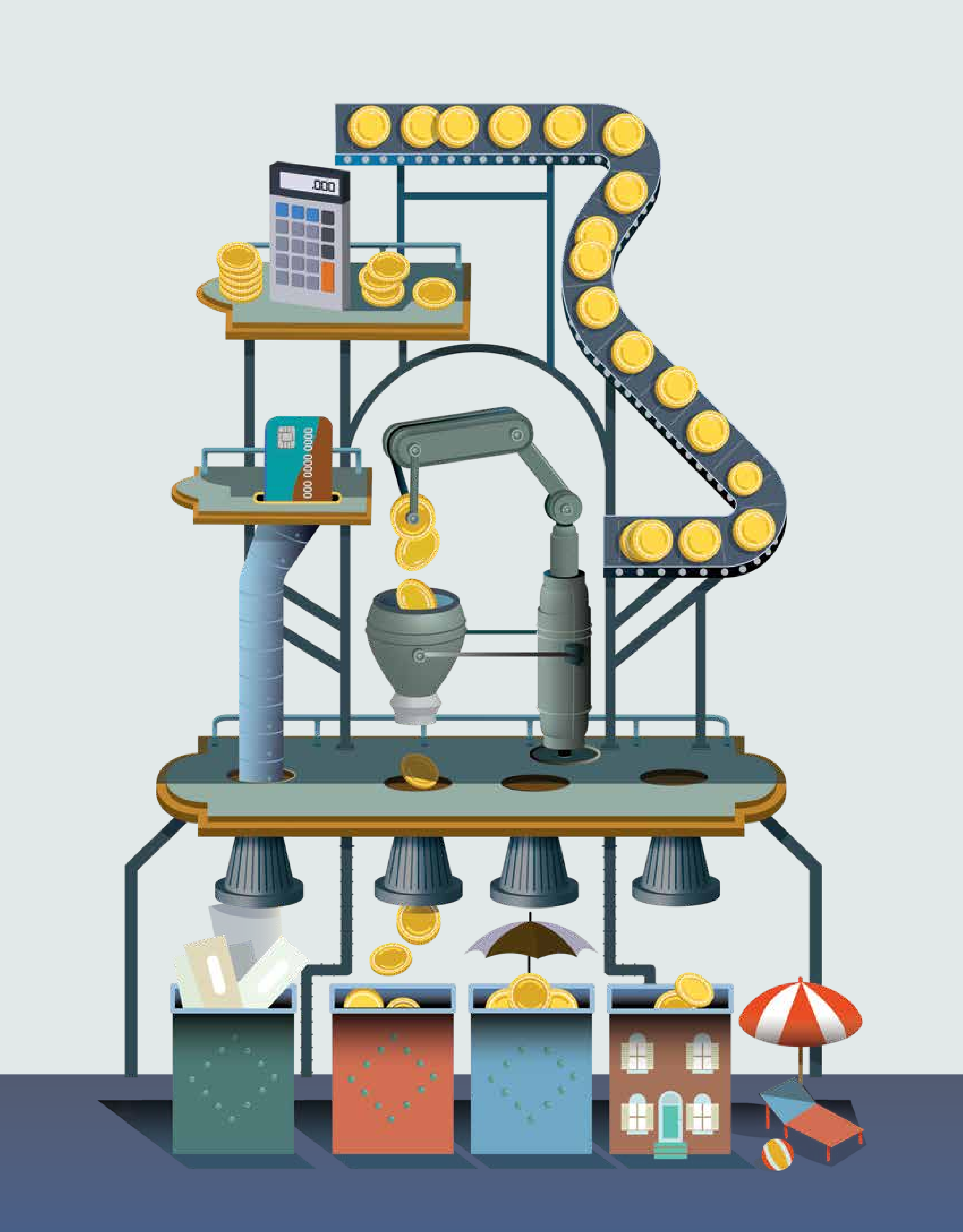


Where Has All THE MONEY Gone?

Using cash flow analysis helps your client's financial future, while increasing your business and referrals.

By Liz DeCarlo | Illustration by Doug Panton

TROY A. COLLINS, ADFP, has clients who earn above-average incomes but still can't get ahead financially. Not only are they not saving or investing, but they've often racked up considerable debt. So his first step is to analyze the client's cash flow, which he believes is a critical part of providing true strategic advice.

"We've been able to turn this around in a relatively short period of time and position them to generate surplus cash flow immediately," said Collins, a 20-year MDRT member from Toowong, Queensland, Australia. The cash flow analysis also resulted in quicker debt reduction, larger wealth accumulation, and greater lifestyle choices for the client and their family. ►

There are different strategies to analyze a client's cash flow: an ongoing cash flow analysis and lifetime cash flow forecasting. Advisors who do cash flow analysis often do a mixture of the two.

