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NOTE ON PERSONAL FINANCIAL PLANNING

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Personal Financial Planning (PFP) is a growing field of expertise. Therefore, it may be useful to understand the basics as a Chartered Professional Accountant and Tax advisor. This note is prepared to provide basic information about personal financial planning process and components.

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Definition of PFP

Personal Financial Planning (PFP) is the continuous and integrative process of managing financial affairs (assets, liabilities, revenues and expenses) in a personal situation, developing strategies and taking actions to achieve life goals. A comprehensive planning will consider all aspects of the professional, personal and family situation of an individual, but it is also possible to focus only on some aspects.

Motivations for PFP

- set a time to reflect on goals and priorities
- prepare for life cycle events (ex: education, retirement, succession)
- improve standard of living
- manage cash flows by balancing inflows and outflows
- optimize tax consequences
- invest intelligently and maximize return on investments
- accumulate wealth
- avoid surprises and be prepared
- be able to assess progress

Constraints

Various general constraints and concepts influence the PFP and the need to get help from an advisor. Some examples for environmental factors are presented:

- economical factors
    - inflation
    - interest rate
    - unemployment rate
- legal factors
    - tax law and regulations
    - corporate law
    - family law
- time value of money

Life Cycle and PFP

Personal situation evolves over time. Over the years, a person will have to focus on various aspects. Age of a person is an indicator of life cycle. Various other factors may affect and changes the PFP. Marital status, family formation and the presence of dependants (dependent children, disabled children, independent children, dependent adult) will impact the PFP. Different events may occur (foundation of a family, wedding, birth or adoption of a child, divorce and separation, death). Lifelong learning effort and career development through employment, business or volunteering will contribute to professional life. Health issues and moving to another country may also influence the PFP.

<table>
<tr><th></th><th>Age</th><th>Marital Status</th><th>Dependants</th><th>Learning</th><th>Employment / Business</th></tr>
<tr><td>Early childhood</td><td>0-5</td><td rowspan="7">Single

Couple

Wedding

Separated / Divorced

Widowed</td><td rowspan="7">Dependent children

Disabled children

Independent children

Dependent adult</td><td rowspan="7">Initial education

Lifelong learning</td><td rowspan="7">Student job

Employment

Business

Unemployment

Volunteer

Retired</td></tr>
<tr><td rowspan="2">Education years</td><td>6-14</td></tr>
<tr><td>15-24</td></tr>
<tr><td rowspan="3">Professional years</td><td>25-35</td></tr>
<tr><td>35-44</td></tr>
<tr><td>45-54</td></tr>
<tr><td>Pre-retirement years</td><td>55-64</td></tr>
<tr><td>Retirement years</td><td>65 +</td><td></td><td></td><td></td><td></td></tr>
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Process and Areas of PFP

Reflection

In the reflection phase, the values, objectives, goals and priorities of a person are examined.

Situational Analysis

In the situational analysis phase, the personal situation (document, financial affairs) are evaluated.

Planning and Action

In the planning and action phase, different options and strategies are identified, analyzed and chosen to meet personal objectives within a set of constraints toward helping current management and preparation for the future. The result is the personal financial plan.

Implementation

In the implementation phase, strategies to control, monitor and revise the plan take place.

Phases	Areas	
Reflection	Reflections on values, objectives and goals	
	Reflections on priorities	
Situational Analysis	Document analysis	
	Financial analysis	Financial Situation (Net worth)
		Revenues and Expenses
Planning and Action	Day-to-day management	Cash Management and Budgeting
		Assets and Wealth Management
		Debt Management
		Risk Management
	Planning strategies	Tax Planning
		Education Planning
		Retirement Planning
		Life Insurance Planning
		Succession and Estate Planning
Implementation	Control strategies	
	Monitoring and revisions	

Process - Reflection Phase

In the reflection phase, values, objectives and goals are examined and priorities are decided.

Reflections on Values, Objectives and Goals

Personal constraints add to the complexity of the PFP process in thinking about values, objectives and goals.

- personal abilities, skills, competencies and attitudes
- financial literacy and tax knowledge
- family situation
- socio-cultural factors
  - ethnicity
  - religion
- previous experiences regarding financial affairs
- potential of inheritance
- dreams
- needs, desires, wishes

Reflections on Priorities

Deciding on priorities will offer orientations for the PFP process and will need balancing personal values to reach personal and financial objectives and goals.

- savings vs expenses
- risk tolerance
- level of debts
- time horizon
- lifestyle
- quality of life
- cost of living
- cost of life
- need of liquidity

Process - Situational Analysis Phase

In the situational analysis phase, an assessment of the personal situation is prepared and serve as a foundation for the strategies. By collecting various information, it will be possible to have necessary foundation about the current situation to establish a diagnosis.

