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Case Study Series

Gerald and Etienne Idowu: A Case in Financial Planning Fundamentals

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Abstract

This case presents a married couple in their early thirties, who have many of the typical financial goals of persons in their life situation. The case information and following structured question items focus on several basic topics in the fundamentals of financial planning, including: financial planning process, information collection, planner professional and ethical conduct, personal financial statement analysis, debt management, and time value of money math. Structured question items appear at the end of the case, organized by topic area.

Introduction

You are a professional financial planner, and you have been engaged by Gerald and Etienne Idowu to assist them in formulating and meeting their financial goals. Although the scope of your engagement is potentially comprehensive, for now you have been asked to focus on planning goals and subject areas that typically are considered fundamentals. Assume today is January 2, 2019.

Gerald Idowu

Gerald is a 32 year-old mechanical engineer and works for a large, multinational aerospace firm. He has worked at the same firm for eight years, and he earns $8,000 gross salary per month. Gerald is in very good health.

Etienne Idowu

Etienne is a 32-year-old nurse. She works two days per week at a local physician's office. Because she is part-time, she does not qualify for any benefits from her job, but she earns $800 gross wage per week. Etienne is in very good health.

The Idowus have been married for 14 years. Gerald and Etienne immigrated to the United States from Senegal when Gerald began college; both are now United States citizens. Etienne worked full time while Gerald attended engineering school. After Gerald finished school, Etienne earned her nursing degree. They have been unable to conceive children, so they are considering adopting an orphaned child from their native Senegal. The Idowus spend heavily, and often have little cash left at the end of the month. The Idowus live in a common law state.

One major spending item for the Idowus is a monthly wire transfer of funds to support their parents, all four of whom are still living and residing in Senegal. Both Gerald and Etienne grew up in poverty, with their parents making extreme sacrifices to send Gerald and Etienne to school both in Senegal and in the United States. Gerald and Etienne both view the monthly support as a moral obligation and an expression of gratitude to their parents.

Stated Financial Planning Goals (in no particular order)

1. Establish a fund for adoption expenses.
2. Reduce debt.
3. Establish a program of investing toward retirement and educational expenses for an adopted child.

Economic Information and Assumptions
Mortgage interest rates: 30-year = 4.8%; 15-year = 4.2%; closing costs = 2% of loan principal.
Expected long-term average returns to S&P 500 = 8.5%.
Current Treasury interest rates: 90-day = 2.2%; 1-year = 2.8%; 10-year = 3.15%; 30-year = 3.65%.
Inflation (Consumer Price Index) is expected to average 3.0% long term.
Today's tuition, fees, books and housing at the local state university = $18,000 per year, expected inflation = 6%.

Balance Sheet (January 1, 2019)

Assets				Liabilities and Net Worth		
		FMV				**Balance**
Checking, Bank #1		$2,500		Credit Card Balance		$15,000
Savings, Bank #2		$5,000				
				Car #1 Note		$30,000
RoyCo Stock		$1,200		Car #2 Note		$12,000
SupremeCo Stock		$1,700		Attorney Fees Balance		$9,000
Gerald 401-k		$22,000				
Gerald Roth IRA		$6,500		Home Mortgage Loan		$277,000
Etienne Roth IRA		$6,500				
				Total Liabilities		**$343,000**
Personal Residence		$355,000				
Car #1		$32,000				
Car #2		$11,000				
Total Assets		**$443,400**		**Net Worth**		**$100,400**

Information about Liabilities
The credit card has interest rate APR = 16.99%. The note secured by Car #1 has an interest rate APR = 4.00%; the Car #2 note has interest rate APR = 2.99%.

Three years ago, Gerald and Etienne engaged an immigration attorney to assist Etienne in gaining permanent residency status (Green Card) so she could legally work in the United States. As the Idowus were very illiquid at that time, the attorney gave them a payment plan for the fees. The terms of the payment plan call for a $255 payment every month until January 1, 2021.

The personal residence purchase was financed with a 30-year loan with monthly payments and 8% annual rate. The Idowus have made only the regular scheduled payments (i.e., no pre-payments of principal).

Cash Flow Statement (year ended December 31, 2018, and expected for 2019)

Inflows		
Gerald Salary	$96,000	
Etienne Salary	$40,000	
Interest Income	$200	
Payroll Taxes Withheld	($9,486)	
Income Tax Withheld	($10,600)	
Net Cash Inflows		**$116,114**
Outflows		
Home Payment (PITI)	$37,500	
Car Note Payments	$16,800	
Attorney Payments	$3,060	
Credit Card Payment	$5,400	
Car Expenses	$4,600	
Utilities	$7,100	
Groceries	$3,400	
Clothing	$4,500	
Payments to Parents	$24,000	
Entertainment	$4,800	
Miscellaneous	$4,200	
Total Cash Outflows		**$115,360**
Annual Surplus (Deficit)		**$754**

Insurance Information
The Idowus are covered under Gerald's employer major medical plan, which pays full premium for employee and spouse. The plan is a major medical with annual deductibles = $500 individual/$800 family, 80/20 co-pay, and $5,000 stop loss including deductible.

The home is insured with an HO3 with Part A coverage limit = $250,000 and no endorsements. Premium = $2,500 per year.

