

There are various reasons why people encounter financial difficulty; however the most common reasons fall under one or a combination of the following categories:

1. Living beyond your means
2. Lack of income
3. Job loss or illness
4. Marital Breakdown
5. Income Taxes
6. Business Failure
7. Financial Infidelity
8. Gambling or substance abuse
9. Student loan debt
10. Identity Theft

## The Top 10 Reasons for Financial Difficulty (and what you can do to avoid them)

In this issue of StartingOver, Victor Fong, Fong and Partner Inc.'s Bankruptcy specialist, examines the first five factors in detail and outlines some suggestions you can use to avoid these pitfalls.

### Reason 1: Living beyond your means

Overspending is the most common reason why people encounter financial difficulty. The reasons why people tend to live beyond their means may be numerous, complex and will vary from one individual to another. However, the most common reasons for overspending, and how they can possibly be addressed, may be explained as follows:

#### ■ Easy access to consumer credit

Why is it so easy to get a credit card? Because credit card companies make a lot of money from interest revenue and credit card fees. It's in their interest to ensure that you apply for as many credit cards as possible.

Consider cutting up your credit cards and your line of credit convenience cards. Keep one or two credit cards for convenience. Pay off the balances on your credit cards in priority of the interest rate charged on each card. Once that's done, consider paying for purchases with cash, or use credit cards only as a convenience, paying off the balance every month.

#### ■ Advertising

We are bombarded with advertisements wherever we go. They beg for your attention, hoping that you'll purchase the good or service being advertised.

The key to dealing with this issue is to become educated about the consumer advertising industry's practices in selling things people may not really need. A good introduction to this subject can be found in the book "No Logo" by Canadian author Naomi Klein. Anyone having an interest in this subject matter may wish to review it as a starting point.

#### ■ Lack of financial education

Simply put, personal money management is not taught in our education system. Therefore, many people are not educated about personal finances and cannot answer basic questions such as the difference between investing money in stocks and a savings account, or whether every person has a right to see their own credit report.

Consider reading a book on personal financial management. There are many excellent books in the marketplace written for readers without a financial or business background.

#### ■ Distinguishing "needs" from "wants"

Before credit cards were invented, consumers could only purchase what they could afford to pay and had to prioritize their purchases by distinguishing "needs" from "wants". With access to credit, consumers can now purchase pretty much anything their credit limit will allow them, so long as they can make their minimum payments.

When faced with your next purchase, ask yourself the following questions:

- Is this something you need (i.e., necessary) or something you want (i.e., nice to have, but unnecessary)?
- If it's a "want", can you afford to pay for it now?
- If you can't afford it now, will you be able to save money to purchase it in the future?

If the answer to all three of these questions is "No", then you cannot afford the purchase at all and should consider declining it.

### Reason 2: Lack of Income

Families that fall below basic family budget levels often lack the income needed to support a safe and decent living standard. Therefore, such families supplement their income by using credit to purchase basic necessities such

as food, clothing and shelter. Eventually, debt accumulates to such a level that families cannot afford to make minimum payments against their debt and may have to file bankruptcy.

Oftentimes, the "working poor" are families headed by single parents, young workers, new immigrants, or workers with less than a high school degree are more likely to struggle to make ends meet.

The existence of a working poor underclass is a symptom of societal problems such as increasing dropout rates in high schools, lack of job opportunities for many young high school and secondary school graduates, and non-recognition of foreign professional credentials or work experience. These problems must be addressed by government policymakers in order to reduce the number of working poor families.

### Reason 3: Job Loss or Illness

A common reason for financial hardship is an unexpected job loss or the inability to work due to a prolonged period of illness or disability. People today are saving less, and often have no savings to draw upon during the period of unemployment or illness. The resultant effect is a significant reduction in income such that living expenses cannot be maintained without going into debt. If the non-working period is prolonged, the debt may have accumulated to such a level that debt payments can no longer be maintained, even after finding employment.

To avoid such a scenario, consider accumulating an emergency fund, equal to three months salary. Such a fund will help you through such difficult times as these.

### Reason 4: Marital Breakdown

Marital separation and divorce is expensive, both emotionally and financially. The effect of family support obligations, the division of family assets, and the loss of income can have a devastating effect on both parties going through a separation.

The statistics are not encouraging. Current Canadian statistics estimate that approximately 38% of marriages will end in divorce before the 30th anniversary of the marriage. It is therefore not surprising that many individuals file for bankruptcy because of financial difficulties resulting from a marital breakdown. The following are some suggestions to mitigate the financial difficulties one may encounter in such a situation:

- If you are not married yet, but plan to marry, consider consulting with a lawyer about obtaining a prenuptial agreement. This is an agreement between two spouses that deals with the financial

consequences of the death or separation of one of the spouses. This is particularly ideal if you are wealthier than your partner or earn significantly more money.

- Familiarize yourself with the family finances. Oftentimes, one partner will leave the details of the family's finances with the other spouse. This can be costly; if you are unaware of the family's finances, it will be more difficult for you to negotiate a proper settlement.
- Maintain a spending record of your partner's spending habits, i.e., review and make copies of credit card and bank statements. It is not uncommon for a vindictive spouse to go on a spending spree in order to deplete family assets or rack up debts.

### Reason 5: Income Taxes

This problem is prevalent among business owners or self-employed professionals. High-income earners often fail to have a strategy in place to reduce the amount of taxes they have to pay and often live expensive lifestyles, such that there is nothing left over to pay income taxes payable. Consequently, the tax debt accumulates rapidly, as penalties and interest on unpaid income taxes is significant.

The best way to prevent this problem from arising is to retain a tax professional for tax planning advice. You may also want to consider retaining a financial planner to work with you in preparing a budget that will account for the income tax payments you'll have to remit.

Next month Victor will discuss the remaining factors people find themselves in financial difficulty. If you have any questions about the topics discussed in this article please contact Victor Fong at 416-260-3264 or via email at [victor@fongpartners.com](mailto:victor@fongpartners.com).

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*Starting Over Personal Financial Difficulties is an overview rather than a complete analysis. Before applying any of these suggestions, consult your Fong and Partners Inc. advisor.*

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