation of an individual's current pay and future financial state by using current known variables to predict future income, asset values and withdrawal plans.

Establishing clear, measurable objectives

Before drawing up a financial plan, you need to know yourself – ie you need to have a good idea of your own needs, wants, priorities, attitudes and aspirations, so that you can develop a personal financial plan that reflects your own personality and situation. You need to be aware of any financial constraints that cannot be changed, because you will have to work around them. You also need to think about where you are in the life cycle and what life events you may encounter. The next step is to think carefully about your financial objectives. This may mean deciding how important it is for you to earn the highest income that you can. Are you prepared to work in a demanding, high-pressure job, working long hours to earn a high income? Would you be willing to manage on a low income for several years while studying for whatever qualifications you need to pursue a highly paid career?

Work-life balance

Attitudes to Financial Planning

The following are some questions that individuals can ask themselves to work out their attitudes to financial planning and so what characteristics their personal financial plan should include. These characteristics will apply whatever their level of income and expenditure, but may lead to different financial objectives for those with lower or higher levels of income and wealth.

a) What are your main needs and wants in life?

Are you satisfied with a basic level of consumption or do you like your luxuries? Do you have any particular needs or strong wants that you feel you must finance whatever happens?

b) What is your attitude to spending money?

Are you easily tempted into making purchases or are you careful? When you want or need something, do you feel a strong desire to have it now, or are you willing to wait until you can afford it?

c) What is your attitude to saving?

Do you feel safer if you have a bit of money put away? Do you feel tempted to spend the money that you have saved, or does it give you satisfaction to see your savings growing?

d) What is your attitude to borrowing and being in debt?

Do you hope to improve your standard of living as you get older? Are you impatient to start earning as much as possible, or are you willing to invest time in further or higher education, or in training, such as an apprenticeship?

f) What is your attitude to risk?

Are you happy to risk your money, even if you do not have much, in the hope of gaining more? Or does it worry you to think that you might lose what you have?

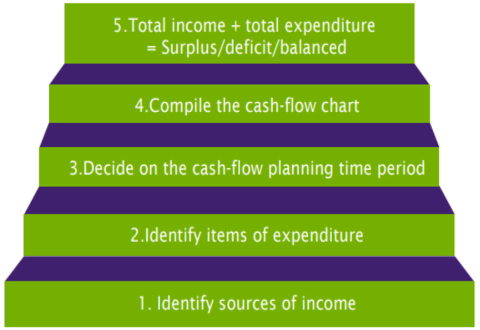
The steps involved in drawing up a budget:

1. Identify and list all sources of income

These sources include wages, allowances from parents or guardians, state benefits, interest on savings and investments, and money received for birthdays or other celebrations. It is helpful to list regular wages separately from wages that are earned less frequently. This makes completing a cash-flow chart easier.

2. Identify and list all items of expenditure.

It is helpful to list all mandatory items first and then the optional items. This makes it easier to see what spending must be met and what you might change when you are using the cash-flow chart to manage your funds. Once again, you cannot rely on guesswork, or expect simply to remember how much you spend and what you spend it on. To compile an accurate assessment of your expenditure, you have to keep a record of what you spend – ideally, every day. Bank account statements will help you to identify the regular payments going out by direct debit and standing orders, and credit card statements will similarly detail how much you spent, where you spent it and what you spent it on. You should keep receipts for purchases that you make using cash, debit cards and cheques.



3. Decide on the time period that you will use in the cash-flow chart

It is useful to choose the length of time between receiving your regular sources of income. So a student who receives a weekly allowance may use a week as the time period, whereas someone with a full-time job who is paid monthly will use a month as the time period.

4. Fill in the figures for all of the various income sources and types of expenditure in the cash-flow chart

Some items of future income and expenditure may be uncertain at the moment, eg wages from a seasonal job picking fruit, or how much next summer's holiday is going to cost. Make a realistic estimate for these items for now and add this to your chart, but make sure that you keep a record of how much you actually earn and spend, because this will allow you to make more accurate estimates in the future.

5. Now you can calculate the total income and total expenditure for each time period

Write the figures in the appropriate fields and calculate the balances to see whether your cash-flow forecast is predicting a surplus (ie income more than expenditure) or a deficit (ie income less than expenditure).

Monitoring Plans

Once they are firmly established, it is vitally important that you monitor your financial plans to check how closely real life matches your income and expenditure forecasts as you live through the time period of your plan. Keeping weekly, or even daily, records of your actual income and expenditure. The difference between the expected and actual figures is known as the 'budget variance'.

