

# PRUDENT PLANNING

Looking beyond  
RRSPs for a  
financially solid  
retirement



by Peter M.  
Cleveland

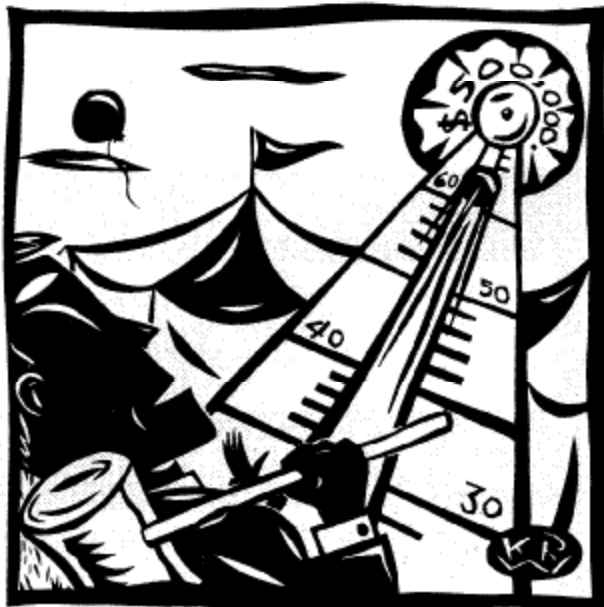


ILLUSTRATION BY KATHY BOAKE

**O**NCE AGAIN, IT'S THAT TIME OF YEAR WHEN WE'RE coerced into reviewing our retirement planning – no doubt a byproduct of effective advertising by RRSP fund managers. Every financial adviser recommends RRSPs and that's good. It forces us to address a matter that is critical to our well-being and, if avoided, would slip away with time to leave us penniless in our golden years.

Something, though, is missed by all this retirement attention. We become so focused on which RRSP fund to select that often too little time is allocated to other financial matters. Just as there is more to life than retirement, there is also more to financial planning than funding that retirement. After all, we must finance our way through life before enjoying a retirement fund. Housing, food, clothing and education for our families are formidable expenses in these recessionary days, and they cannot be left to a singular retirement view.

A master financial plan is necessary just to reconcile our gross spending habits with our net incomes. But plans often mean we must deny ourselves of something, and denial is never as attractive as an unrestricted lifestyle. Nevertheless, even the most stubborn non-planner must pay for his lifestyle as he goes. This is reality. So, for the moment, let's assume everyone has struck an accord with this reality.

To develop a successful master plan, certain key criteria must first be addressed. Everyone must develop and commit their key criteria to writing and adapt their personal plan to accommodate them. If the criteria are not in writing, there will be no

standard by which to measure success.

To create that standard of measurement, master financial plans must include written goals that are both quantifiable and attainable given available financial resources. Financial independence as a goal is not specific enough for the planner to know when something has been accomplished. If the goal, instead, is to save \$500,000 by the age of 55, then success can be measured. The investment income earned from achieving this goal may then result in financial independence. Similarly, planning for a Mercedes-Benz and a ski chalet in Switzerland is unreasonable if your annual household income is \$50,000.

The plan should address each written goal by category, and then personalize each category to match your needs and resources. Goals can be grouped into monthly living expenses, home purchase and finance, automobile replacement, life and other insurance, secondary education financing, income tax, vacations, and retirement and estate planning.

For each goal, the planner must commit to at least one specific action plan. Action plans define the route to achievement and permit a comparison to reality so that your accomplishments and the merits of the original plan can be evaluated. Dates must also be assigned to identify short-term and long-term milestones for measurement.

Above all else, action plans must be specific. For example, you can state that the family automobile will be traded for a new vehicle in July 1993, or that \$200 will be deposited in the savings account at the end of each month. The planner knows if she hasn't traded the automobile by July 31, 1993, she hasn't achieved her action plan. And if the 30th day of the month passes without \$200 being deposited, then savings goals are not being met. If the examples were restated – the automobile will be traded when repair costs increase, and any money left over at the end of each year will be deposited in the savings account – they would lack the quality of a definitive measurement. When would you know if automo-

ble repair expenses had increased to an intolerable level, making replacement attractive? Similarly, no one has any "leftover" money at the end of each year – not unless it is quantified in advance and paid into a savings account as if it were an expense item.

The plan must also provide family security in case of unpleasant events such as death, loss of employment or any special health needs. Plan for a safety net of three months income as a cushion to recover from such crises, and keep your cache in a separate bank account. Potential inheritances would also be addressed in this section of the plan. However, never count on inheritances to justify current spending. It simply isn't prudent planning.

You should consider your feelings about investment risk when making the plan. If you are conservative by nature, you will gravitate to term deposits, government treasury bills or blue-chip stocks. If you're excited by gambling, then penny stock in start-up companies will be more appealing. Regardless of your investment temperament, a substantial portion of your assets should be protected in safe investments just in case your gambling luck fizzles out.

A good plan of action includes projected net worth and cash flow statements prepared with your goals and action plans as assumptions. These projections provide the opportunity to fine-tune unrealistic goals and actions that can't be financed within the time period originally planned. When the period covered by the plan lapses, actual net worth and cash flow statements should be prepared to determine any significant variances from projections – all to provide useful guidelines for the fine-tuning of next year's master financial plan.

Finally, the plan must be updated annually to reflect progress and unforeseen events that either slow or accelerate the attainment of goals. This step reveals milestones for success and celebration, and provides the encouragement to build better, more promising plans.

All these components come together to form a master financial plan. The absence of any one key criteria presents an unnecessary risk for failure, the greatest risk being the failure to use the document as a monthly checklist to implement your action plans. As goals are achieved, they give way to new objectives. Each year's plan builds upon the last. Before you know it, you've planned your way to retirement's doorstep, and the accumulated benefits of all those RRSP contributions are now in full view. You won't enjoy that comfortable view, though, without the effective use of annual financial plans to find your way to the doorstep. ■

---

*Peter M. Cleveland is a senior vice-president of Ernst & Young Inc., Ottawa.*