PacificCPE

COURSE
40859A

Cash Flow, Budgeting, and Niche Planning Strategies

Managing client cash flow and budgeting concerns is a foundational skill for any financial planner, and serving specialized client populations adds another layer of complexity. This combined course addresses practical cash flow management techniques alongside an introduction to niche planning strategies for unique client situations. CPAs and tax professionals will come away with a stronger toolkit for guiding clients through everyday financial decisions while also recognizing opportunities to serve distinct markets or specialized planning needs.

CREDIT HOURS 2 | FIELD OF STUDY BUSINESS | EXAM QUESTIONS 10

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LEARNING ASSIGNMENTS AND OBJECTIVES

Assignment

- Study the full course materials included here.
- Complete the review questions after each chapter.
- Answer 10 final exam questions.
- Final exam is scored immediately, 70% or better passes.
- Certificate of completion is available in your account.
- Failed exams can be retaken free of charge.

Course Objectives

- Recognize examples of consumer debt.
- Recognize characteristics of 529 plans.

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Chapter 1: DISPENSING ADVICE ON CASH FLOW MANAGEMENT AND BUDGETING CONCERNS

Chapter Objective

After completing this chapter, you should be able to:

- Recognize examples of consumer debt.

"It all starts and ends with cash flow!" Clients can have grandiose plans for gathering assets and tying their objectives to meet the accumulation of these assets over their lifetimes, but if they are not identified clearly and funded appropriately, that will probably not happen. Our role is to help plan out recommendations and build a strong foundation that can enable clients to fund throughout the planning process. Cash flow is the magic key for future success. I tell clients all the time that you can't pay bills without having sufficient cash flow to help during the process.

Part of managing cash flow is to have a handle on debt management. It is too easy to lose track on minimizing or eliminating debt, so careful attention needs to be present here. Debt can come in short-term or long-term denominations, which could generate a very different game plan when managing. In addition to the obvious, the problem with accumulating too much debt is that it could affect credit scores, which ironically will make it more challenging and more expensive to borrow funds to cover the debt, which is the purpose to begin with.

CASH FLOW PLANNING

Cash flow planning ties into the seven-step financial planning process discussed in Chapter 1 of course 40853A. The essence and foundation of financial planning can be found in the proper management of cash flow. This is the beginning and should be done for all clients during every planner–client review, regardless of net worth and income. After review, if the cash flow looks well, then we know that the client is on the right track. We won't know that until we perform the cash flow analysis. If not, we know where to start working with our clients. If the numbers don't work out, referrals for debt management counseling can be made. Many times, the client's personality, attitudes, values, and financial background can be important considerations that are necessary to gain cooperation in this area. This is where strong communication, coaching, and behavioral finance issues by the planner can be of help. Talking through these issues, identifying both good and bad past experiences, can make the client realize what is necessary to get on the right path. I have seen many wealthy clients essentially cash poor and have seen clients with a moderate income do extremely well because they are tied to the cash flow management process.

Cash flow statements should be done at least annually, perhaps quarterly, but ideally monthly. Since this is the measuring stick for the attainment of objectives, analyzing cash flows more frequently will help ensure that the client doesn't get too far off course. If they do get off course, we need to tell them that something has to give! It's really not a hard concept. Either they pare down their objectives to make them more realistic and attainable based on their current financial situation, or they should spend less; they could save more, they could restructure their liabilities, reallocate their assets, or invest differently. That could mean perhaps taking a little more risk, but you would need to be careful with this last possibility. If the client is not willing to make any necessary changes, it would be an impossible situation to work with them and manage their expectations.

The process used to manage cash flow is the same for most everyone, but since people are on different ends of the pay scale, resources accumulated, future inheritances, and other possibilities, the numbers will appear to be different for each of our clients. Our job as advisors is to help them understand and recognize how to work within their budget.

Rattiner's Secrets

My client explanation in this area is pretty direct. Moneywise, whatever comes in goes out. When it leaves, it can either be saved or spent. That's the process (assuming clients pay their bills on a timely basis). Inflows come from a variety of sources, including active, passive, portfolio, and other types. **Outflows** consist of savings and expenditures. Expenditures can be further broken down into fixed and variable (discretionary) expenditures. The rule of thumb I use for clients is that if they can save 10% of their gross income each year for approximately 20–30 years, they should be able to retire on roughly 80% of their current expenditures. I tell my clients they are never too young to begin saving. And if they are older, it's never too soon to begin. What I have seen from clients is delayed savings ultimately leads to delayed retirement.

