Chapter 1
Financial Planning

INTRODUCTORY NOTES

This chapter sets the stage for the many financial decisions people have to make. It examines the need for and benefits of a personal financial plan, and it provides an overview of a five-step process of making a financial plan. Later chapters elaborate upon the factors involved in financial planning decisions. The terminology used in this chapter will be explained in more detail later.

ANSWERS TO THE PROBLEMS

1. Jan and Dave
   a. Jan and Dave's net worth.

JAN AND DAVE'S NET WORTH STATEMENT

ASSETS		
Liquid Assets		
Cash, Bank Accounts (savings & chequing)	$811.00	0.5%
Canada Savings Bonds	$1,500.00	0.9%
Life Insurance Cash Surrender Value	$4,000.00	2.4%
TOTAL LIQUID ASSETS	**$6,311.00**	3.8%
Other Financial Assets		0.0%
RRSP's	$3,755.00	2.2%
Pension Plan Credits	$0.00	0.0%
TOTAL OTHER FINANCIAL ASSETS	**$3,755.00**	2.2%
Real Estate		
Home (market value)	$145,000.00	86.5%
TOTAL REAL ESTATE	**$145,000.00**	86.5%
Personal Property		
Vehicles	$12,500.00	7.5%
TOTAL PERSONAL PROPERTY	**$12,500.00**	7.5%
TOTAL ASSETS	**$167,566.00**	**100.0%**
LIABILITIES		
Short-Term Debt		
Current Portion of Mortgage	$7,454.88	6.7%
Current Portion of Car Loan	$1,500.00	1.4%
TOTAL SHORT-TERM DEBT	**$8,954.88**	8.1%
Long-Term Debt		
Mortgages	$88,545.12	80.1%
Long-Term-Portion of Car Loan	$1,500.00	1.4%
Other Debts, Tuition, Business etc	$10,000.00	9.0%
TOTAL LONG-TERM DEBT	$100,045.12	90.5%
TOTAL LIABILITIES	**$110,500.00**	**100.0%**
NET WORTH = ASSETS-LIABILITIES	**$57,066.00**	
RATIO ANALYSIS		
Liquid Assets to Short-Term Debt		70%
Net Worth to Total Assets		34%

Jan and Dave's liquid assets are too low compared with their current liabilities. The couple may face liquidity problems since they can meet only 70 percent of their current obligations.

Over 85 percent of their assets are tied up in a single asset - their home. This could be risky if they need to sell their home after house prices have fallen. They need to diversify.

Their net worth is 34 percent, which means that for every dollar of assets, Jan and Dave own only 34 cents. In other words, creditors own 66 percent of everything they have.

In a discussion with their financial counsellor Jan and Dave should raise the following issues:

1. The need for a budget and better control of spending to enable them to build up an emergency fund and retire short-term debts.
2. The need for retirement planning and tax deferment.
3. Provision for the children's education.
4. The need for a risk assessment
5. The need to review of their insurance coverage.
6. Diversification of their investments.

b. Cash flow

Jan and Dave's Monthly Cash Flow Statement

Cash Inflow	
After-tax Income	$4,309.00
Interest Income	$6.88
Dividend Income	
Total Cash Inflow	**$4,315.88**
Cash Outflow	
Housing	$1,185.00
Food	$650.00
Transportation	$200.00
Gifts	$150.00
Clothes	$400.00
Entertainment	$150.00
Magazines, etc.	$35.00
Life Insurance	$110.00
Debt repayment (except mortgage)	$430.00
Baby Sitter	$40.00
Miscellaneous	$300.00
Total cash Inflow	**$3,650.00**
Net Cash flow	**$665.88**

Their cash flow situation shows that they have a cash inflow of $4,316 and a cash outflow of $3,650, resulting in a net cash flow of $666 per month. Nothing is set aside for medical expenses, personal spending, retirement savings, education savings, or a vacation. The lack of weekly allowances is a sign of poor management. The large miscellaneous expense also needs to be investigated. To increase savings they could reduce their non-essential spending on gifts, entertainment, and recreation.

c. If Dave could not work they would have problems. Their Canada Savings Bonds could be redeemed, but this money would run out in a couple weeks. If Dave got laid off or got sick he would have to at least two weeks before receiving Employment Insurance, and this would be only 55 percent of his insurable earnings to a maximum of $423. Sickness benefits would be paid for a maximum of 15 weeks. They could borrow from the life insurance policy. It is possible that they will need to use their line of credit, which will increase their debt load.
d. They don't seem to be saving very much. If they do not change, any money they receive will be spent. Their debts might increase because of emergencies or because they lack the savings to buy the things they want. It is likely that they won't have enough money for retirement or for their children's education.
e. Jan and Dave are not good financial managers. When they moved they had no money set-aside for closing costs and new drapes. It was also unwise to take out a loan for a new car just before moving. They need to set some goals and identify priorities. Looking at their resources and spending is a good place to start. They need to keep records so they can check their progress and make any necessary changes.

2. Agree or disagree.
    a. Agree. Small, short-term goals can be more easily achieved . Success will encourage more planning.
    b. This depends on your point of view. A budget can, however, give you control over your financial affairs.
    c. Disagree. Planning may help then to balance their income and spending.
    d. Agree.
    e. A newly married couple will have a greater need for a spending plan because they do not yet know what their expenses will be. They also need a financial plan to help define their financial values and goals.
    f. Disagree. It may be difficult but it is important to make a plan because of the irregularity of their income and expenses.
    g. Disagree. You can budget for basic necessities, which correspond to a minimum level of income and buy non-essentials when there is more money.
    h. Disagree. The unexpected can be included in a budget along with regular expenses.
    i. This is not necessarily true. While the amount of paperwork may be a reason, there are others such as procrastination, which are just as important.

