Douglas W. Jones, CLU®, ChFC®
Melissa Shaw, CFP®

JONES ASSOCIATES
Financial and Insurance Services, Inc.

26477 Rancho Parkway South
Lake Forest, CA 92630
(949) 699-1660
(800) 729-6344
(949) 699-1069 Fax
www.JonesFinancial.com
e-mail: info@JonesFinancial.com

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Your Financial Affairs: What Your Children Should Know

Many parents may find it uncomfortable, or even believe it is unnecessary, to inform their children about personal finance matters. Yet, communicating openly with your family members can help to reassure them about your financial and health care wishes. This may also ease the decision-making process for your family in many important areas.

As time goes by, informing your children of financial, estate, and medical arrangements that could affect the entire family helps everyone prepare and plan for the future. This does not need to include detailed facts and figures; however, you may want to consider sharing the following information with your adult children:

- **Life Insurance.** Life insurance is typically purchased to provide a death benefit to help cover final expenses, estate taxes, outstanding mortgages, other liabilities, and lost income. Knowledge of the existence and location of life insurance policies can be of the utmost importance to children when settling their parents' finances in a timely manner.
- **Other Insurance.** Be sure to inform children of other insurance policies that you may have, including health, disability income, and long-term care insurance. If you're age 65 or older, make sure your children have a basic understanding of **Medicare** coverage and are aware of any health insurance policies that exceed Medicare coverage. Older adults can greatly benefit when their children understand and follow appropriate procedures, as well as submit any necessary forms on deadline.

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Valuing a Closely Held Business

For many small business owners, valuing a **closely held business** is an important part of estate and financial planning. Because valuation is a multi-faceted endeavor, a comprehensive approach is needed. Equity interests in a closely held business are not frequently sold or otherwise transferred, which can make it difficult to ascertain a valuation. Therefore, valuing a business (a **sole proprietorship**, a **partnership**, or a **corporation**), involves an analysis of specific conditions that can affect closely held businesses.

Getting Down to Business

Whenever there is a need to perform a business valuation for estate purposes, there are potentially seven areas that must be researched in order to arrive at a fair value for the total business. Each area may address issues that are somewhat abstract and/or difficult to quantify. Here is a general overview:

1) The nature, scope, and history of the business operation must be reviewed. The product or service rendered must be evaluated by past performance, as well as the risks inherent in all phases of operations. While disregarding past events that are unlikely to recur, capital structure, sales records, growth, and diversity of operations can speak volumes about the past and even future performance of the business.

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- **Wills.** Preparing a will allows you to avoid leaving the disposition of your estate up to your particular state and its probate laws. To help ensure that your assets are distributed according to your wishes, both you and your spouse should prepare wills, review them regularly, and make necessary updates as circumstances change.

  Although specific contents can be kept private, it is important to disclose the existence and location of wills to several family members or a trusted legal advisor. Keep in mind that bank safe-deposit boxes may be temporarily sealed at death, so you may want to choose an alternate location for this key document. For example, the original will may be left with your legal advisor for safekeeping.

- **Trusts.** Trusts can help protect your estate from unnecessary taxation or mismanagement. Make sure to discuss pertinent terms with those who will be involved. As children reach adulthood, it is common for parents to select a responsible son or daughter to act as **trustee** in the event of the parents' death.

- **Living Will.** This document specifies your preferences regarding the administering or withholding of life-sustaining medical treatment. Under many state statutes, a patient must be considered "terminal," "permanently unconscious," or in a "persistent vegetative state" before life support can be withdrawn. Be sure to provide copies of living wills to anyone who may be involved with the health care of you or your spouse, and keep the originals in a safe, readily accessible place.

- **Health Care Proxy.** This legal document allows you to appoint a person to act as an agent on your behalf to make medical decisions, should you become incapacitated. It is important to file a copy of the health care proxy with your primary doctor and your hospital, if possible. In addition, be sure that the individual appointed as your agent retains a copy.

- **Durable Power of Attorney.** With a durable power of attorney, an individual or financial institution may act as an agent to oversee your legal and financial affairs, even if you become incapacitated. Grown children need to be informed of the steps that have been taken to ensure the competent direction of your finances, should the need arise. However, their actual *involvement* in your financial matters may be limited, according to your wishes. A power of attorney automatically terminates upon the death of the principal.

