

**MODULE 6 PART 2**  
**FINANCIAL PLAN CONSTRUCTION & PROFESSIONAL RESPONSIBILITIES**

**SAMPLE QUESTIONS**

**Case Study**

Jackson and Clara Tan had approached you, a CFP with an established Financial Adviser Corporation – Committed Financial Planners Group Pte Ltd for a host of financial planning advise. Your firm is licensed to provide advise on all areas of financial planning except for legal advice and discretionary fund management. Committed Financial Planners Group Pte Ltd charges a fee for the advice given and retains commissions on products placed in fulfillment of the plan’s objectives. Following a first round of meeting with Jackson and Clara, the following information was secured. Based on the information you are to formulate and present a plan that meets the clients’ objectives.

**Personal Data**

**Jackson Tan**

Jackson Tan was born on 3<sup>rd</sup> March 1950 and is the managing partner of a successful art dealer business. It is only in recent years that the partnership started turning in good profits. The partnership agreement is as follows:

	Jackson Tan	Steven Lim	Joseph Ng
Salaries Per Annum	\$180,000	\$60,000	\$60,000
Profit Sharing Ratio	4	2	2
Interest On Capital	5%	5%	5%

The profit and loss account for the year ended 31<sup>st</sup> December 2002 is as follows:

**Sales** \$1,500,000

**Less:**

Cost of goods sold \$ 480,000

Gross Profit \$1,020,000

**Less:**

Expenses (inclusive of Partners’ salaries and interest on capital) \$ 515,000

Operating profit \$ 505,000

Investment income received \$ 25,000

**Net Profit** \$ 530,000

Included in the expenses are:

- a) Depreciation \$52,400
- b) Approved donation \$25,000

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The partners' capital as at 1<sup>st</sup> January 2002 were:

Jackson Tan : \$150,000  
 Steven Lim : \$ 75,000  
 Joseph Ng : \$ 75,000

The wear and tear allowance for the Year of Assessment 2003 is \$93,000.

### **Clara Tan**

Clara was born on 15<sup>th</sup> July 1953 and works as an Administration Manager for Seijo Mitsui, a large Japanese conglomerate with global presence. She had been with the company for 20 years and had received a long term service gratuity of \$25,000 on 31<sup>st</sup> December 2002. This was included in her terms of employment when she first joined the company. Her monthly salary is \$8,000 per month (before CPF deduction) and she had been receiving an average yearly bonus of 2.5 months over and above her 13<sup>th</sup> month pay.

### **Children**

Jackson has two children from his previous marriage. His ex-wife has custody of both children, Ronald and Jason, aged 15 and 16 respectively. As his ex-wife is currently unemployed and not remarried, Jackson is still making alimony payments of \$6,000 per month.

Jackson and Clara have one child, Jane aged 12, from their marriage. When Jane was born, Clara's father had set aside a lump sum of \$15,000 for his granddaughter in a fixed deposit account as a gift. The account has been opened in the name of Clara and Jane as a trustee account. The amount has remained untouched and has a balance of \$17,934 as of today.

### **Investment Information**

Jackson and Clara do not have much experience in financial investments. They do have however investments in the following Unit Trust Funds:

Fund	No. of Units	Date of Purchase	Purchase Price		Today's Price		Expected return	Risk free rate	Beta	Benchmark
			Bid	Offer	Bid	Offer				
Trends	15,000	3 years ago exactly	1.18	1.20	1.50	1.53	9%	2%	1.1	7%
Strategic	20,000	5 years ago exactly	0.98	1.00	1.50	1.53	10%	2%	1.3	8%

Additional Information on unit trust funds

- Subscription fee of 2% and
- Realization fee starting at 3% in the first year, 2% in the second year and 1% in the 3<sup>rd</sup> year and thereafter 0%.

Both Jackson and Clara are considering taking profits by liquidating their investments in one of the above funds since they appear to be doing well. However they are unsure which one to liquidate.

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They have also solicited some advice from a friend whom they think is investment savvy. Their friend has recommended they invest into the shares of Pateo Industries Inc a company in the United States, the CEO of which was recently reported in the press to have said:

“2002 was another successful year for Pateo Industries. As in 2001, sales, assets and operating income have all continued to grow at a rate of 20%.”