Document Analysis

In the document analysis steps, the objective is to collect all relevant information and to examine various documents. The step will be facilitate with proper records management and filing system.

- basic information about family members
- tax returns
- investments portfolio
- employee benefits booklets
- pension statements
- insurance policies
- will
- power of attorney
    - for personal care
    - for property
- contracts
    - employment contract
    - shareholder agreement
    - partnership agreement
    - buy-sell agreements
- private corporation documents, if applicable
- trust agreements
- location of documents

Financial Analysis

By preparing a financial analysis, a person present the financial situation, which become the starting point for the PFP. A personal financial statements (PFS) is an inventory of the financial position (assets, liabilities, net worth) and an analysis of revenues and expenses (see Appendix A for examples of content of personal financial statements, including notes). Cash flow statement may offer a presentation of cash inflows and outflows on a cash basis instead of an accrual basis.

Process - Planning and Action Phase - Day-to-Day Management

Cash management and Budgeting

With cash management, the step involves management of cash flows (cash inflows and outflows). With proper treasury management, financial affairs are managed on a daily basis.

Examples of activities:
- collecting income on a timely basis
- paying bills and expenses
- paying credit cards
- setting up an emergency funds (ex: 10% of gross income or 3-6 months of expenses)

Budgeting is a process to plan and to offer a tool to control revenues and expenses and acquisition of assets. Budget will also look at cash flows. By preparing a budget, it offers a guide to compare the reality with plans.

Examples of activities:
- track revenues and expenditures
- track cash inflows and outflows
- offer a template

Assets and Wealth management

Regarding assets and wealth management, a number of major decisions occur many times in a lifetime. Examples of decisions are housing, transportation and investment.

Steps in purchasing assets
- look around and shop
- evaluate options
- make your selection
- purchase
- financing your purchase
- maintain your assets (repairs, renovations)

Housing
- principal residence
- cottage
- ownership (rent or buy decision)

Transportation
- walk
- automobile, motorcycle, bicycle
- bus, train, airplane
- boat, recreational vehicle (RV)
- ownership (lease or buy decisions, car sharing option)

Investments

- types of investment
    - cash and cash equivalencies
    - deposits in financial institutions
        - cash in bank accounts
        - term deposits
        - Guaranteed Investment Certificate (GIC)
    - bonds
        - treasury bills (T-Bills)
        - Canada savings bonds
        - provincial savings bonds
        - municipal bonds
        - corporate bonds
    - equities
        - shares in public corporations
        - shares in private corporations
        - common vs preferred shares
    - interest in a partnership
    - mutual funds
        - equity fund
        - income / bond fund
        - balanced fund
        - ethical fund
        - international fund
        - dividend fund
    - commercial paper
    - bankers' acceptance
    - commodities (gold, silver)
    - deferred income plans
    - derivatives
        - options (call, put)
        - warrants
        - rights
        - futures
    - real estate
        - principal residence
        - cottage
        - rental property
    - personal use property
        - household assets
        - automobile, recreational vehicle (RV), boat, kayak, canoe
        - art work (painting, sculpture)
    - tax shelters
        - flow-through shares
        - income trusts
        - limited partnership

- investment style
    - active vs passive
- different tax treatment of investment income
    - interest
    - dividend
    - capital gains
- factors
    - risk vs return trade-off
    - long term vs short term perspective
    - pleasure of investment
    - management requirements effort
- diversification
    - between types of investment
    - between different countries
    - risk tolerance
- valuation issues
- types of investment risk
    - business risk
    - market risk
    - marketability risk
    - liquidity risk
    - reinvestment risk
    - default risk
    - interest rate risk
    - inflation rate risk
    - political risk
    - exchange rates risk
    - term risk

Debt management

For debt management, the challenge is to use debt as an advantage and to avoid falling in the credit trap and financial difficulties.

- types of liabilities
    - loans
        - line of credit
        - credit card
        - consumer loan + single purpose loan
        - student loan
    - mortgages
        - home mortgage
        - second mortgage
- financial difficulties
    - risk of insolvency
    - refinancing and debt consolidation
    - proposal (consumer, commercial)
    - bankruptcy
- financing issues
    - loans for investment and interest deductibility
    - credit ratings
    - debt capacity
- examples of strategies
    - refinance
    - reduce debt
    - leases
    - eliminate in priority debt with highest interest rate (ex: credit card)
    - replace debt with non-deductible interest by other with deductible interest
    - reimburse faster mortgage and loan

Risk management

Risk management is a process to handle risks by using various strategies and techniques. All risks are not equal.

