CHAPTER 1
INTRODUCTION TO FINANCIAL PLANNING
LEARNING OBJECTIVES

After reading this chapter, you should be able to:

- Describe the personal financial planning process.
- Diagram the personal financial planning process as defined by the CFP Board’s Job Task Domains and Financial Planning Practice Standards.*
- List the contents of a comprehensive financial plan.
- Describe the establishment and definition of the client relationship including the introductory meeting and engagement letter.
- Define the activities that are typically part of the scope of an engagement.
- Describe the client data gathering process including internal and external data.
- Understand what goes on in the analysis and evaluation of the client’s financial status.
- Understand the development and presentation of financial plan recommendations.
- Understand the implementation of financial plan recommendations.
- Understand the monitoring of the plan.
- Describe the benefits from financial planning.
- Clearly delineate why clients use a professional financial plan.
- Have a broad understanding of the practice of financial planning.
- List and differentiate the various recognized certifications in financial planning.
- Have a broad view of the employment and job outlook for financial planners and the various means of compensation for financial planning services.

* CFP Board Resource Document - Student-Centered Learning Objectives based upon CFP Board Principal Topics.

INTRODUCTION

This textbook is a valuable resource for financial planning students and practitioners, including those with either limited or substantial experience, and those who are interested in improving their financial planning skills. The broad knowledge base required of a financial planner is covered in an introductory manner throughout this textbook, including the financial planning process from the initial contact with a client to the presentation of the plan itself. Case studies are included in the textbook that cover a range of scenarios from basic to more complex. Varied financial planning approaches are provided to ensure that the financial planner has the appropriate planning methodologies necessary to arrive at logical and substantiated planning recommendations. This textbook should remain an important reference tool for the financial planner seeking knowledge and assistance in the preparation of professional comprehensive personal financial plans.

PERSONAL FINANCIAL PLANNING

Personal financial planning (financial planning) is the process of formulating, implementing, and monitoring financial decisions into an integrated plan that guides an individual or a family to achieve their financial goals.
**THE PROCESS**

The process of financial planning includes, but is not limited to:

**Establishing and defining the client relationship**
- the introductory meeting
- identifying general goals and objectives
- formulating an engagement letter

**Gathering client data**
- gathering internal client data, including goals
- determining relevant external data

**Analyzing and Evaluating Client’s Financial Status**
- preparing data analysis including an evaluation of the client’s risk management portfolio, financial statement analysis, and the external economic environment
- establishing alternative options (plans) to achieve financial goals including time frames

**Developing and Presenting Financial Plan Recommendations**
- selecting one set of recommendations from the alternative options

**Implementing Financial Plan Recommendations**
- defining the planner’s responsibilities separately from the client’s responsibilities
- guiding the implementation of the plan

**Monitoring the Plan**
- setting a schedule for the periodic review and adjustment of the agreed to plan

Exhibit 1.1 provides a visual representation of the financial planning process.

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1. Abbreviated from the CFP Board’s Financial Planning Practice Standards.
CHAPTER 1: INTRODUCTION TO FINANCIAL PLANNING

CONTENTS OF THE FINANCIAL PLAN

A financial plan is a written document that generally sets out a list of recommendations to achieve a set of goals and objectives based on an understanding of a client’s current financial situation. A financial plan is the work product and result from the application of several financial planning concepts to a client’s current and prospective financial situation. The application of the concepts (listed below) considers the client’s financial goals and values (internal data) and the external environment (external data). The external environment includes current and expected future income, gift and estate taxes, investment returns, inflation and interest rates.

Financial planning concepts applied include:

- an evaluation of the client’s risk management portfolio (includes risks retained and risks transferred through the use of insurance contracts)
- financial statement preparation and analysis including cash flow analysis and budgeting
- emergency fund and debt management (short-term goals)
- long-term goal planning including:
  - achieving financial security (retirement planning)
  - education planning for children’s or grandchildren’s college or private secondary education
  - planning for lump-sum purchases (major expenditures)
  - legacy planning (estate planning)
- income tax planning is integrated throughout all aspects of the plan
- the investment planning portfolio is used to fund many of the client’s short and long-term goals

In order to apply each of these concepts to a client’s current and prospective financial status, the financial planner uses tools such as financial statement preparation and analysis, cash flow analysis, and budgeting. This chapter introduces the first two steps in the financial planning process including: (1) establishing the relationship and (2) gathering client data. The chapter also provides information regarding the financial planning profession. The entire financial planning method is comprehensively reviewed in Chapter 3 (Financial Planning Approaches) and then applied to a case in detail in Chapter 6 (Burke Case). Two additional case studies in Chapters 10 and 18 (Rudolph Case Part 1 and 2) provide additional applications of and insights into the financial planning process.

Key Concepts

Underline/highlight the answers as you read.