Given such an upbeat statement by the CEO of Pateo Industries, Jackson and Clara are tempted to commit a substantial sum into this share but at the same time are unsure if this is the correct decision. They want a more professional opinion. Accordingly, you have secured the financial statements of Pateo Industries which read as follows:

**Pateo Industries Financial Statements, 1999 - 2002 (\$ thousands)**

<b>Income Statement</b>	1999	2000	2001	2002
Sales Revenue		\$100,000.00	\$120,000.00	\$144,000.00
Cost of goods sold		\$ 55,000.00	\$ 66,000.00	\$ 79,200.00
Depreciation		\$ 15,000.00	\$ 18,000.00	\$ 21,600.00
Selling and Administrative Expenses		\$ 15,000.00	\$ 18,000.00	\$ 21,600.00
Operating Income		\$ 30,000.00	\$ 36,000.00	\$ 43,200.00
Interest expense		\$ 10,500.00	\$ 19,095.00	\$ 34,391.00
Taxable income		\$ 19,500.00	\$ 16,905.00	\$ 8,809.00
Income Tax		\$ 7,800.00	\$ 6,762.00	\$ 3,524.00
<b>Net Income</b>		<b>\$ 11,700.00</b>	<b>\$ 10,143.00</b>	<b>\$ 5,285.00</b>
<b>Balance Sheets (31st Dec)</b>				
	1999	2000	2001	2002
Cash and marketable securities	\$ 50,000.00	\$ 60,000.00	\$ 72,000.00	\$ 86,400.00
Accounts receivable	\$ 25,000.00	\$ 30,000.00	\$ 36,000.00	\$ 43,200.00
Inventories	\$ 75,000.00	\$ 90,000.00	\$108,000.00	\$129,600.00
Net plant and equipment	\$150,000.00	\$180,000.00	\$216,000.00	\$259,200.00
<b>Total Assets</b>	<b>\$300,000.00</b>	<b>\$360,000.00</b>	<b>\$432,000.00</b>	<b>\$518,400.00</b>
Accounts payable	\$ 30,000.00	\$ 36,000.00	\$ 43,200.00	\$ 51,840.00
Short term debt	\$ 45,000.00	\$ 87,300.00	\$141,957.00	\$214,432.00
Long term debt (8% bonds maturing in 2008)	\$ 75,000.00	\$ 75,000.00	\$ 75,000.00	\$ 75,000.00
<b>Total Liabilities</b>	<b>\$150,000.00</b>	<b>\$198,300.00</b>	<b>\$260,157.00</b>	<b>\$341,272.00</b>
Shareholders' equity (1 million shares outstanding)	\$150,000.00	\$161,700.00	\$171,843.00	\$177,128.00
Market price per common share at year-end		\$93.60	\$61.00	\$21.00

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**Other Data Secured**

Ratio	Industry Average	Ratio	Industry Average
Fixed Asset Turnover	0.700	Net Profit/Pretax Profit	0.60
Inventory Turnover	0.500	Pretax Profit/EBIT	0.800
Average Collection Period	60 days	EBIT/Sales	30%
Current Ratio	2.0	Sales/Assets	0.303
Quick Ratio	1.0	Assets/Equity	1.500
Interest Coverage Ratio	5	Compound leverage factor	1.200
ROE	8.64%	ROA	12%
P/E	8		
P/B	0.69		

**Pateo Industries Statement of Cash Flows (\$ Thousands)**

	2000	2001	2002
<b>Cash Flow from Operating Activities</b>			
Net income	\$ 11,700.00	\$ 10,143.00	\$ 5,285.00
Depreciation	\$ 15,000.00	\$ 18,000.00	\$ 21,600.00
Decrease/(increase) in accounts receivable	\$ (5,000.00)	\$ (6,000.00)	\$ (7,200.00)
Decrease/(increase) in inventories	\$ (15,000.00)	\$ (18,000.00)	\$ (21,600.00)
Increase in accounts payable	\$ 6,000.00	\$ 7,200.00	\$ 8,640.00
	\$ 12,700.00	\$ 11,343.00	\$ 6,725.00
<b>Cash Flow from Investing Activities</b>			
Investment in plant and equipment	\$ (45,000.00)	\$ (54,000.00)	\$ (64,800.00)
<b>Cash Flow from Financing Activities</b>			
Dividends paid	\$ -	\$ -	\$ -
Short-term debt issue	\$ 42,300.00	\$ 54,657.00	\$ 72,475.00
Change in cash and marketable securities	\$ 10,000.00	\$ 12,000.00	\$ 14,400.00