- process of risk management
  - identifying the risks and threats
  - setting risk management objectives
  - evaluating the risks
  - selecting strategies on how to handle risks
    - risk control
      - risk avoidance
      - risk reduction
    - risk financing
      - risk transfer
      - risk sharing
      - risk retention
  - implementation
  - monitoring the risks
- types of risk
  - death
  - health (medical, critical illness, disability)
  - property and casualty (home, automobile)
- structure of insurance
  - group vs individual
  - governmental vs private
- type of insurance
  - life
    - temporary: term
    - permanent: whole, universal
  - health (medical: drug, dental, vision)
    - governmental coverage
    - extended health coverage
  - disability
  - property and casualty (home, automobile)
  - liability (personal, professional)
  - long-term care
- issues about insurance
  - representation of facts with a declaration / statement of facts
  - coverage and exclusions
  - designation of beneficiaries
    (irrevocable, revocable)

Process - Planning and Action Phase - Planning Strategies

Tax planning

Tax planning are strategies and techniques to optimize present value of after-tax individual and family net worth.

- tax planning strategies
    - apply the known legislation
    - reduce tax payable
    - defer tax
    - shifting income / deductions / credits
        - over time
        - between types
        - between entities
        - between jurisdictions
    - income splitting / income sprinkling
        - between spouses
        - with children
        - with other family members
    - choice of transactions
    - choice of business structure
- tax rates
    - effective
    - marginal
- charitable giving (during life time and upon death)
    - gift of money
    - gift of property
    - gift of publicly trades shares
    - gift of ecologically sensitive land
    - gift of remainder interests in property
    - gift of life insurance and annuities
- tax consequences on
    - various types of income
    - disposition of asset
    - wealth
    - various ownership structure

Education Planning

Education planning are strategies and techniques to accumulate funds to pay for education costs of family members (own and/or dependents), especially at post-secondary institutions.

Related tax issues

- Registered Education Savings Plan (RESP)
  - Canada Education Savings Grant (CESG)
  - Canada Learning Bond (CLB)
- Registered Retirement Savings Plan (RRSP)
  - lifelong learning exception
  - regular withdrawal
- use of trusts for education of children and grandchildren

Sources of funding

- Registered Education Savings Plan (RESP)
- Registered Retirement Savings Plan (RRSP) (lifelong learning exception)
- Tax-free savings account (TFSA)
- use of personal funds
- disposition of assets
- government assistance (loans and
- scholarship
- tax credits
- loans
- parents' contributions

Education timing

Funding period (x years)	Education period - Needs of funds (y years)	
Now	start of training	end of training

Steps in education planning

- determine time horizon
- choose education program
- estimate the funding period
- estimate the education period (number of months / years) to finance
- estimate the cost of education
  - tuition and school related expenses
  - living expenses
- estimate the necessary funding (per month, semester, year)
- evaluate the sources of funding available

Retirement planning are strategies and techniques for accumulation of wealth and for withdrawal during pre-retirement and retirement years.

Sources of retirement income and funds

- governments programs
  - Canada Pension Plan / Québec Pension Plan (CPP/QPP)
  - Old Age Security (OAS) and Guaranteed Income Supplement (GIS)
  - Canada Child Benefit (CCB)
  - employment insurance (EI)
  - workers' compensation programs
  - income assistance programs
- deferred pensions plans
  - Registered Pension Plan (RPP)
    - defined benefit plan
    - defined contribution plan
  - Registered Retirement Savings Plan (RRSP)
  - Registered Retirement Income Fund (RRIF)
  - Deferred profit sharing plan (DPSP)
  - supplemental pension arrangements
    - supplemental retirement plans
    - retirement compensation arrangement (RCA)
- retiring allowance
- selling assets
- estate freeze
- other
  - Life income funds (LIF)
  - Lock-in retirement income funds (LRIF)
  - annuities

Factors to consider for retirement

- inflation
- life expectancy
- income tax
- rate of return
- lock-in funds

Retirement timing

Funding period (x years)	Retirement period (y years)

Now Retirement date Death

Steps in retirement planning

- set goals
  - desired retirement vision
  - desired retirement date
  - desired quality of life
- determine time horizon (funding period and retirement period)
- estimate rate of return
- estimate risk tolerance
- estimate income at retirement
- estimate spending requirements
- estimate difference and needs of funding
- financing of needs for retirement

Factors during retirement period

- layer different sources of funding (income and disposition of assets)
- structure income in order to preserve tax credits and government benefits
- create efficient cash flow

Calculations (see Note on PFP Retirement Planning Analysis)

A) Excess Discretionary Cash Flow during Funding Period
B1) Retirement Goal
B2) Retirement Cash Flow

Factors to consider for life insurance

- age
- gender
- health (medical history and current health)
- habits (smoking, drinking, drugs)
- pre-existing conditions
- family's medical history
- physical condition (weight, height)
- occupation and profession
- lifestyles choices and hobbies (ex: mountain climbing, skydiving)
- marital status and number of children
- amount needed (existing policy and new policy)
- level of income

