

Financing the Future

reverse engineering is another way of saying, “working backwards,” a process that can be effective when solving a crime, finding out what’s causing a health problem or locating a missing airplane. But sometimes we don’t have the luxury of looking backwards. Take retirement planning, for instance: it’s almost exactly the opposite of reverse engineering. We have very few *knowns* on which to base our plan, which, by definition, is forward-looking. You will not know whether you have reached your goal until it is too late.

Retirement planning is a moving target in many ways. We depend on more assumptions than would ever be acceptable for a NASA engineer signing off on a multi-billion dollar rocket launch. In fact, there are more variables we don’t know than those we do. For example, we don’t know what:

- Inflation will be in the future;
- The future holds for income, capital gains and estate taxes;
- The equity or fixed income markets will do in the future;
- Our earnings (ability to save) and expenditures will be; and
- How long our money has to last.

So how can we possibly plan for the future when so little is within our control? The old saying, “Without a map, any route will get you there,” comes to mind. But wouldn’t we rather have an idea of how likely we are to meet our ultimate financial goal?

What Good is 20/20 Hindsight, Anyway?

Retirement projections are quite possibly the best tool financial advisers have, using history to help estimate and extrapolate what lies ahead. What if you knew today how much the rest of your life was likely to cost in inflation-adjusted dollars? What if you knew—based on the aforementioned “cost of life”—that some dramatic changes needed to be made to your savings/investment/tax planning efforts? Or, what if you found out you were exactly on track? Experience tells us that, with each



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passing year and update to our retirement projections, our planning becomes more accurate. Retirement planning is not a one-time project.

An evolved retirement projection can give a good idea as to whether the various inputs need to be changed to reach a family’s goals. For example, if it appears that there is not enough money at the intended retirement

Retirement Planning Analysis: The Ultimate Financial Planning Tool

age, spending might be cut. Or the required rate of return on the investment portfolio might be increased (along with the increased risks of doing so). Of course, these (or other) changes have considerations that must be dealt with. They present the opportunity for us to assist our clients in understanding the various choices available to them, as well as the associated ramifications.

‘You Are Here’

Thus, retirement planning involves all aspects of financial planning and is likely the most valuable service a financial adviser can offer. A retirement plan cannot be created without the most basic of financial information: a budget (a projected “personal income statement” or “personal profit & loss statement”). Further, a personal balance sheet (based on current market values) should also be part of the plan, since the projections will be used to determine how much wealth a family will need (to produce the necessary income at “retirement”). This is the “You Are Here” spot on a map.

More advanced uses of these projections include estate planning, insurance planning and income tax planning. Retirement planning crosses all fields of personal financial planning.

The inputs from income tax planning relate to both the cost of income taxes over the budgeted life as well as the relationship between income tax reduction and retirement planning devices (pension plans, IRAs, etc.).

Does the End Justify the Means?

Insurance planning and estate planning are primarily affected by the end result (e.g., is there an excess at the end of the plan?). If we find that a client is has sufficient wealth that they do not need earned income and can retire if they wish to, that client might seem to not have a need for life insurance. However, what if an unmarried client has a \$12 million estate consisting of music catalogs? Musicians often own royalties, and the value of a royalty is based on the future amounts to be received.

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This might be significant wealth, but it's not liquid. Life insurance is likely an important potential solution. Each client situation is unique, and a retirement projection can help to coordinate the various areas of personal financial planning.

An evolved retirement projection—after at least a couple of years—can indicate the likelihood of whether there is now, or will be, more money than the family will need.

Estate planning using the results of a retirement projection can be much more effective than without. The projection can help determine whether a family has an excess now and, if so, how much. An estate plan without this information is like flying blind. We've encountered well-meaning attorneys suggesting a gifting program for a family that does not have excess wealth. Make the children wealthy while the parents struggle financially in the final years? Sometimes our job requires us to save our clients from themselves—and maybe even their other advisers.

Unusual Planning

Estate planning—using retirement projections—can provide some unusual planning ideas. We recently had a client whose retirement projections indicated an excess in wealth (she has more than she will need with conservative assumptions), but who does not have a projected taxable estate. Our assignment to her was to create a list of things she would like to do in life, but have not yet done. She called back the next day, excited to let us know that she had created that list. Together we estimated the costs of the items on her list and determined that she could easily afford everything she included. Her fear of the unknown—whether or not she could spend as she wished, but also leave as much as she desired to her children and grandchildren—kept her from even entertaining the possibility. Had we not asked the questions and used the answers to develop a detailed projection, I don't know that she would have felt comfortable treating herself the way she deserves to be treated in retirement.

What if there is substantial excess wealth projected? The opportunity for more advanced estate planning is the result. A family with much more than it will ever need might be interested in legacy planning—providing funds either to charities through various estate planning devices, to future family members through dynasty planning or possibly a combination of both goals. Legacy planning involves defining the family's desired impact on the future. Maybe, for example, establishing an entity that will provide future food for those in need, or one that might encourage future family members to be involved in some aspect of society. If you watch public television, you have seen the results of legacy planning: “This program has been brought to you by the XXX Foundation.” Details of advanced estate planning are beyond the scope of this article. However, the importance of retirement projections in legacy planning cannot be underemphasized.

Legacy planning is used to minimize or eliminate estate taxes, so this is an important part of the planning. The ultimate goal is often to maximize the effect of the family's wealth on society, so minimizing costs (such as estate taxes) is a related, and hugely important, goal.

The bottom line is that we, as advisers, must understand a client's future needs and wants. This means asking a lot of questions and listening to the answers, over a period of years, if not decades. Future needs and wants, and their priority, have a tendency to change over time for most clients.

Whether it's basic living expenses, education planning for children or grandchildren, or working on a multi-generational legacy plan, it can all be broken down into projections in much the same way. So while the conversations may differ, the approach can look quite similar.

Good financial advisers will have regular conversations with their clients' CPAs, business managers and estate planning attorneys to ensure all relevant information is being considered. 

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Stocks, Bonds and Mutual Funds: A Comprehensive Guide to Successful Investing

- Sept. 16, Orange County North (www.calcpa.org/SuccessfulInvesting)

Advanced Personal Financial Planning Update

- Oct. 29, Burbank (www.calcpa.org/advancedPFPUupdate)
- Oct. 29, webcast (www.calcpa.org/advancedPFPUupdate_webcast)

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