

# Chapter 1

## Overview of a Financial Plan

### ■ Chapter Overview

Every individual and family needs to develop a financial plan. Financial planning will help them clarify their goals and ensure that spending, financing, and investing decisions are aligned with those goals.

Chapter 1 discusses the benefits of financial planning: making your own financial planning decisions, judging the advice of financial advisers, even, becoming a financial adviser. In addition, this chapter briefly discusses the five component plans that make up the over-all financial plan. These components are budgeting and tax planning, financing your purchases, protecting assets and income, investing your money, and planning your retirement and estate.

Each of these component plans requires six steps. First, an individual must establish financial goals. Once these are established, the individual must consider his or her current financial position. Next, alternative plans that could help achieve the goals should be identified and evaluated. One plan should then be chosen and implemented. In the final two steps, the individual would evaluate his or her financial plan and revise it as needed.

### ■ Chapter Objectives

The objectives of this chapter are to:

1. Explain how you could benefit from personal financial planning
2. Identify the key components of a financial plan
3. Outline the steps involved in developing a financial plan

### ■ Teaching Tips

1. Discuss this quote with students: “Most people don’t plan to fail, they fail to plan.” Ask students for examples of situations (financial or otherwise) where they have seen this happen. Guide the discussion toward financial matters.
2. Relate financial planning to planning a trip.

#### Steps in Financial Planning

Set goals  
Determine your current financial position  
Identify and evaluate alternative plans  
Choose and implement a plan  
Evaluate plan  
Revise plan as needed

#### Steps in Planning a Trip

Decide where you are going  
Locate your home on the map  
Identify and evaluate alternate routes  
Pick a route and start journey  
Is the trip going smoothly?  
Road construction causes major delays, so you pick an alternate route

A financial plan is just a financial road map.

- The Financial Planning Standards Council provides a list of “10 Questions to Ask Your Planner”. These questions can be accessed at <https://www.financialplanningforcanadians.ca/financial-planning/questions-to-ask-your-financial-planner> and may be reviewed in class with students. In addition, students may be asked, through individual or team work, to develop more detailed answers to certain questions. For example, the question “What services do you offer?” may be followed up with a student or group assignment to answer the question “What are the different services that a financial planner may offer their client?”.
- Many younger students have difficulty recognizing the benefits of devising a financial plan now. Money talks, however, and an effective demonstration of the time value of money involves the “Rule of 72.” Briefly stated, the Rule of 72 is an indicator of how long it will take a single sum of money to double in value at a given interest rate. The time is computed by dividing 72 by the interest rate. For instance, at 12% a sum of money would double every six years. Provide this example for students: What if your parents had been able to invest \$1,000 at 12% the day you were born?

<b>Age</b>	<b>Value of Investment</b>	<b>Age</b>	<b>Value of Investment</b>
0	\$1,000	36	\$64,000
6	2,000	42	128,000
12	4,000	48	256,000
18	8,000	54	512,000
24	16,000	60	1,024,000
30	32,000	66	2,048,000

This concept can also further be used to determine the rate of return necessary to achieve a financial goal by simply dividing 72 by the number of periods available to reach the goal. This answer will provide the percentage return needed to reach a goal. For instance, a \$10,000 down payment on a house is desired in 6 years. Currently, \$5,000 is the amount saved. The needed return would be 12%. Other considerations, such as amount of risk to be taken, would then also need to be assessed, but this is a quick tool to make preliminary estimates.

- Have students write up a set of goals. Suggest a minimum of 2 goals for each time frame—short, medium-, and long-term goals. One of the short-term goals should be achievable by the completion of the course. Remind students that goals need to be monitored and assessed to determine progress toward overall life goals.
- Review the interactive “Path to CFP Certification” with students. The pathway may be accessed from the FPSC website, [www.fpsc.ca](http://www.fpsc.ca), and is currently available at <http://www.fpsc.ca/beaplanner/path-to-certification>. This would be an important exercise for those students who wish to become a financial adviser or planner, but do not know what they need to do to become certified. As a follow up question, have students delve deeper into what they specifically need to do to complete each step.
- Teams—at the beginning of the semester/class, assign groups of 3–5 students to a team. In many chapters, these teams can be used for discussion purposes, reviewing quantitative materials, and quizzes.
- Discuss with students that goals are not stagnant. They change as an individual’s life changes. The addition of a spouse or child, change of career or job, etc., would often create

a need to review  
and perhaps modify financial goals.