- **Assets and Debts.** It can be beneficial for your children to know that you have compiled a list of your assets and debts, even if you choose not to show them the list. An asset list updated regularly may include information on your bank accounts, real estate holdings, pension payments, annuities, business agreements, brokerage accounts, boats, cars, artwork, collectibles, jewelry, or other valuables, and insurance policies. A debt list may include information on your current mortgages, consumer indebtedness, personal loans, and business obligations. For both lists, be sure to identify where the paperwork and associated files for each item can be found.

Initially, preparing these lists and the associated documentation may seem like an overwhelming task. However, once completed, both you and your adult children may experience a sense of relief in the knowledge that thoughtful planning was discussed and implemented according to your wishes. $

Outsourcing: A Solution for Small Businesses?

When you first launched your business, you probably handled most of the tasks associated with daily operations yourself, or with the help of a small group of employees. But as your company has grown and your needs have become more complex, you may find the management of certain processes increasingly challenging. To successfully meet these challenges, you generally have three choices: expand the workload of your current employees, hire new employees with the expertise you need, or outsource the responsibilities to service providers or individual contractors that specialize in the work that needs to be done.

What Should Be Outsourced

Many companies routinely outsource several vital business processes that are not within their core capabilities, such as IT maintenance, Web development, human resource management, marketing, public relations, and call center services. To determine which areas of your business are suited to outsourcing, analyze how efficiently certain tasks are currently being performed within your company. If responsibilities involved for certain positions have expanded and you believe these roles could be better managed elsewhere, it may be time to delegate the work to a service provider or staffing agency. This is especially true, for example, when a specific job has become more complicated, and the employee in that role would require additional training to meet the new requirements for performing well.

Outsourcing vs. Hiring

Once you have identified the areas in which your firm needs help, determine whether it makes sense to outsource. If you and your current employees are already extremely busy, it may not be practical to add to existing workloads; this could be distracting from the core activities of your business.

Hiring additional employees is an option, but for small and midsize firms in particular, bringing in external providers may be preferable to adding workers to the payroll. If the workflow tends to fluctuate, bringing on contractors who are available as needed may be a better solution than hiring permanent staff members.

Service providers and staffing agencies that specialize in human resources or IT can often provide talent with greater expertise than an individual employee might have, who may find it difficult to keep up with changing legislation and industry developments. Employees may also be reluctant or unable to take on new responsibilities as your requirements change, and they may require training. When you contract with a staffing agency or service provider, you are gaining access to a talent pool with a wide range of skills, knowledge, and resources.

Outsourcing certain functions may also prove to be more cost-effective than maintaining them in-house. You are likely to pay external contractors more per hour than you would an employee, but their on-call flexibility and high level of skills may make it worth it over time. Outsourcing can also have a positive effect on cash flow. Whereas taking on permanent employees becomes a fixed cost, outsourcing is a variable cost and can therefore free up capital for investment elsewhere in the company.

Choosing Outsourcing Partners

Selecting outside vendors can take time. Be sure to use your professional network and ask for referrals to vendors with good reputations. Also, check that the vendors you choose are financially stable. If possible, arrange to meet with the individuals who will be handling your account. Discuss in detail what services are to be delivered, how performance will be measured, and under what circumstances the contract can be terminated.

As with permanent employees, it is important to cultivate your relationships with vendors to obtain the results you want. Even if the contractors you hire excel at what they do, they will be unable to perform their assignments effectively without guidance and regular internal communication. If, for example, your firm hires an agency to handle marketing, provide detailed information about your firm, customer base, and company sales goals. Remember to maintain regular contact with all providers, to ensure they are meeting your expectations.

In some instances, outsourcing may be unpopular with existing employees. They may worry about their own jobs or resent having to interact with outside firms for work that was previously performed in-house. So it is important to explain why you are outsourcing work and how it may contribute to the growth of the business.

Outsourcing can be a viable solution for small businesses that are seeking professional help with vital business functions that exceed their core capabilities. Take time to consider all the factors involved to help determine if outsourcing is right for your company. $

Valuing a Closely Held Business

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2) By analyzing both related business sectors and current economic conditions, an appraisal can be made regarding the future potential for business profits. Generally, the greater the expectation of profits, the greater the value of the business. The appraiser should evaluate the industry, as well as the position of the particular business within the industry. The economic climate may impact the ability of all businesses to generate profits. Often, insight can be gained from looking at several competitors' past performance and future growth potential.