Collins tracks cash flow on a monthly basis, and also does lifetime forecasting. He uses a detailed expenditure spreadsheet and goals matrix, and an online wealth portal. The online portal links the client's bank and transaction accounts, which then data-feed up to six months of transaction history for Collins' team to review.

"With these tools, we then break the data down to fixed and discretionary expenditure, plus financial allocation to future goals," he said.

On an ongoing basis, they track the client's actual expenses every month against projected expenses, with the goal of having surplus cash flow to reduce debt and increase wealth accumulation.

Clients receive a monthly cash flow and asset management report that illustrates how they are tracking to plan. All the client needs to manage are their discretionary expenses.

Collins recommends his clients keep a separate discretionary account for items such as groceries, dining out, clothing, entertainment and other activities. "By having these funds isolated, they can better manage cash flow and lifestyle, then systematize the rest, including bills, loan commitments and investing," he said.

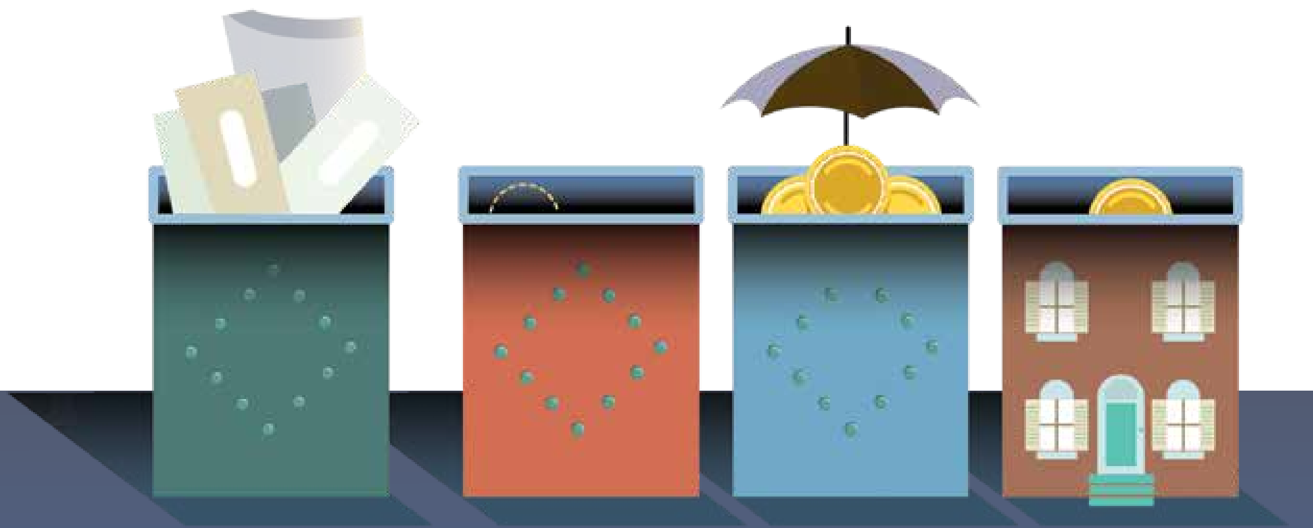
Monthly tracking is critical to Collins. His wealth portal feeds the data directly from the client's bank accounts, so they're never more than 30 days behind. He also meets with clients every six months for a progress meeting, and then annually for a strategy meeting.

Cash flow analysis also resulted in quicker debt reduction, larger wealth accumulation and greater lifestyle choices for the client and their family.

AURORA L. TANCOCK, FLMI, CFP, another cash flow analysis advocate, provides clients with a spreadsheet and asks them to go through the last three months of credit card and bank statements to complete each item on the list. Like Collins, she divides the spreadsheet into items that can't be negotiated, such as mortgage payments, utilities, and car and home insurance, and items that can be adjusted, including entertainment, eating out and vacations. If the client is overwhelmed by this exercise, Tancock asks them to bring those statements with them to the meeting and her team will help analyze expenses.

"This helps you really understand the financial shape a client is in, whether they are living within their means or getting further and further into debt if the expenses are higher than income," said Tancock, an 18-year MDRT member from St. Catharines, Ontario, Canada. "We don't start concentrating on building wealth if the day-to-day expenses aren't covered."

Tancock has seen clients with a monthly income more than $2,000 greater than their expenses, but they have no idea where that extra money is going. "This tells us they need to pay themselves first so they don't spend it,



and we then set them up on a monthly savings plan," she said. "The money is invested in a high-interest savings account to make sure they have an emergency fund first. If they keep on saving without needing the funds because of overspending, we then start investing those funds for future goals."

A cash flow analysis also identifies which debts should be paid off first based on the interest rate charged, rather than money owed. If the cash flow shows a negative, Tancock helps identify items that could be reduced, such as expensive coffees and designer clothing.