9. Use the interactive Financial Services Career Map offered by the Canadian Securities Institute, [https://www.csi.ca/student/en\\_ca/careormap/index.xhtml](https://www.csi.ca/student/en_ca/careormap/index.xhtml), to open a discussion on the various career paths available in the financial services industry. Have students use the map to provide a brief overview, in a class presentation or written report, of the roles, responsibilities, and opportunities offered in a particular financial services career.
10. Online courses—individual or team submissions on questionnaires, review sheets, and Internet exercises can be helpful.
11. Assign the internet exercise: [http://cgi.money.cnn.com/tools/prioritize/prioritize\\_101.jsp](http://cgi.money.cnn.com/tools/prioritize/prioritize_101.jsp). This takes students through a prioritizing goals exercise. Require students to hand in the final summary or send it online to the instructor. This is a good exercise because it forces individuals to make choices. To reach goals, it is impossible to “have it all.” There are several reiterations before the goal statement is summarized in rank order.

## ■ Suggested Answers to Chapter Overview Questions

1. Mo and Farah are in their early career life stage. They should consider following the pay-yourself-first principle. They should also manage any student loans and other short-term debt that they incur so as to ensure that they are not working for the sole purpose of making their monthly payments. The couple should prioritize their goals of saving for a car, a wedding and honeymoon, buying a home, and saving for retirement. The couple should also consider investing their money in various investment options, such as mutual funds.
2. Mo and Farah should establish SMART goals. In other words, they should make sure that their goals are specific, measurable, action-oriented, realistic, and time bound. In doing so, the couple will be in a better position to prioritize their goals and are less likely to give up on the things that they wish to accomplish.
3. The couple could ask for references from family, friends, or colleagues. When choosing a financial advisor, it may be helpful to conduct an interview of 2 to 3 financial advisors in order to determine an appropriate fit between their needs and what the financial advisor is able to offer. The Financial Planning Standards Council (FPSC) offers a series of questions that Mo and Farah can use when interviewing candidates. These questions can be accessed on the FPSC website at <https://www.financialplanningforcanadians.ca/financial-planning/questions-to-ask-your-financial-planner>.

## ■ Answers to End-of-Chapter Review Questions

1. Personal financial planning is the process of planning your spending, financing, and investing activities, while taking into account uncontrollable events such as death or disability, in order to optimize your financial situation. A personal financial plan specifies your financial goals, describes the spending, financing, and investing activities that are intended to achieve those goals, and the risk management strategies that are required to protect against uncontrollable events such as death or disability.

2. An opportunity cost is what you forgo as the result of a decision. Some of the opportunity costs of spending \$10 on lottery tickets every week might be: lunch out once a week, reducing debt by an additional \$40 per month, or having \$520 in savings at the end of the year.
3. An understanding of personal finance enables you to make more informed decisions about your financial situation. You would be able to better judge the advice of financial advisers. You might even pursue a career as a financial adviser.
4.
  1. Budgeting and tax planning
  2. Financing your purchases
  3. Protecting your assets and income (insurance)
  4. Investing your money
  5. Planning your retirement and estate
5. Budget planning represents the process of forecasting future expenses and savings. It involves evaluating your current financial position by assessing your income, your expenses, your assets, and your liabilities.
6. Your net worth is your assets (what you own) minus your liabilities (what you owe). You can measure your wealth by your net worth and budgeting strategies can help you increase your net worth and thereby your wealth. For example, you can build your net worth by setting aside part of your income to invest in additional assets or reduce your liabilities.
7. Income is influenced by your life stage. If expenses are not accurately estimated, it may be difficult to reach savings goals.
8. The key financial considerations during the early career life stage are to adopt the pay-yourself-first principle, manage your debt, buy furnishings for your own place or a car for your first job, and build your investment portfolio by starting with a mutual fund.
9. No, waiting for milestones before creating a personal financial plan can be very dangerous because you may not have any time to prepare.
10. Many financial decisions are affected by tax laws, such as certain types of income being taxed at a higher rate than others. Knowledge of tax laws allows you to make more favourable choices.
11. Liquidity means having access to ready cash, including savings and credit, to cover unexpected expenses. In managing your liquidity you consider money management and credit management. Money management deals with deciding how much money to retain in a liquid form and how to allocate the funds among short-term investment instruments. Credit management deals with the decisions about how much credit you need to support your spending and which sources of credit to use.
12. An emergency fund contains the portion of savings that you have allocated to short-term needs such as unexpected expenses in order to maintain adequate liquidity. An alternative to establishing an emergency fund would be to rely on credit to supplement your liquidity.