3) Book value, defined as assets minus liabilities, is readily obtained from the balance sheet. However, in most cases, balance sheet adjustments according to book value will need to be made for an accurate reflection of economic versus tax depreciation.

4) Profit and loss statements must be scrutinized to determine the company's earnings history. While the Internal Revenue Service (IRS) may require the past five years of profit and loss statements, for example, the agency generally will not respect five-year earnings averages, due to the belief that averages do not indicate realistic valuations. It is common for appraisers to "capitalize" earnings as a means of reducing future income to a single number, otherwise referred to as present value. Capitalizing earnings is a method used to determine how much an individual will pay for a business given the level of risk involved. Typically, the greater the risk, the less the buyer will pay, and vice versa.

5) Where appropriate, the dividend-paying capacity of the company will be determined from financial statements. However, dividends may not be a reliable criterion of market value for a closely held company since the controlling stockholders may have used discretion in opting to pay deductible salaries and bonuses, rather than nondeductible dividends.

6) The most difficult area for valuation purposes is goodwill, or the ability of a business to earn a return over and above what it could on its fixed assets alone. Consumer satisfaction, trust, and trademarks may be important factors in gross revenues. In addition, intangible goodwill value can be based upon location, reputation, or clientele. While it may be difficult to determine a precise valuation, an independent appraiser may be able to discern the overall significance of the company's goodwill.

7) If shares were purchased in the last three years, for example, the price paid for an interest in the business may be a significant factor in valuation for a closely held business. In this case, the IRS may scrutinize when the sale was made, whether the interest sold was controlling or a minority block, and whether or not the sale was forced by other conditions in the business or circumstances associated with the buyer or seller.

Wherever possible, each area must be reduced to specific numerical values. The IRS cautions against averages to prevent the appraiser from simply averaging factors, such as book value, goodwill, and capitalized earnings, and then coming up with a figure. Courts generally agree with the IRS in not giving credence to averages and formulas. As a result, valuation has become more complicated.

While determining the valuation of a closely held business may seem overwhelming at first, it may prove useful in estate and financial planning, as well as **business succession planning**. Because the valuation process is intricate and involves many variables, be sure to consult with qualified professionals. $

Playing by the IRA Rules

Individual Retirement Accounts (IRAs) offer favorable tax-deferral benefits to individuals who are saving for retirement. But with those benefits, there are certain rules about when distributions may be taken to avoid penalty taxes. Contributions to a traditional IRA, depending on your income and participation in employer-sponsored plans, may entitle you to certain current income tax deductions. Further, because your funds are not taxed until distributions begin, your savings have the potential for tax-deferred growth. Generally, IRAs are designed to work as long-term savings vehicles, but you may be able to withdraw funds early and without penalty, provided your situation qualifies as an exception.

The Age 59½ Rule

The age 59½ rule provides that, if you take distributions from your traditional IRA before you reach the age of 59½, you may be subject to a 10% Federal penalty tax in addition to regular income tax. However, you may not have to pay the penalty tax if your early distribution meets certain requirements.

Exceptions

You may be eligible for penalty-free qualified distributions, if one of the following exceptions applies:

1. You are taking distributions as the beneficiary of a deceased IRA owner. Generally, if you inherit an IRA, you are required to take required minimum distributions (RMDs) over a period no longer than your life expectancy. For nonspousal beneficiaries, RMDs must begin in the year following the year in which the IRA owner died. Spousal beneficiaries may have additional time to begin taking RMDs, depending on certain factors, including whether they opt to treat an inherited IRA as their own. This penalty tax exception does not apply to spousal beneficiaries who opt to treat the account as their own IRA.

2. You are paying for certain first-time homebuyer expenses, generally referred to as qualified acquisition costs, such as buying, building, or renovating a first home. Distributions, which may not exceed $10,000, may be used to cover qualified costs for you, your spouse, your children, or your grandchildren.

3. You, your spouse, or dependents have unreimbursed medical expenses that total more than 10% of your adjusted gross income (AGI) (7.5% if you are age 65 or older, but only through 2016). If a medical expense for you, your spouse, or a dependent qualifies as an itemized deduction on your income tax return, it will generally qualify for this penalty tax exception.

4. The distributions are part of a series of substantially equal periodic payments (SEPPs) made at least annually that meet certain additional requirements. The Internal Revenue Service (IRS) currently recognizes three methods for calculating SEPPS: the required minimum distribution method, the fixed amortization method, and the fixed annuitization method. Once SEPPs begin, they must be made for five years or until you reach age 59½, whichever is later.

