

The Importance of an Annual Financial Checkup

It's one of the six steps of the financial planning process. But, oftentimes, it's the one step that gets overlooked. It's the sixth step – the annual financial check-up.

The annual financial check-up is indeed the most important of the financial planning steps. And yet, financial planners and clients sometimes downplay its significance.

What is the annual review and why is it so important? In short, the annual review is the opportunity to measure a client's progress against their plan of action. It's also the one time when planners and clients can examine the many changes that typically occur any given 12-month period – the birth of a child, the death of a loved one, the loss of a job, a major purchase – and then readjust the client's financial plan, charting a new course if need be or further affirming the client's progress towards their personal financial goal achievement.

Indeed, lives are seldom static and that's why financial plans are not necessarily set-and-forget documents. But what exactly should financial planners and clients examine in their annual meetings? And when should they conduct their annual meetings.

Typically, financial planners will collect a client's data, prioritize their goals, examine their resources, make recommendations, and implement a plan as part of the financial planning process. In an annual review, the financial planner will do much of the same and then some. They will first typically examine a client's progress against the plan time frames. This sort of monitoring benefits both planners and their clients. Clients get an opportunity to step back from their busy lives and review their goals and confirm that their priorities remain the same. Planners have a chance to reconnect with their clients to affirm their positive actions towards goal achievement or to help refocus them so that they don't get too far off track. And planners get a chance to enhance the relationship and trust.

In some cases, planners and clients will want to establish a regular appointment, meeting on an annual basis, and in some cases on a quarterly or semi-annual basis. Typically, the planner and client will review in these meetings short-term goals, examining what if anything may have changed. In some cases, the planner will make changes to a client's investment portfolio in light of tactical or strategic asset allocation models in place. In other cases, a planner will suggest changes based on certain life events. The birth of a child or grandchild may require a discussion about 529 plans. A divorce may require changing beneficiary designations on retirement accounts and life insurance policies.

In addition a planner may want to review with their clients new research that has become available in the interim to either confirm rationale or provide a basis to alter a client's short-term or long-term strategies. For instance, new research that shows the escalating costs of nursing homes or health care in retirement wouldn't change the goal of "secure long-term retirement," but it would change the strategy to achieve that goal.

Besides reviewing family developments, planners would also address in an annual review regulatory and other changes that could affect adversely or positively a client's financial plan. The new Medicare Part D plan or the introduction of the Roth 401(k) could prove useful to some clients. In other cases, the annual review is a chance to review potential changes, changes in the federal estate tax laws, for instance, and devise possible plans of actions.

Planners and clients will often want to measure the “performance” of the investment portfolio as part of the annual review. Typically, performance should be measured against several benchmarks, the most important of which is the client’s own personal goals. For instance, if the planner and the client established that a portfolio should grow by 5 percent per year before taxes then the performance should be measured against that yard stick. To be sure, it’s important that portfolios be measured against standard benchmarks. But only as a point of reference. Meeting personal investment goals is far more important than over performing or underperforming the Dow Jones industrial average. By and large, it’s imprudent for planners and clients to make wholesale changes to a portfolio based solely on one quarter as well as one year of performance.

In summary, annual reviews provide a chance for planners to examine a client’s long-term goals. These reviews can establish whether the client is generally on course to meet their goals. It’s also a chance to review changes that have occurred and begin to anticipate changes that may occur. It’s a chance to implement any new plan of action that has been developed in light of changing goals or changing performance. And then last, the annual review provides the perfect opportunity to establish future review meetings.

One of the most important worksheets to review is a balance sheet or net worth statement. If reaching all of the client’s goals will require a net worth of \$1 million at some point in the future, it is the balance sheet that will demonstrate movement toward or away from that goal. It is a road map. When going out of town, a map is almost always consulted before and during the trip. Progress toward your ultimate destination is noted by each passing town or landmark. It is easy to see when you move off track and what corrections should be made to get you back on the correct path in the least amount of time or distance. The balance sheet measures your progress toward your monetary goal in a finite manner. What the numbers show from year-to-year are not as important as what they show after several years looked at as a whole.

May 2006 — This column is produced by the Financial Planning Association of Southern Wisconsin. We can be a continued resource for your personal finance coverage. If you use this column in whole or part, please credit the chapter or one of our CERTIFIED FINANCIAL PLANNER™ members.

CFP®, CERTIFIED FINANCIAL PLANNER™ and the federally registered CFP (with flame logo) are certification marks owned by Certified Financial Planner Board of Standards, Inc. These marks are awarded to individuals who successfully complete CFP Board’s initial and ongoing certification requirements.