13. Factors considered in managing financial resources include: the size of the loan you can afford to borrow, the length of time for the loan, and selecting a loan that charges a competitive low interest rate.
14. The primary objective of investing is to use funds not needed for liquidity purposes to earn a high return. Most investments also carry an amount of risk. Potential investments include stocks, bonds, mutual funds, and real estate.
15. A plan to protect your assets requires insurance planning, retirement planning, and estate planning. Insurance planning involves determining the types and amount of insurance that you need such as automobile, homeowner's, and life. Insurance reimburses you for damages to your assets, limits your exposure to potential liabilities, or protects your income. Retirement planning involves determining how much money you should set aside each year for retirement and how you should invest those funds. Retirement planning must begin well before you retire so that you can accumulate sufficient money to invest and use after you retire. Estate planning is the act of planning how your estate will be distributed before and/or after you die. Effective estate planning can protect your wealth against unnecessary taxes and ensure that your wealth is distributed to your family in the manner that you desire.
16. Retirement planning involves determining how much money you should set aside each year for retirement and how you should invest those funds. Retirement planning must begin well before you retire so that you can accumulate sufficient money to invest and support yourself after you retire.
17. Estate planning is the act of determining how your wealth will be distributed before and/or after your death. The purpose of estate planning is to protect your wealth against unnecessary taxes, and ensures that your wealth is distributed in a timely and orderly manner.
18. When people focus on their desire for immediate satisfaction and/or the pressure they feel from their peers, they may spend excessively. For example, the desire for immediate satisfaction provides a strong dose of pleasure. However, the boost provided by the "shopping therapy" may quickly vanish, so that additional therapy (shopping) is needed. The spending can become addictive. The behaviour of people who spend based on immediate satisfaction and peer pressure causes them to spend excessively now, which leaves nothing for the future.
19. Budgeting focuses on the relationship between your income and your expenses. Financing focuses on depositing a portion of your excess cash in an emergency fund, obtaining credit to support your purchases. Protecting your assets and income focuses on determining your insurance needs and spending money on insurance premiums. Investing focuses on using some of your excess cash to build wealth. Planning your retirement and estate dictates the wealth that you will accumulate by the time you retire and its distribution before and/or after your death.
20.
  1. Establish your "SMART" financial goals
  2. Consider your current financial position
  3. Identify and evaluate alternative plans that could achieve your goal
  4. Select and implement the best plan for achieving your goals
  5. Evaluate your financial plan
  6. Revise your financial plan

21. Your goals will influence the amount of money and the timing you need to achieve the goals. A SMART goal is a goal that is specific, measurable, action-oriented, realistic, and time-bound. For example, a goal could be specific in that you may want to save a specific amount of money, pay down a specific amount of debt to improve your creditworthiness, or have a specific cash flow at retirement. A goal is measurable when you quantify your goals. An action-oriented goal is a goal in which you have listed specific action steps that will help you meet your goal(s). Realistic goals have a stronger likelihood of being accomplished. Short-term goals are those to be accomplished in less than a year such as saving \$500 for Christmas gifts. A medium-term goal takes from one to five years to accomplish, such as paying off a 3-year note. A long-term goal takes more than five years to accomplish; an example is saving for retirement in a set number of years.
22. Some factors that might affect your current financial position are: your level of debt, your marital status and family responsibility, your age, and your level of wealth accumulated.
23. Your goals are where you want to be and your current financial position is where you are. Your alternative financial plans will “map” how to get from one position to the other. Several alternative financial plans are possible given one’s current financial position and goals. For example, two alternative plans may involve different amounts of savings.
24. Once you have developed and implemented a plan, you must monitor it. Monitoring the plan will ensure that you are following the plan and that the plan is working as intended.
25. You may find you need to revise the plan to make it more realistic. In addition, your life circumstances and financial condition may change. As your financial conditions change, your goals may change, especially as the results of specific events such as graduating from a post-secondary institution, getting married, or the birth of a child.
26. • Bank deposit rates: buy now vs. save decision.  
• Prices of homes and cars in your area: planning for purchase.  
• Financing rates on car loans, personal loans, and home loans: deciding how much of a loan you can afford.  
• Stock price quotations and quotations on other investments: deciding when to invest and where to invest.  
• Insurance quotations based on your needs: getting the best value for your insurance dollar.  
• Tax rates: for tax planning.  
• Retirement rules: retirement planning.  
• Financial calculators: determining how your savings will grow or what your mortgage payment will be.
27. There are several different levels of unethical behaviour by financial advisers. Some advisers are involved in Ponzi schemes and are focused on stealing your money. A more modest level of unethical behaviour is providing advice that is intended to benefit them, not you. An understanding of personal financial planning will enable you to make some decisions without an adviser. If you require an adviser, you will be better prepared to determine which advice is truly intended to benefit you.