"Although it takes additional time to go through the cash flow analysis with clients, it really helps you understand their financial situation and how you can best serve them," Tancock said. "They appreciate the advice and the fact that you hold them accountable."

After the initial cash flow analysis, Tancock includes a net worth analysis that's updated during each annual review of assets and liabilities. If it shows the debt is increasing instead of decreasing, they do another cash flow analysis or identify if the debt increase is due to a one-time event.

Clients of all ages and economic levels need cash flow analysis, but how detailed it is depends on where the client is in their life. From a young person hoping to purchase their first home, to those planning to retire soon, understanding their cash flow is a way to understand what decisions they should be making.

Tancock has helped young home buyers identify what their future costs will be to own a home, which includes

Understanding cash flow to prepare for the future

BY USING LIFETIME CASH FLOW FORECASTING, Charlie Reading, APFS, demonstrates to his clients the future impact of the decisions they make today. He starts with understanding their current financial information, including details about their pension and state benefits. Next, the client is asked what they anticipate changing in the future. Will they be paying school fees, upsizing, downsizing or retiring?

"We also want to know what they would love to do, so that we can try and build them a plan that includes these aspects too," said Reading, a two-year MDRT member from Rutland, England. "We show them different scenarios — for example, if they have insufficient money to live the retirement they want, at what age or net worth do they need to either downsize or rein in the spending so they don't run out."

Reading updates the cash flow analysis yearly, and also gives them online access to the information so they can log in and run different scenarios themselves. "It has made a massive difference," he said. "It helps us give clients a greater peace of mind by allowing them to see into their financial future."

Recently, Reading met with a new client who was being forced to retire two years early, and as a result he didn't believe he had enough money to deliver the lifestyle he had promised his family. He felt he had let them down. "Using lifetime cash flow forecasting, we were able to show him that he had enough money," Reading said. "And that even if he lived to age 100, he was very unlikely to run out. He could even afford the new kitchen he promised his wife."

Cut the credit cards

I WAS REFERRED TO CLIENTS who needed help with their retirement planning. They had a good pension, but could not get ahead of their debts. They completed the cash flow analysis, which showed they were meeting day-to-day expenses, but the amount going toward debt repayment was quite high and, as a result, there were no extra funds to invest.

As we dug deeper into their debt payment, it came to light that they had seven different credit cards, all with outstanding amounts. They were paying down something on every card, but the amount was whatever they decided each month, and the minimum was always paid. They had no idea of the interest rate they were paying on each card. One of them was 27%.

We prioritized the payments based on the interest rates, as there was not enough equity in their home to qualify for a line of credit. They cut five of the credit cards in half, and seldom used the other two by reducing frivolous expenses.

Five years later, the credit cards have been paid off, they downsized to a much smaller home to reduce their outstanding mortgage amount, they are now concentrating on paying down the mortgage, and they have a modest investment portfolio and life insurance in place.

— Aurora Tancock

CONTACT:

Troy Collins
troy@collinsfinancialgroup.com.au

Charlie Reading
charlie@efficientportfolio.co.uk

Aurora Tancock
aurora@atfs.ca

"The process of cash flow management has significantly enhanced our engagement with our clients as our value proposition is more at a strategic level, rather than transaction."

— Aurora Tancock

the mortgage, utilities and home insurance. "They sometimes qualify for a certain amount of mortgage, but after completing the cash flow, it becomes clear, based on other expenses or responsibilities, they can't afford it."

With clients who are planning for retirement income, the cash flow analysis helps them understand what their current lifestyle is costing them. "We then remove those items that will disappear at retirement (mortgages, hopefully, and current yearly savings) and then add those that may increase (more time to travel and pursue hobbies)," she said. "This gives them a clear vision of what their retirement income needs to look like."

For high-net-worth clients, Tancock uses the information on the cash flow analysis to identify what their lifestyle costs and, based on this, how much of their assets will be used and how much will be left as inheritance. This has led to them not only investing their funds, but also to purchasing life insurance for estate planning purposes.

Which leads to another benefit of cash flow analysis: the products are a natural element of the client's financial plan. "The products such as insurance, superannuation and investments will come, but they are the last part of the process, not upfront," Collins said. "The engagement, relationships and professional satisfaction you can have by delivering real financial advice and strategies to your clients will result in business growth and less reliance on products and commissions."

Tancock agrees. "This has not only increased the amount of business they do with us, but they sing our praises and our firm has become a referral-based practice."

"Using cash flow modeling and tracking clients' progress enables us to engage with clients beyond the placement of product," said Collins, who runs a fee-based practice. "The process of cash flow management has significantly enhanced our engagement with our clients as our value proposition is more at a strategic level, rather than transaction."