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### Insurance Information

Jackson is a believer in having sufficient life insurance coverage whereas Clara only pays perfunctory attention to it. The insurance information you have gathered is as follows:

	Jackson	Clara	Cash Value	Remarks
Medishield Plus	Plan A	Plan A		Annual premium of \$480 for the family
Mortgage Insurance	Joint life for the amount outstanding			Annual premium of \$1,800
Group term policy		Coverage of \$150,000 on death and permanent disability		Premiums are sponsored by the company. The payout from the policy is one lump sum of \$150,000 on death or permanent disability
Whole of life	\$500,000		\$22,000	Annual premium of \$15,000. Benefits payable in one lump sum on: a) Death, or b) Total & permanent disability. The total and permanent disability benefit will continue paying \$50,000 per year until Jackson reaches 65 years old.
Term policy (renewal option for 5 years due in 2005)	\$300,000			Annual premium of \$1,800. Benefits payable in one lump sum on: a) Death, or b) Total & permanent disability. The total and permanent disability benefit will continue paying \$30,000 per year until Jackson reaches 65 years old.

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**Other Assets Information**

Items	Current Market Value	Remarks
Residential property	\$1,080,000	Joint name
Cars	\$95,000	Jackson's Toyota Camry
	\$80,000	Clara's Honda CRV
CPF – Jackson	\$10,000	Ordinary Account
	\$3,000	Special Account
	\$30,000	Medisave Account
CPF- Clara	\$50,000	Ordinary Account
	\$35,000	Special Account
	\$30,000	Medisave Account
Savings account	\$150,000	Joint Account
Fixed Deposit	\$750,000	Joint Account
Gratuity receipts	\$25,000	Clara's gratuity payment from the company for her long service. Amount is deposited in a savings account in Clara's name.
Jewelry, collectibles	\$105,000	Clara's personal collection of jewelry and antiques
Art pieces	\$550,000	Jackson's personal collection of art pieces
Grandfather's gift (Fixed Deposit)	\$17,934	
Current Account	\$50,000	Joint Account

**Liabilities Information**

Items	Current Outstanding Amount	Remarks
Home mortgage	\$327,991.30	Balance of 10 years outstanding mortgage
Car loan	\$45,000	Jackson's car, balance of 5 years outstanding payments
	\$35,000	Clara's car balance of 4 years outstanding payments
Credit cards	\$5,000	Jackson's expenses
	\$3,200	Clara's expenses
House renovation loan	\$35,000	Balance of 2 years outstanding payments

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**Expenses Information (Consolidated)**

Items	Payment (annual)	Remarks
Mortgage	\$39,438.12	\$12,000 payment through Clara's CPF and balance by cash through Jackson's income
Car loans	\$14,000	Jackson's car
	\$11,376	Clara's car
Car expenses (combined)	\$16,000	
Utilities	\$9,000	
Food and groceries	\$12,000	
Child's education	\$12,000	
Vacation	\$18,000	
Clothing	\$14,400	
Savings	\$74,400	
Telecommunications	\$12,444	
Parents	\$48,000	Jackson parents are dependent on him but are not living in the same household. Clara's parents are not dependent on her and live independently.
Domestic Help	\$14,400	2 domestic help were employed. One for Jackson's family and the other for Jackson's parents.
Life insurance premiums	\$18,600	
Personal income taxes	\$76,812	Taxes that were paid for YA 2002
Recreation/Entertainment	\$12,000	
Donation/Gifts/Offerings	\$12,000	
Personal upgrading	\$3,000	Does not qualify for tax deduction
Alimony	\$72,000	
Home renovation loan	\$43,200	
Club membership and dues	\$16,800	

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## **Qualitative Considerations**

### **1. Jackson's and Clara's attitude towards money**

Due to Jackson's many years of struggle in his business both Jackson and Clara have strong views about money. They feel it is highly important to set aside sufficient cash for rainy days. Also being in their early fifties, they are acutely aware of saving for their retirement and saving for Jane's university education.