5. You qualify with certain physical and/or mental conditions as being disabled, determined by a physician and if the disability can be expected to result in death or continue for an indefinite duration.

6. You are paying medical insurance premiums due to unemployment. If you lost your job, and received unemployment compensation for 12 consecutive weeks, you may take distributions from your IRA account, penalty tax free, during the year in which you received unemployment compensation, or in the following year, but no later than 60 days after you have been re-employed.

7. You are paying for higher education expenses, such as tuition, fees, and books at an eligible educational institution (generally all accredited postsecondary institutions). The distributions may not exceed your qualified education expenses, or those of your spouse, your children, or your grandchildren.

8. The distribution is attributable to an IRS levy of the IRA.

9. Reservists qualify while serving on active duty for at least 180 days.

IRAs are strictly regulated to ensure that they are used as vehicles for retirement savings. Therefore, they generally work best as long-term savings vehicles. However, if you do need income from your IRA before you reach age 59½, it is important to know if your situation excuses you from the penalty tax levied on early distributions before making a withdrawal. Playing by the rules may save you money and help preserve your savings for retirement. Be sure to consult your tax advisor to determine whether your individual situation will qualify as an exception. $

Life Insurance: How Much is Enough?

You may already be aware of the importance of having enough **life insurance** coverage to handle financial matters that could affect your family in the event of your death. However, determining the appropriate amount of coverage for your family can be complicated. Rather than using an arbitrary formula, such as having enough coverage to equal five to seven times your annual salary, you may want to conduct a "**needs analysis.**"

A needs analysis incorporates an evaluation of your family's most important financial obligations and goals. It can help you plan to address mortgage debt, college expenses, and funds for your family's future, as well as liquidity for meeting potential estate tax liabilities with life insurance coverage.

Mortgage Debt

You may want to consider whether your life insurance proceeds will be sufficient to help pay the remainder of the mortgage on your home. If you are carrying a large mortgage, you may need to increase your life insurance coverage. If you own a second home, you may also want to factor that mortgage into the formula.

College Expenses

Many people want life insurance proceeds to help cover their children's undergraduate college, and possibly graduate school, expenses. The amount needed can be roughly calculated by matching the ages of your children with projected college costs adjusted for inflation. Because it may be difficult to project costs that far into the future, it is important to revise this calculation periodically, as your children get closer to college age. When estimating long-term savings goals, it may also be a good idea to be as conservative as possible.

Your Family's Lifestyle

The amount you may need to help provide for your surviving spouse and dependents will vary according to your age, health, retirement plan benefits, Social Security benefits, and other assets, along with your spouse's earning power. Many surviving spouses may already be employed or will find employment, but your spouse's income alone may not be sufficient to cover your family's current lifestyle. Providing a supplemental fund can help your family maintain its standard of living in the event of your death.

Estate Taxes

Life insurance has long been recognized as a method for establishing liquidity at death to pay estate taxes and maximize asset transfers to future generations. Be sure to consult your qualified tax and legal advisors to help ensure the desired results.

Existing Resources

If your current assets and any other death benefits are sufficient to cover your financial needs and obligations, you may not need additional life insurance for these purposes. However, if they are inadequate, the difference between your total assets and your total needs may be funded with life insurance.

You must consider many factors when completing a needs analysis. In addition to the areas already mentioned, ask yourself the following questions:

- What are your estimated Social Security benefits at retirement?
- How do you "inflation-proof" your family income, so the real purchasing power of those dollars does not decrease?
- What is the earning potential of your surviving spouse?
- How often should you review your needs analysis?
- How can life insurance help provide resources for your retirement?
- How do you structure your estate to reduce the impact of estate taxes?
- Which of your assets are liquid and which would not be reduced by a forced sale?
- Which of your assets would you want your family to retain for sentimental reasons or for future growth possibilities?

As you evaluate your insurance needs, remember to assess your existing policies. Calculate the additional coverage you may need based on your family's financial obligations and any other resources, such as retirement benefits and personal savings. Planning now may help to protect your family's financial future. $

Disability Income Insurance: Protecting Your Most Valuable Asset

Have you ever wondered how you would manage financially if you were to sustain an injury or illness that left you unable to work? How long could you maintain your standard of living, pay your bills, and cover your daily expenses? The likelihood of such an event may be greater than you think. According to the latest statistics from the Council for Disability Awareness, Americans underestimate their chances of experiencing a long-term disability: 64% of working Americans believe they have a 2% or less chance of being disabled for 3 months or more during their working years; however, the reality is that the odds of experiencing a long-term disability are about 25%.