Life insurance timing

Funding period	Needs of funds period	
	Funds for Parent 2 and children	Funds for children

Now Death Parent1 Death Parent2

Funding period	Needs of funds period
	Funds for children

Now Death both Parents

Steps regarding life insurance planning

- determine time horizon
- develop scenarios
    - funding following death of one parent (spouse and/or children)
    - funding following death of both parent
- estimate life insurance needs

Life Insurance Needs Analysis (see Note on PFP Life Insurance Needs Analysis)

A) Cash Required at Death
B) Cash Required after Death (Long-Term)
C) Annual Living Expenses
D) Actual Annual Income to Cover Living Expenses
E) Additional Insurance Needed

Succession and Estate Planning are strategies and techniques for distribution of wealth and for withdrawal before and after death.

- steps in succession and estate planning
    - set objectives and goals
    - identify and evaluate issues
    - estimate value of estate net worth
    - identify and select heirs (who, how, how much, when)
    - select executor
    - monitor plan
- steps following death
    - collect documents (will, death certificate, funeral arrangement)
    - transmit information (notice to various stakeholders and requests)
    - identification of assets and liabilities
        - payment of liabilities
        - disposition of assets
        - cash available
    - manage estate
    - distribution of cash and assets from estate
- need to revise key documents
    - will (importance of will)
    - power of attorney
        - for personal care
        - for property
- use of trusts in estate planning
    - control
    - beneficiaries
    - estate freeze
- types of trusts
    - testamentary trust
    - inter vivos trust
- Registered Disability Savings Plan (RDSP)
    - Canada Disability Savings Grant (CDSG)
    - Canada Disability Savings Bond (CDSB)
- death benefits
- life insurance
- taxation upon death
- timing of distribution
- transfer of a business
    - use of capital gains exemption
- impact of shareholders' agreement
- control issues
- probate will

Process - Implementation Phase

Control strategies

Control strategies are strategies and techniques for controlling the management of financial affairs and evaluate achievements of goals. The budget may offer some guidelines on the financial affairs.

Monitoring and revisions

Monitoring and revisions are strategies and techniques for monitoring and revising the personal financial planning to take into account changes in personal situation and goals.

- examples of events bringing a need for revisions
    - marriage, separation, divorce
    - birth of a child
    - death in the family
    - health issues (illness, loss of mental capacity)
    - advancement of children to post-secondary institutions
    - sabbatical leave (return to school, extended vacation, personal project)
    - change in professional activities (unemployment, new job, new career, retirement)
    - purchase / sale of a business / family business
    - emigration / immigration
    - financial difficulties
    - reception of an inheritance
    - major tax legislation changes
- possible solutions
    - increasing revenues
    - reducing expenses
    - selling assets
    - purchasing assets
    - paying liabilities
    - obtaining financing
    - changing the timeframe
    - modifying goals

Role of Advisor

- understand the needs and preferences of client
- assess and document client situation
- list and examine feasibility of options
- make recommendations specific to a client
- implement your strategies
- monitoring and revising the plan

Appendix A - Personal Financial Statements

Balance Sheet

Assets	*Liabilities*
Current Assets Cash Term deposits and GIC *Capital Assets* Real estate Automobiles Personal assets Non-registered investments Registered deferred plans Investment in private corporations Investment in partnerships Life insurance	*Current Liabilities* Credit cards Accounts payable Line of credit Bank loans Loans *Long-term debts* Mortgage Tax liabilities Other debts
	Net worth

Income Statement

Revenues	*Expenses*
Income from Employment Income from a Business Income from Property Pension income Capital gain Other income	Food Housing Utilities Transportation Medical Clothing Insurance Purchase of assets Education Recreation Vacation Savings and investment Taxes Fun money
Excess (Deficiency) of Revenues over Expenses	

Notes on Personal Financial Statement

- Personal family situation
- Significant accounting policies
- Bank accounts (checking, savings)
- Term deposits and GIC
- Investments
    - Investments in partnerships
    - Investments in private corporations
    - Stocks options
- Marketable securities
    - Bonds
    - Equities
    - Mutual funds
- Registered deferred plans
    - TFSA - Tax Free Savings Account
    - RPP - Registered Pension Plan
    - RRSP - Registered Retirement Savings Plan
    - RRIF - Registered Retirement Income Fund
    - RESP - Registered Education Savings Plan
    - RDSP - Registered Disability Savings Plan
    - DPSP - Deferred profit sharing plan
- Real estate
    - Principal residence
    - Cottage
    - Rental property
- Personal assets
    - Household assets
    - Other personal property (automobile, boat)
    - Listed personal property (paintings, jewelry)
- Life insurance
- Current debt
    - Credit card
    - Bank loans
    - Line of credit
- Real estate mortgages
- Tax liability
- Insurance policies
- Commitments
- Contingencies
- Subsequent events