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Methods of monitoring

The simplest way in which to monitor your budget is to keep receipts for all of your purchases and use them, together with bank account statements, to keep a written record of your income and expenditure, writing the actual figures in a column next to your forecast figures on your cash-flow forecast using a spreadsheet program (such as Excel). With a spreadsheet, you can enter the projected and actual income and expenditure data into the relevant boxes; if you have set up your spreadsheet well, it will then automatically calculate totals, sub-totals, balances and variance.
Popular software, online websites and apps include:

Free
Money Advice Service Budget Planner
Money Dashboard
Debt Advice Foundation Budget Planner
Money Saving Expert's Budget Planner

Paid-for
You Need a Budget
Moneydance
Good Budget

These and other similar systems allow you to manage and monitor your finances 'live' online; some will sync your financial information through wi-fi connections, so that it is available on different platforms (ie PC, smartphone and tablet). This enables you, for example, to use your phone when you are out shopping to update your record of actual expenditure every time you make a purchase.
Each system or tool is designed to be user-friendly and easy to use, and they do not require any previous financial knowledge. There are usually comprehensive instructions and 'how to' video tutorials available to help you to understand how they work, and some also offer online advice and support.

Keeping an accurate record of the plan

It is important to keep accurate records of your financial plans. Different people will do this in different ways and each will come across some problems from time to time.

Organised People

Those who always keep receipts and other financial documents, and who keep records of how much they earn and spend – will not find it hard to compile detailed financial cash-flow plans, whether they use one of the financial apps listed, simpler budgeting spreadsheets, or even simply a pencil and paper.

Unorganised People

People who are less organised may simply jot down a few figures on the back of an envelope every week or month to see how much they have spent and how much money they have left until they receive their next allowance or salary payment.

People who do not forward plan

They may simply check their current account balance when they think of it, or when they need to use their debit card to withdraw cash or pay for an item. Some will simply keep using their debit card until a card payment is refused because they have used up that month's money. This approach to personal financial planning is very 'hit and miss'. There is no planning for emergencies – or even foresight that they will occur – so these people have to do a lot of 'firefighting' (ie they simply deal with problems as they arise).

Envelope Budgeting

The idea is that the individual will set aside a number of envelopes and on the front of each write the name of a different bill or other item of expenditure (over the short or medium terms), along with the average monthly payment. When the individual receives some income (eg they get paid), they will divide the available money between the envelopes; if there is sufficient money, enclosed in each envelope will now be enough to pay for the item of spending detailed on its front. When the time comes to pay each bill, the money is taken out of the appropriate envelope to pay for that bill. If there is money left over after all of the available cash has been allocated, the surplus is then used to cover 'pocket money' spending and unexpected bills. This system should therefore stop individuals from spending money that they will need to pay their bills.

Zero-based Budgeting

The aim is to ensure that every penny of your income is spent purposefully and wisely. you have to draw up a detailed cash flow forecast allocating every single penny of your expected income to a different expenditure envelope. The envelopes need to cover all of your expected spending, preferably over a period spanning the next 12 months. So you will have envelopes for all of your mandatory and essential spending, and for all your expected discretionary spending, right down to allocations for sweets and snacks, newspapers and magazines, takeaways, cinema outings, etc.

Opportunity Costs

Opportunity costs are defined as the value of what you have to give up to consume something else, eg the value of the summer holiday that you have foregone because you would rather keep your subscription TV channels, or the value of the gym membership that you have cancelled so that you can afford the loan repayments on your new furniture.

Financial planning with interlocking time periods

To be effective, personal financial plans should cover short-term, medium-term, longterm and very long-term time periods; the plans for each period should all interlock. The short-term plan, in particular, should be sufficiently flexible to accommodate changing future needs, wants and aspirations.

◆ The short term might mean one or two weeks, or it might mean several months.
◆ Someone planning to get married in two or three years' time might consider themselves to be making long-term plans, but a person putting money into a high-risk investment product would need to be prepared to keep their money in that investment for at least ten years.
◆ Students in their last year of school or college might see the school year as the medium term and everything after that as the long term.
◆ People in full-time employment may view the next few years as the medium term, with the long term happening in five or ten years' time – or even longer.

The key when defining the 'short', 'medium' and 'long' terms is to find the time period that is meaningful to your own circumstances.

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Adapting plans to changing circumstances

It is harder to plan for the long term because there are so many unknown variables that might affect your plans. There are personal factors, such as changes in someone's wants and aspirations, or changes in their needs, eg leaving home to rent with friends or starting a family. There are some factors over which they have only limited control, eg being able to work only at certain times to fit in with studies or a shortage of local jobs.

Adapting plans in order to fulfil longer-term goals

Different people have different approaches to setting themselves goals and achieving aspirations. If, however, someone has a longer-term goal that requires money to finance it, it is best that they plan for that goal rather than leave things to chance. The key is to act now to make some provision for the future. Individuals do not know what will happen to them in the future, but if they have some money saved or a plan to work their way out of debt, their life choices are less constrained by their finances. There must be a certain amount of flexibility in a budget because changes in circumstances mean that things will not go according to plan; the longer the term of your budget, the more likelihood there is that the actual outcome will be different from what you had hoped. If you keep an eye on how things are going, then it is easier for you to make adjustments so that you can still achieve your long-term aspirations. People's typical long-term goals will, of course, depend on their stage in the life cycle.

Key ideas in this topic

◆ The necessity of monitoring personal budgets and longer-term plans in maintaining sustainable personal finances
◆ The various methods of monitoring finances, including free online services and smartphone apps
◆ The need to adapt personal financial plans in response to changes in external and personal circumstances if plans are to be kept on track