

Creating Good Money Habits



Many Australians delay taking control of their finances because they don't have the time, they find it too daunting or they may just not know where to start. The reality is though the sooner you take charge the sooner you can start working towards achieving better results, especially in the long term.

To assist you in this process CPA Australia has developed *30 Ways to Build Your Wealth* - a series of five fact sheets to get you on the path to good money management. This fact sheet provides helpful tips on creating good money habits. The other fact sheets cover spending money to make money; being tax savvy; becoming financially literate; and maximising your entitlements - all of which can be downloaded at www.cpaaustralia.com.au/links?30wayskit

While the information highlights some factors to consider and how these may impact your finances, it does not replace the need for ongoing financial planning advice that is tailored to your specific needs.

1. Save first – spend later

Saving is easier if you commit to putting the money aside at the start of your pay period and spending what is left, rather than trying to limit your spending and saving the amount left over.

Many people get used to spending their money rather than saving it.

It's easier not to miss something that you didn't think you had in the first place. A savings plan can include a simple bank savings account, or it could be one of many other investment options available, such as managed funds.

An automatic deduction, either directly from your pay, or from your bank account a day or two after you get paid, is one of the easiest ways to set yourself up so that you save first. That way, you know exactly how much you have left to spend each pay period. Many people already do this as they have set up their mortgage payments this way.

2. Ensure enough risk in a portfolio

Too little investment risk can be just as dangerous as too much investment risk.

Richard was very afraid to take any investment risks to invest in shares or property, but knew the importance of saving for the future. He put \$500 per month into a Cash Management Trust which was earning a healthy 5 per cent per annum. He reinvested all interest received.

Paula on the other hand was also saving \$500 per month. She understood the importance of including investments that were more volatile and risky in the short term, but offered her better long term returns, so invested in a professionally managed share portfolio. Her portfolio only paid 3 per cent per annum in fully franked dividends (which were reinvested) but it also grew at a compound rate of 4 per cent.

They both invested for 20 years and were both on a marginal tax rate of 30 per cent over the time. So does the 2 per cent additional return make that much difference?

In Richard's case, after losing 1.5 per cent of his 5 per cent return to tax each year, his final balance after 20 years is a healthy \$164,000, \$120,000 of which was his own contribution.

Paula effectively paid no tax on her dividends and her final balance was \$276,000. If she cashed her investment, she would have a potential Capital Gains tax liability of just under \$10,000, but would still have \$100,000 more than Richard.

It works the other way as well. Many retirees think they need to 'protect' their retirement nest eggs by taking little or no risk. If someone had an allocated pension of \$100,000 and was drawing \$9,000 per annum, with a 5 per cent per annum return, their money would last just over 16 years. If slightly more risk was taken, so that the return averaged 7.5 per cent over the long term, the investment would then last almost 24 years.

3. Set goals

If you don't set yourself personal financial goals, then how do you know what you are trying to achieve financially?

Everyone has goals that they would like to achieve, from buying that "must have" dress or paying off a home to travelling overseas. The reality is that most people do not think about what their goals really are, or the finances needed to achieve those goals. And if you don't know where you are heading, then how do you know how to get there?

Ask yourself – what do I want to achieve? Remember it is important to be specific and make your goals measurable so you can see the results. Ensure that the goals are attainable, realistic, and within sensible time frames. If your goal is to save \$40,000 in two years and you only earn \$20,000 a year, then you're setting yourself up for failure.

Once you have decided on your goals and their timeframes, then you can begin to make informed choices about how to work towards achieving them.

Remember, you can break your goals into chunks so that you can achieve your overall goal in stages. For example, if you want to save for a holiday, you could set a goal of saving \$200 a month or even \$50 a week.

4. Budget

Budgeting is an essential tool to help you manage your personal finances and, most importantly, your cash flow.

Budgeting requires you to list all your sources of income and all of your outgoing expenses. You can then identify if you are spending more than you earn or if you have a surplus of funds.

It is important that you're realistic. If you find you're spending more than you earn, the budget will help you to review your expenses and see what areas you may be able to reduce expenditure in immediately. Alternatively, if you have a surplus of funds, you can then use this surplus to establish a regular savings plan in your budget to work towards your personal finance goals.

Many electronic budgets allocate annual expenses such as car registration, across an entire year. However, if you're not paying by the month, it's important that you allocate the full expense when it actually occurs to ensure you have enough cash that month to pay for these big bills.

It's best to prepare a budget based on your pay cycles. If you have access to a computer, a spreadsheet is the best way to set up a budget so that it can be updated if and when your circumstances change. If you're not sure what you spend, start by looking at bank balances and old credit card statements; you'll be surprised by what you see.

5. Save part of pay increases and one-off payments

Next time you receive a pay increase or a one-off payment, why not save half of it – you haven't had this money to meet expenses in the past, so hopefully you won't miss it.

When we know we are going to receive a pay increase or a one-off payment, such as a tax refund or the baby bonus, our first thoughts always turn to how we can buy that new TV or take another holiday. We never seem to think, 'we could use this money to start or add to our savings plan'. As the saying goes, you don't miss what you never had.

It's important that you get to enjoy these windfalls and achievements, but why not spend half and save half. For example, if you know you are going to receive a one-off payment, like the baby bonus, why not use half to set up a savings plan for your new baby. There are savings accounts now that require no minimum, have no ongoing fees and return a good interest rate.

Or, if you know you are in line for a pay rise, why not use this as an opportunity to start a regular savings plan. Saving as little as \$20 a week adds up to more than \$1,000 per year, even with no interest! You could arrange with your employer to have part of your salary transferred directly into a separate savings account for you.

6. Consolidate accounts

Consolidating multiple accounts can reduce the fees and charges you incur and help you reach your goals sooner.

Many of us have multiple accounts and probably don't even give it a second thought. For example, how many of us have two or more bank accounts? Or more than one credit card? Or even multiple superannuation funds as a result of changing jobs?

Spreading your risk across multiple funds means you may need more than one fund, but if you have multiple accounts with small balances and are finding it difficult to keep track of everything, now might be the time to consolidate and avoid paying multiple fees and charges. And if you're consolidating your superannuation, many funds have investment choices in them so you can still spread your risk but instead of doing it across many funds, you can do it within the one fund.

7. Teaching children to save

Set a good example for your kids now and they will reap the benefits in the future.

From when our children are very young, we try to teach them as much as we can and lead by example. We do this because we know that what our children learn in their early years will shape them for the rest of their lives. We encourage them to use manners, be polite, respect their elders and so on. But how many of us actually talk about or even teach our children about managing money? Too many parents seem reluctant to discuss money with their children.

By teaching our kids about the value of money and some basic principles, we can help set them on the right track for life.

Start with some basic examples. Instead of buying that special toy or video game for them why not help them learn to save for it? Show them by putting a certain amount away each week from their pocket money, that they can save up for the toy and buy it themselves. This will demonstrate to them the value of saving and a sense of how much things really cost.

Furthermore when they go into the store to buy the toy themselves, they will have a sense of pride in what they have achieved on their own. And they will probably look after it better and play with it more!

To locate a CPA Financial Planning Specialist who can assist you with your financial planning needs, visit <http://www.cpaaustralia.com.au/links?findafp>

Note: Information is current as at 1 May 2006.

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