In breaking down the client's outflows, we may be able to offer some guidance and direction based on the category type. With fixed expenditures, the client has little option in manipulating these. Payments for mortgage, rent, car, home equity loans, student loans, other fixed-payment loans, and perhaps other expenses where there is little maneuverability to change are a foregone conclusion. However, with discretionary expenditures, this is where the client may have the most control and opportunity to make changes, which can enable us to help make a difference to have things happen appropriately for the client. Savings is where the client is pulling their money to accomplish those objectives identified during the financial planning process. The objective here is always to max out when possible.

This is where the heart of the discussion rests with my clients. The secret to success in financial planning is to minimize the discretionary expenses, take those previously allocated funds and re-route them into the savings category, and then earmark those funds specifically to accomplish the

prioritized objectives we discussed in Chapter 1 of course 40853A. With objectives being defined as definite and measurable, meaning each with a specific time frame and dollar amount, clients will realize that this type of planning is relevant and extremely possible in satisfying those objectives designed for immediate and long-term success.

This is the initial discussion for my clients before anything else regarding funding objectives occurs. As we keep saying, it's all about managing your client's expectations and there is no better way to alert your clients that they are on the right path or not anywhere near it. I don't beat around the bush with clients since if we don't start off at the same point, we will end up differently in both availability and accessibility of funds needed to make the intended targets.

Sometimes it is a struggle for younger clients who are not there yet because it is too far down the road. But there is no time like the present to begin planning. Many times, I will take out my HP12C calculator and do rough calculations on the spot. For example, if a client saves $6,000 per year in an IRA, and over 40 years earns at a reasonable 6% return, it will amass into $928,572 at retirement. Not bad! I demonstrate that type of concept with various scenarios in the hope the client will act upon it sooner rather than later. I encourage them to save for the rainy day, as life has many curveballs, as explained below. Another effective strategy is to print out the numbers and give them as a spreadsheet under different scenarios so the client can see the various possibilities, react to them, and take them home as the necessary objective to help them begin their planning opportunities.

The practical thing with assisting your clients with cash flow planning is that technology can greatly assist in this area. It could occur as a reporting mechanism where cash flow is entered manually, can be tracked electronically, or can happen piecemeal electronically as purchases and other things happen for the client. But before cash flow management can occur, the client needs to set up their system of controls properly. That's where budgeting comes in.

Managing Cash Flow
• Cash Flow Planning • Budgeting • Change in Cash Flow Alignment • Emergency Fund Planning • Debt Management Ratios • Consumer Debt • Housing Costs • Total Debt • Savings Strategies • Debt Management • Secured vs. Unsecured Debt • Buy vs. Lease/Rent • Mortgage Financing • Types of Mortgages • Home Equity Loan and Line of Credit • Refinancing

BUDGETING

A budget is used to plan and evaluate the income, expenses, and spending patterns of an individual or couple. It should provide a realistic estimate of the individual's income and expenditures, prepared using actual historical information and considering the individual's financial goals and time frame for achieving those goals. It then serves as a control document to compare actual spending to desired spending.

There are three stages of the budgeting process:

1. Estimate income (gross or "net" after taxes).
2. Estimate expenditures (both fixed and variable expenses, while also keeping inflation in mind).
3. Budget for savings (should be planned as an integral part of the budget and not just as a "hoped-for" residual amount).

The resulting savings at the end of the budget period are sometimes referred to as "discretionary cash flow" since this is the amount that remains for investment after payment of all monthly expenses (including taxes). It's important to reflect taxes into the calculations because our clients

will generally not have choices to defer or eliminate. Clients will have to pay for their expenses after taxes are figured into the calculation, from the net amount. Lastly, it is impossible for a client to grow their net worth without having some discretionary cash flow that is available to them for investment purposes.

Rattiner's Secrets

When developing a budget, it is important to determine the necessity of certain daily, monthly, or annual expenses. The "why" of certain expenses can make it a discretionary (tending to be a variable) or a non-discretionary (fixed) expense. Ask the client questions about expenses that don't easily fit on the non-discretionary expense side to determine whether they are indeed necessary. Finally, recognize that items that are discretionary for some clients may be non-discretionary or fixed expenses for others.