### **2. Marriage**

As Jackson had experienced a failed marriage, he is very determined to make his second marriage work. He is extremely concerned about Clara's financial well-being should he die prematurely. He would rather Clara not get involved in his business as it is an extremely trying one. He would rather Clara sells the business to the surviving partners at a pre-determined price upon his death so that Clara can have sufficient funds to stay home to raise their daughter, Jane.

Although his first marriage had failed, he still feels responsible for his ex-wife and his two sons from the first marriage. He had expressed his wish to leave a token sum of \$25,000 for each son and \$100,000 for his ex-wife upon his death. He had made this known to Clara and she is in full support of his decision. However he has yet to make a will.

### **3. Investments**

Although Jackson and Clara have strong views about keeping sufficient cash, influenced by difficult years that Jackson had gone through, they are also aware that leaving pure cash in bank deposits in a low interest environment is not an ideal proposition. They are open to investment recommendations provided they are relatively safe and highly liquid.

## **Economic Environment**

The Ministry of Trade and Industry has announced that the expected GDP growth rate for Singapore for the year will be between 2% and 5% despite the Iraq War and the SARS outbreak. There were expressions of optimism for the rest of this year by many industry leaders following announcement of better than expected results of the US economy. This has resulted in the STI Index moving up for the last 6 weeks.

## **Assumptions**

- Inflation rate 3%
- Interest rate 1%
- Government bonds 2%
- Mortgage rates 3%
- Education costs inflation 6%

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## **Requirements for CFP Module 6 Paper 2**

Please answer **ALL** the following questions that will form the basis of the financial plan. The time and length of response to each question should be judged based on the points awarded. **It is conceivable that you may run out of time unless time is apportioned appropriately for each question.**

**You may use bullet points format in response to the questions. (Please ensure they are easily comprehensible)**

### **Question 1 (18 marks)**

Construct the income statement of Jackson Tan and his pro-forma tax statement for YA 2004 (using the same rules as YA 2003), assuming his income remains the same. Devise a legitimate tax plan for Jackson and contrast the tax savings as a result of your recommendations. You are to include all caveats pertaining to tax planning.

Please show all appropriate workings.

### **Question 2 (18 marks)**

Give an appraisal of Jackson's and Clara's current financial standing and highlight their strengths and weaknesses (comment only from data derived from the financial statements only. **DO NOT COMMENT OUTSIDE OF THE FINANCIAL STATEMENTS INTERPRETATION**). In your answers you are to construct the appropriate financial statements.

### **Question 3 (18 marks)**

Advise Jackson and Clara which unit trust fund investment they should consider redeeming. Justify your recommendations by showing:

- Absolute returns
- Compounded returns
- Risk adjusted returns
- Comparison with benchmark established

Also advise Jackson and Clara whether they should invest in Pateo Industries, using the financial statements of Pateo Industries as your reference point. Justify your recommendations.

Please bear in mind their qualitative considerations when making your recommendations.

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**Question 4 (18 marks)**

Advise Jackson and Clara whether there will be any estate issues should either party die and if there are, what you would recommend they do to avoid such issues.

**Question 5 (18 marks)**

Advise Jackson on his insurance needs, bearing in mind that should he die prematurely, his desire is for Clara to stay home to care for Jane. Your basis of recommendation must include the following:

1. Provision for debt cancellation
2. Provision for Jane's 4-year university education which is currently estimated at \$50,000 per year.
3. Provision for 65% of Clara's income till age 80 taking into consideration inflation.

and recommend any other areas of personal risk management that Jackson should consider.

Please show all workings.

**Question 6 (10 marks)**

Please write standard disclosure paragraphs that are in compliance with the Financial Advisers Act for the following:

- a) Disclosure of a Financial Adviser's representative
- b) Disclosure of investment products; vis-à-vis
  - i. Risks of the product
  - ii. Pricing of the product
  - iii. Projection of returns
  - iv. Free-look/Cancellation period

- End of paper -

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