3. Figure 1.1
    a. Finding a job, career advancement, saving for an emergency fund, buying a house, starting an investment portfolio, and paying off student loans.
    b. Buying a house and furniture.
    c. Setting up an education fund, buying disability insurance and life insurance and estate planning.

   d. Re-examining disability insurance, life insurance, critical care insurance, the estate plan, and the education plan.
   e. Paying off the mortgage on the house, increasing savings and investment, and beginning to think about retirement planning.
   f. Increasing saving, increasing assets, and arranging the asset mix by emphasize growth to ensure an adequate retirement income.
   g. Managing assets wisely and rearranging the mixture of assets with the emphasis on income and low risk instead of on growth.
   h. Selling the house and move to more manageable accommodations, considering buying an annuity to minimize the risk of running out of money.

4. The spending diary may make Julie more aware of her spending and could be a form of spending control. However, it lacks a means helping her to analyze her spending and is really more show than substance.
5. It is very important. The reason for an emergency fund is to provide for unexpected expenses. To borrow from the fund defeats its purpose.
6. People generally become financially distraught because of loss of income or an increase in expenses. Loss of income could occur as a result of an unexpected job loss, a catastrophic illness or debilitating injury, returning to school, or retirement. Expenses increase because of emergencies, having children, borrowing with expensive credit card debt, extravagant lifestyle expenditures.
7. Sean and Melanie are living beyond their means. They are making extensive use of expensive credit card credit by not paying off the monthly balance, taking the maximum time to pay off other loans, and paying high rates of interest, thus causing their interest costs to soar. Since they have no emergency fund, an impending loss of income together with the costs associated with costs of a possible transfer have put them in the “credit trap”.
8. Answers will vary, but most students will have done very little in the way of financial planning.
9. They could easily identify goals and set priorities, as well as assess their priorities.
10. Answers will vary. They may be motivated to control their spending if they could be convinced that doing so may allow them to reach otherwise impossible goals with limited resources.
11. The future value of Yolanda's money was greater than Dan's because it had a longer time to compound interest.
12. A financial counsellor would ask Darryl and Llana to examine their financial values and goals. Before they can develop a realistic financial plan they will have to agree on similar goals. Then they would have to review their expenses and revise them to become more realistic.
13. Lucy’s financial plan
   a. Lucy needs a financial plan. She should take responsibility for her financial affairs, and modify her lifestyle to bring expenses in line with income.
   b. Several factors have lead to the creation of Lucy’s current problems. They include a lack of interest and knowledge in financial matters, a lack of

planning when her marriage was threatened, an unwillingness to change her lifestyle to fit the reality of her situation, and she only had a concern with her immediate needs and did not prepare for the future.

c. Lucy will turn age 65 in about 15 years, so she needs to start planning for a comfortable retirement income at once; otherwise, she will be faced with living out her golden years on the Old Age Security pension. She needs to make some serious decisions regarding investing her divorce settlement to provide a retirement income. Additionally, she should continue to work where she could contribute to a Registered Pension Plan, the Canada Pension Plan, and Registered retirement Pension Plan.

14. Go to FPSC - Certified Financial Planner - Financial Planning Process for a detailed explanation of the five-step process used by the Canadian Institute of Financial Planners.

A Comparison Of Steps In The Financial Planning Process

Step	**Figure 1.3 of the text**	**Financial Planners Standards Council**
One	Identify goals & set priorities	Establish the client – planner engagement
Two	Assess resources	Gather client data and establish your goals
Three	Balance future cash flows	Develop and present the financial plan
Four	Develop implementation & control strategies	Implement your financial plan
Five	Evaluate progress	Monitor the financial plan

SUPPLEMENTARY ACTIVITIES

1. Make a financial plan for yourself following the steps in the book. This involves the following:
   a. Identify your goals and priorities.
   b. Assess your resources.
   c. Balance future cash flows,
   d. Develop and use control strategies.
   e. Evaluate your progress.

   Use the following guidelines:
   1. Decide what time period to use**.** In order to do this while you are studying the course you need a short time period.
   2. Think about your goals and priorities**.** What do you hope to achieve and which goals are the most important?
   3. Predict the financial resources that will be available for the period**.** Summarize the resources you expect to have in the next month and calculate the total.
   4. Estimate your expenses for the period**.**
   5. Balance your resources and expenses**.** Compare your estimated income and expenses. If they do not balance look again at your estimates
   6. Record-keeping**.** Keep a record of your income resources and expenses.
   7. Evaluate the results**.** Construct a chart so that you can compare your plan with what actually happened. Did the plan work? If not what did you do wrong?

   This exercise can become the focus of the whole course by providing the students the opportunity to apply the material they are learning about. They may learn that they will be living a frugal lifestyle for a long time due to their large student loans. This exercise also permits the students to build the plan as they proceed through the course. Students should start the plan as soon as possible as it can become daunting.

2. Conduct a survey of family members about their financial planning experiences. Use the following questions as a guide.
   (a) What does the word budget mean to them? Is their definition similar to the one used in the text?
   (b) Find out if they make financial plans and if not, why not?
   (c) What methods are used to control their financial plans?
   (d) How do they save? Do they "pay themselves first" or do they use what is left at the end of the month for their savings?