1. Define the steps in the financial planning process.
2. Explain the difference between internal and external data collected as part of the financial planning process.
3. Identify financial planning concepts that are applied to a client’s financial plan considering the client’s profile, financial goals, and values.
4. Know what the financial planner should attempt to accomplish during the client introductory meeting.
Establish and Define the Client Relationship

Communication with Client
The role of the financial planner is to educate the client, gather relevant information, analyze that information, and assist the client in preparing and implementing a financial plan that will achieve the client’s financial goals within the desired time frame.

In order to educate the client and gather relevant information, the financial planner must be able to communicate effectively with the client. The planner must respect the client and establish a relationship of trust. The planner must be empathetic and assess the attitudes and values of the client as well as the client’s risk tolerance and views regarding savings, spending, taxation, and financial discipline. Issues such as the importance of work versus leisure time, job security, community service, attitudes regarding children from previous marriages, former spouses, and the client’s extended family all are important in understanding and assisting the client to achieve their goals.

How does a planner effectively communicate with a client? From the onset, the financial planner should address the client formally (Mr., Mrs., Dr., etc.) using the appropriate salutation. This formality can be relaxed later in the relationship if the client is more comfortable with first names. The planner should actively listen to the client and especially to the verbs the client uses. This often indicates the client’s learning style. Use of phrases such as “see what I mean,” “imagine that,” and any other words that imply that the client is a visual learner suggests that the planner should use examples including charts, graphs, and other visual aids to make the client more comfortable. If the client appears to pay attention to every spoken word or is asking for an explanation of words, the client’s learning style is likely that of a verbal learner and graphics may be supplemented with carefully selected words. There is some data that suggest that up to 65 percent of people are visual learners. A generous use of pictures, graphs, and charts is always helpful in the communication process.

As a matter of professional courtesy, the financial planner should respect the client’s time. This means being punctual, starting on time, ending on time, and telling the client how long each meeting will last. In order to establish a trusting relationship, the planner can

Key Concepts
Underline/highlight the answers as you read.

1. List the elements of the financial planning engagement letter.

2. Describe the purpose of a financial planning client questionnaire.

3. Summarize the types of necessary quantitative and qualitative data that is collected from the client.

4. Provide examples of external environment data that a financial planner needs to know in order to properly analyze, evaluate, and make recommendations related to a comprehensive financial plan.
generally share prior experiences. However, the planner must ensure that the client knows that client information is confidential by not identifying details about other clients.

The planner can show empathy by use of nonverbal pacing and showing a genuine interest in the hobbies, activities, vacations, and children of the client. To make communication effective, the financial planner can use restatement, paraphrasing, summarizing, open ended questions, and questions that show interest. These techniques can assure minimal miscommunication allowing the planner to reach the pertinent details.

Introductory Meeting
If there has been little communication before the first meeting, the financial planner should at least provide the client with a list of documents and information that the client needs to provide for the first meeting (e.g., get to know each other, collect some data, answer questions, clarify goals, reduce fears). At the first meeting, the financial planner should assist the client with establishing defined goals and discuss how the client’s values fit into those goals. There will also be a general discussion of the client’s personal data and family data. Typically the planner will meet with either one, or preferably both spouses to get an overview of the family and extended family (e.g., ages, marital status, children, grandchildren, net worth, income, self employment). From this basic information the planner can make a preliminary assessment of the general risks and goals of the client.

The financial planner and client should mutually agree as to how they will communicate (e.g., email, office telephone, cell phone) and how often they will meet (e.g., 2 hours per week for 10 weeks). The client should be given a time frame for when the plan will be completed (e.g., 3 months). The financial planner should discuss the planning process, fees, and answer questions that the client is likely to have. The planner should effectively manage the client’s expectations and have a remedy for instances when the client is dissatisfied. At the end of the introductory meeting an engagement letter should be prepared and sent to the client for approval.

Engagement Letter
An engagement letter is a legal agreement (a contract) between a professional organization and a client that defines their business relationship. The engagement letter should define the parties to the agreement, the specific services to be provided, the duration of the agreement, the methods of communication (email, meetings), and the expected frequency of contact. The letter should also specify the conditions under which the agreement can be terminated.

Elements of an engagement letter:
- define the parties to the agreement
- a description of the mutually agreed upon services (the scope of work)
- the time horizon for the work to be completed
- a description of the fees and costs
- the obligation and responsibilities of each party (planner/client) regarding:
  - defining goals, needs, and objectives
  - gathering data
  - projecting the result of no action
  - formulating alternative possibilities
- selecting from those alternatives
- establishing who is expected to implement which elements of the plan (this can be subject to revision at the implementation phase of the process)
- defining who has monitoring responsibilities
- delineating services that are not provided, such as legal documents or income, gift, or estate tax return preparation

In addition to the above, there should be a mutual understanding regarding the use of proprietary products and/or other professionals or entities in meeting any of the service obligations in the engagement agreement.