I tell my clients to constantly go out 12 months in the **budgeting process.** First, the client can see the natural progression of expenses moving forward. Second, it allows the client to stay on top of their spending habits, so it does not get out of hand too quickly. When one month ends, remove that month and add the new 12th month out. This allows the client to always keep looking forward for 12 months at a time. This will also impact where the cash flow statement goes, which as we'll see takes the final results from the budgeting process. Monitoring the budgeting process enables the client to stay on a better course for attaining objectives.

I have developed a master budget/cash flow statement and balance sheet for all of my clients. The reason is simple. This allows all clients to follow the same format, though not necessarily using the same accounts. Since the numbering system is universal, if a client has a question, anyone in the office can help answer the question since all the clients' statements are set up in the same manner. For example, for the balance sheet, assets are listed in the 1000s, liabilities in the 2000s, and net worth as 3000.

Under cash flow, inflows are listed in the 4000s and outflows in the 5000s. You can have many different account titles under each heading and subheading, and the client just addresses the ones that are relevant to them. See Figure 4.1 for a sample cash flow statement and Figure 4.2 for a sample balance sheet.

FIGURE 4.1 SAMPLE CASH FLOW STATEMENT

CASH FLOW STATEMENT
B. Prepared Right
For the Year Ending 12/31/2X

INFLOWS: (1) - GROSS INCOME	Account Number	Amount
ACTIVE INCOME - EARNED INCOME: #4000	**4000**	
w-2 - #1	4010	$
w-2 - #1	4020	$
w-2 - #1	4030	$
w-2 - #1	4040	$
Self Employment - 1099 Misc - #1	4050	$
Self Employment - 1099 Misc - #2	4060	$
Bonus/Commissions - #1	4070	$
Bonus/Commissions - #2	4080	$
Alimony - #1	4090	$
RETIREMENT INCOME SOURCES: #4100	**4100**	
RMD #1	4110	$
RMD #2	4120	$
Pension #1	4130	$
Pension #2	4140	$
401(k)/403(b)/457 #1	4150	$
401(k)/403(b)/457 #2	4160	$
IRA #1	4170	$
IRA #2	4180	$
PASSIVE INCOME: #4200	**4200**	
Real Estate	4210	$
Property/Limited Partnership #1	4220	$
Property/Limited Partnership #2	4230	$
Property/Limited Partnership #3	4240	$
Property/Limited Partnership #4	4250	$
Property/Limited Partnership #5	4260	$
Property/Limited Partnership #6	4270	$
Property/Limited Partnership #7	4280	$
Royalty Income	4290	$

FIGURE 4.1 SAMPLE CASH FLOW STATEMENT (CONTINUED)

INFLOWS: (1) - GROSS INCOME	Account Number	Amount
PORTFOLIO INCOME: #4300..#4499	**4300**	
Interest #1	4310	$
Interest #2	4320	$
Interest #3	4330	$
Interest #4	4340	$
Dividends #1	4350	$
Dividends #1	4360	$
Dividends #1	4370	$
Dividends #1	4380	$
Capital Gains/(Losses) #1	4410	$
Capital Gains/(Losses) #2	4420	$
Capital Gains/(Losses) #3	4430	$
Capital Gains/(Losses) #4	4440	$
OTHER INCOME: 4500..4699	**4500**	
Social Security #1	4510	$
Social Security #1	4520	$
Disability Income #1	4530	$
Disability Income #2	4540	$
Gambling Income (Loss) #1	4550	$
Gambling Income/(Loss) #2	4560	$
Game Show/Other	4570	$
State Refund	4580	$
Miscellaneous	4610	$
Miscellaneous	4620	$
Miscellaneous	4630	$
Miscellaneous	4640	$
TRUST & ESTATE INCOME	**4700**	
Trust Income #1	4710	$
Trust Income #2	4720	$
Estate Income	4730	$
POTENTIALLY TAXABLE INCOME	**4800**	
Sec 125 Cafeteria Plan Contributions	4810	$
Employer Health Care Sponsored Premiums	4820	$
Other Pre-Tax Benefit Expenses	4830	$
Tax-Sheltered Retirement Plan Contributions	4840	$