To be prepared for such a situation, it is important to *plan ahead*. To help protect yourself, you may wish to purchase an **individual disability income insurance** policy, which would replace a portion of your income in the event that you experience a qualifying disability. Consider the following when choosing among the coverage options:

- **Definition of Disability.** Carefully review the policy's definition of disability. Some policies may provide coverage if you are unable to work in the occupation in which you were employed or for which you were trained, or if you can no longer earn as much as you once did in that field. In contrast, other policies may offer coverage only if you are unable to work in *any* occupation. In other words, if you were to sustain a disability but were able to work in a lower skilled, lower paying job, you may not receive benefits.

- **Residual Benefits or Partial Disability Coverage.** Under specific circumstances, if you become disabled and are only able to earn a *portion* of your previous income, residual or partial disability coverage pays a percentage of your benefits.

- **Guaranteed Renewable.** With this feature, the insurer cannot refuse to renew your policy prior to the policy expiration date or change any terms, except for premium cost, as long as you continue to pay your premiums on time.

- **Guaranteed Insurability.** This provision allows you to increase your coverage amount, even if you experience health changes that would otherwise prevent you from obtaining additional disability coverage.

- **Cost-of-Living Adjustment (COLA).** This feature helps protect your benefits against the effects of inflation during a long-term disability.

It is important to note that the cost of a disability income insurance policy varies according to the scope of coverage you choose, and there may be an additional premium for adding any **riders**.

The Outlook without Protection

Without a disability income insurance policy in place, there are alternatives, but they come with shortcomings. For instance, you could self-insure. But, even if you save 10% of your salary each year, one year of disability could easily deplete many years of savings. Or, perhaps your employer provides group disability insurance. Unfortunately, **employer-sponsored plans** are often limited in scope and duration, and generally coverage is not portable upon termination of employment. **Workers compensation** may be an option if an injury occurs on the job. However, eligibility and benefits vary by state.

To qualify for **Social Security** disability benefits, specific criteria must be met, and you may have to wait several months for payments to begin. Social Security disability was not intended to be an individual's sole source of disability income. Benefits are often less than what is needed to cover living expenses.

An illness or injury that reduces or eliminates your primary source of income can be a financially challenging experience. Therefore, you may want to consider disability income insurance as part of your overall financial strategy. Be sure to consult with a qualified professional. $

E-Learning: Doing the Virtually Impossible

People often struggle to balance their personal and professional lives. You may be juggling parenting and domestic responsibilities with a full-time career, as well as caring for aging parents. Finding the extra time to pursue an education or finish a degree, until recently, may have seemed out of the question.

But today, electronic learning, or e-learning, has changed all that. E-learning refers to the use of computer-based electronic technology as an educational tool. Internet, email, websites, Multimedia tutorials, micro-games, lesson-based podcasts, simulations, blog posts, and online discussion groups are some of the platforms used to deliver, facilitate, and enhance learning. Some online courses are "synchronous." This means all students must be online at the same time for live discussions or exams. Other e-learning courses allow students to work independently during the week, but require weekly deadlines for assignments and exams. Still others allow students to work at their own pace. They may finish the course as quickly, or as slowly, as they like.

Rather than the traditional classroom experience, e-learning offers a far more flexible way to achieve educational goals and remain competitive in the workplace. Many people are self-directed and self-motivated with the ability to multitask; ideal candidates for e-learning. It is important to keep in mind that, because a growing number of online courses are including participation in blogs, wikis, or game-like simulations, e-learners must have good computer skills and access to computers with high-speed Internet connections. Students who are unsure about their ability to use such technology should seek online schools with readily accessible help desks and other technological guidance and support.

Even in a challenging economic climate with a tight job market, college graduates may fare better than those without college degrees. In addition, in recent years, the responsibility for training and higher education has shifted from the employer to the employee in the workplace, which essentially requires workers to be more in charge of their own career growth and responsible for the acquisition of more marketable skills. As technology continues to advance, people in the workforce may need as much education and training as possible in order to keep up in the competitive job market. $