## ■ Answers to Financial Planning Problems

1.

### Part a

Julia's Income		\$1,600
Julia's Expenses:	\$350	
	100	
	250	
	200	
	200	
	150	
Total Expenses		<u>\$1,250</u>
<b>Available for savings: (\$1,600 - \$1,250)</b>		<b>\$ 350</b>

### Part b

Increase in car payment	= \$75
Increase in insurance	= \$60
Opportunity cost	= \$135 per month that could not be used for savings, other purchases, etc.

2. Net worth is the difference between assets and liabilities:

$$\$3,000 - \$500 - \$135 = \$2,365$$

3. Arianne added \$1,200 to her assets and \$500 to her liabilities, so her new net worth is:

$$\$5,000 + \$1,200 - \$500 = \$5,700$$

4. Buying the No HD-TV would not change her net worth as she would be exchanging one asset for another. Investing \$500 at 10 percent for one year will be worth \$550 in one year.

5. Although the situation seems dismal, Jason has a couple of options. First, he could look for a car that requires payments of less than \$200 per month in either financing costs or lease payments. This would require him to consult various dealers. Second, he could buy a cheaper car using the classifieds in the newspaper. In either case, Jason's net worth will be reduced by a large percentage, since a new car will require a down payment even if he finances it. If Jason buys a cheap car using the classifieds or another source, his cash flow will not be affected if he finds a car cheaper than \$3,000.

## ■ Answers to Challenge Questions

1. Yes, Jeevun's goal is a SMART goal. First, Jeevun has specified his goal by indicating that he would like to increase his net worth. Second, his goal is measurable since he has indicated that he would like to increase his net worth by 10%; and, in order to do so, he has decided to increase his contributions to his RRSP by \$200 per pay cheque. Third, Jeevun's goal is action-oriented in that he has contacted his benefits administrator at work to change his contribution plan and he has contacted his financial advisor to discuss investment options. Fourth, his goal appears realistic since his actions suggest that he can make the increased contributions. Finally, Jeevun's goal is time bound because he has indicated that he would like to increase his net worth by 10% in the next year.
2. Eriel is in the early career life stage. At this stage, she should consider following the pay-yourself-first principle. That is, she should deposit some money from her pay cheque into a savings account BEFORE she considers spending any of her disposable income. In order to ensure that this is a SMART goal, she should specify the purpose for her savings. For example, is she saving to create an emergency fund, to fund a trip that she would like to take, or to start saving for retirement? If she is saving for a trip, she should measure her goal by measuring the costs associated with potential trips that she would consider. She could do this by going online or contacting a travel agent. This will help her determine how much she should put aside in a savings account. A SMART goal should also be action-oriented. Eriel should go to her bank and set up a regular withdrawal from her deposit account to a savings account that coincides with the day she is paid. If Eriel creates a savings goal that is realistic, she is less likely to stop saving. For example, if Eriel is only able to save \$50 per month right now, she should take this into consideration when planning her trip. Perhaps it is unrealistic right now for her to be saving for a trip and she should instead concentrate on building her emergency fund. On the other hand, she may recognize that she needs to adjust her spending patterns so that she is able to save the amount she needs for the trip she is considering. Finally, Eriel's goal needs to be time bound. If she does consider going on a trip, when would she like to take it? Is she able to save enough in that time frame to pay for the costs associated with the trip or does she need to save for a longer period of time? In the early career life stage, Eriel should manage her debt so that it does not get out of control and/or she does not take on financial commitments, such as a car loan, that prevent her from meeting her other, and perhaps, more important goals. This will allow Eriel to balance her savings goals. In the early career life stage, Eriel should also confirm that she has adequate personal property, health, and life insurance to meet her needs. She should also start considering her investment options as she her savings continue to accumulate.



## ■ Suggested Answers to Ethical Dilemma Questions

- a) Based on the information provided, Michelle may have acted unethically in her dealings with Michael. Michelle was aware that the car needed some work. If she knew what work needed to be done on the car, she should have provided Michael with this information. In addition, the price of the car may suggest that Michelle knew the car was worth less because it needed work. On the other hand, she did indicate to Michael that the car “needed some work but that it seemed to be mechanically sound”.
- b) Based on the information Michelle provided, Michael should have had a mechanic inspect the car before he purchased it. He could also have attempted to obtain the vehicle identification number to find out if the car had been previously in an accident. Purchasing a car is discussed in chapter 6.
- c) Before purchasing a vehicle, Michael should have been specific about the purpose for the vehicle. Did he need a car for work or did he just want to purchase his dream car because it appeared to be a good deal? In considering his purchase, Michael should have measured the potential costs associated with vehicle ownership. It appears that Michael did not take into consideration the maintenance costs associated with the car and the potential impact these costs would have on how much more he would need to work and the impact that this decision would have on his ability to go to college. In considering his actions, Michael should have researched the potential costs of vehicle repair and the more common problems associated with this particular car. Michael should have also researched whether or not this car was available for sale through other sellers. Given the significant impact this car purchase had on other aspects of his life, it appears that Michael’s car purchase was unrealistic at the time of purchase. Furthermore, Michael should have planned the purchase to coincide with a time frame that allowed him to save adequately for ongoing maintenance costs. If he had a realistic time frame for his vehicle purchase, Michael may not have needed to take pick up some extra shifts at work in order to pay for his vehicle problems.