Gerald's employer provides Gerald with group term life insurance equal to two times his annual salary; Etienne is beneficiary. The Idowus have no other life insurance. Gerald's employer provides employees with 12 paid sick days per year, and employees with catastrophic conditions can draw up to 90 days of paid sick leave from a sick leave pool. The Idowus have no other disability insurance.

The Idowus carry full coverage on their automobiles. Their liability limits are 50/100/50, and their part D deductible = $200.

Investments Information
The Idowus have a long-term goal of investing toward retirement and toward the education of one child, should they be able to adopt. They tell you that they have moderate risk tolerance.

Schedule of Investments

	FMV	Basis	Beta	5-year Mean Return	Date Acquired	Note(s)
RoyCo	$1,200	$3,400	1.80		2010	NASDAQ technology company
SupremeCo	$1,700	$4,200	1.65		2010	NASDAQ biomedical company
Roth IRAs	$13,000		0		2010-2015	FDIC-insured CDs, 5-year term, 2.1%

Jake Savage

Nine years ago, Jake Savage, a financial advisor with GlamCo Financial, provided financial planning services for the Idowus. In his position, Savage was licensed to sell securities and insurance products, and his compensation was a straight commission on product sales.

Savage obtained Gerald's name from a university graduation list published in the newspaper, and indicated that he had worked for some of their classmates and also for a few well-known local residents, whose names he named. When visiting the Idowus, Savage convinced them that a variable annuity and the investments in RoyCo (basis = $3,400) and SupremeCo (basis = $4,200) stocks would meet their goals, which were assumed to be the "typical goals of a young married couple." After the stock investments suffered quick losses, Savage was always unavailable when the Idowus called, and he never returned their calls. He ended up leaving the firm and the state. The annuity did not perform as illustrated, and the Idowus ended the annuity, paying a 15% surrender fee.

Tax Information

Real property taxes on the home = $7,500 per year. The Idowus file married filing jointly for Federal income tax, and there is no state income tax where they live.

Adoption Information

The Idowus have found an adoption agency that can assist them in adopting a Senegalese infant. The agency quotes a cost range = $25,000-$30,000. It is estimated that the adoption process will take about 30 months from initial contract with the agency to final completion of adoption, and the costs would be distributed approximately evenly by calendar quarter over that time period.

Once the adoption is completed, the Idowus do not plan to have additional children. They expect that the one adopted child will have the typical expenses associated with raising a child, including four years at the local state university.

Retirement Information

Gerald hopes to retire at age 67. The Idowus expect a retirement period = 25 years.

Etienne is the beneficiary of Gerald's 401-k. Gerald's 401-k is invested in the stock of his employer; this is the only option for employees in the plan. The plan matches half of the employee's contributions up to a maximum employer contribution = 4% of the employee's salary. Gerald has not made contributions to the plan during the past few years.

The Idowus' Roth IRA investments are both in certificates of deposit at an FDIC-insured bank. The current CDs mature in January 2022 and have an APR = 2.1%. Each IRA names the surviving spouse as death beneficiary.

Estates Information

Neither Gerald nor Etienne has a valid will, power of attorney or living will.

Questions:

Financial Planning Process

1. Which step(s) of the financial planning process did Jake Savage perform?
2. Which step(s) of the financial planning process did Jake Savage NOT perform?
3. Evaluate the statement: "typical goals of a young married couple."

Information Collection

4. Produce a proper statement of the adoption fund objective.
5. Name five other items of information you would ask the Idowus to provide you.
6. When interviewing the Idowus about their finances, which topics will require much delicacy on your part?
7. What immediate financial goals, in addition to their stated goals, would you suggest for the Idowus?

Planner Practice and Ethics

8. Name some professional concerns you should have about your professional relationship with the Idowus.
9. How should you respond when the Idowus tell you about their experience with Jake Savage?
10. Identify, giving examples, of principles of planner ethical conduct that Jake Savage may have violated.
11. How, in this specific case, might the planner-client relationship benefit from fee-only planner compensation?
12. Etienne asks you about financial planner certifications. Name and briefly describe three of them.

Financial Position and Statement Analysis

13. Name five financial weaknesses for the Idowus.
14. Name five financial strengths for the Idowus.
15. Name two deficiencies of the format and reporting in the balance sheet.
16. Compute and discuss the following financial ratios for the Idowus:
    a. Emergency fund
    b. Housing debt payment ratio
    c. Total debt payment ratio
    d. Solvency ratio
    e. Savings rate
17. Which phase of the financial planning life cycle are the Idowus in?

Debt Management

18. What are the advantages and disadvantages of the Idowus using an ARM to refinance the home?

19. Which of the Idowus' debts contribute to a potential income tax itemized deduction for interest paid?
20. If the Idowus were to enter Chapter 7 bankruptcy, what would be the total value of their bankruptcy estate?

Time Value of Money

21. How long will it take the Idowus to pay off the credit card balance at the current level of monthly payments?
22. If the Idowus re-finance the home loan with a 30-year loan, how long will it take to recover closing costs?
23. What will the IRAs be worth at retirement age assuming no new contributions and continued investing at 2.1%?
24. What is the monthly payment on the Idowus' home loan?
25. How long ago did the Idowus buy their house?
26. If the Idowus' adopted child starts college in 16 years, and they invest at 8%. What is the present value of college costs?

Author

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