## ■ Answers to Mini-Case Questions

Brittany’s goals do not meet the SMART goal criteria. With respect to her goal of paying off her credit card, Brittany has been somewhat specific in that she has indicated that she would like to pay off her credit card eventually. In addition, her goal is measurable since she has an outstanding balance of \$8,000 and is currently making the minimum monthly payment of \$250. On the other hand, Brittany has not clearly specified by when she would like to pay off her credit card. As a result, she has not taken any additional steps to pay off her credit card beyond making the minimum monthly payment of \$250. It is also not clear as to whether or not she would be able to pay off her credit card in a realistic time frame since she does not monitor her daily spending habits and the impact these have on her cash flow. Brittany’s retirement goal is specific and measurable in that she has indicated that she will save \$4,000 per year for her retirement, which is 35 years from now. However, she has not indicated how much retirement income she will need once she is in retirement. As a result, it is difficult to say whether the \$4,000 per year is too little or too much. Brittany could reinforce the concept of SMART goal planning by spending some time determining the amount of income she needs during retirement.

## ■ Answers to Questions in The Sampson Family: A Continuing Case

### Current Financial Position

<u>Major Assets</u>	<u>Amount</u>
Savings	Low
Money Owed	\$150,000 mortgage, \$2,000 credit card balance
Salary	The Sampson's income was \$54,000, but will now be about \$66,000 since Sharon just started a part-time job

### Financial Goals

	<b>Goal 1. Purchase a New Car for Sharon this Year</b>	<b>Goal 2. Pay for Children's Post-secondary Education in 12-17 Years from Now</b>	<b>Goal 3. Set Aside Money for Retirement</b>
How to Achieve the Goal	Assess alternative plans available and choose the most appropriate plan given the financial situation.	Assess alternative plans available and choose the most appropriate plan given the financial situation and the savings necessary for Sharon's new car.	Set aside a manageable and realistic amount each month toward retirement. This amount is currently contingent on meeting their other, shorter-term plans of buying a new car and saving for their children's post-secondary education.
How to Implement the Plan	Sharon decided saving \$500 a month is the best plan; deposit the money in a liquid investment, such as a savings account.	The Sampsons decided saving \$300 a month is the best plan. Long-term investments, such as a tax-deferred education account (RESP), should be considered as investments.	Seek the advice of a financial adviser to assess different investment options, such as stocks or bonds. The Sampsons should be aware that advisers may exaggerate the potential of investments and may recommend investments that give the adviser high commissions.

How to Evaluate the Plan	Sharon should monitor the progress to ensure that saving \$500 each month is not too ambitious and is realistic.	The Sampsons should monitor the progress to ensure they are saving \$300 each month, especially given the additional savings for Sharon's new car.	The Sampsons should monitor their progress to ensure they are saving at least some money for retirement. Since this is a very long-term goal, an annual assessment of their retirement savings is appropriate.
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### ■ Answers to Myth or Fact Margin Questions

Page	Myth or Fact
3	Financial planners and advisers are registered with a provincial financial planning regulatory agency.
	Myth. Although the Institute of Advanced Financial Planners offers a Registered Financial Planner designation, and the activities of planners/advisers/dealers are regulated if they are registered with the Mutual Fund Dealers Association of Canada (MFDA) or the Investment Industry Regulatory Organization of Canada (IIROC); there is no provincial financial planning regulatory agency that registers financial planners and advisers.
5	Budgeting is more important for individuals who have trouble covering their monthly expenses.
	Myth. Budgeting is a tool that you use to help you reach your financial goals. As such, budgeting is for everyone.
13	When setting goals, it is important to share them with family members so you are motivated to achieve them.
	Fact. In general, sharing your goals, such as saving up for a Christmas vacation, will help motivate you to achieve them. Similar to a New Year's Resolution, a goal that is shared with the ones who are most affected by your personal success are more likely to be achieved.