

Instructions: Read the information provided about William and Marilyn Mathews and choose the best answer to the multiple-choice questions that follow.

WILLIAM AND MARILYN MATHEWS
Case Scenario and Multiple-choice Questions
Released as of November 1994

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Your clients, Bill and Marilyn Mathews, have asked you to help them with a number of issues facing them as Bill prepares to sell his business and formally retire. Marilyn will also retire, having worked as the company bookkeeper for twenty years. Negotiations for the sale of Bill's business, Calculator City, are almost concluded, pending resolution of a number of questions Bill raised regarding installment payments for the business as well as a request from the proposed owner that Bill continue to provide consulting services.

I. PERSONAL INFORMATION

	<u>Age</u>	<u>Health</u>	<u>Occupation</u>
William Mathews	65	Excellent	Business Owner
Marilyn Mathews	63	"	Bookkeeper
John Mathews (son)	32	"	Engineer
James Mathews (son)	30	"	CPA
Grandchildren	3, 4, 5, and 7	"	

Neither son has any intention of becoming involved in the business. The Mathews file a joint tax return. Client and spouse have simple wills leaving all to each other.

II. ECONOMIC ENVIRONMENT

The current economic environment exhibits low real short-term rates, high real long-term rates, little economic growth, and high unemployment.

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III. CLIENT OBJECTIVES

1. Maintain current lifestyle, including frequent travel.
2. Revise estate plan to minimize taxes, take advantage of opportunities in various elections available in the Internal Revenue Code, and maximize amounts passing to children and grandchildren.
3. Review investment portfolio and make changes as necessary to reflect different priorities and risk tolerance levels during retirement. Initial indications are that the clients are willing to take normal investment risks, desirous of adequate current income, reasonable safety of principal, inflation protection, tax advantage, and some modest long-term appreciation, in that order of priority.
4. Review and revise total risk management and insurance situation as necessary to provide adequate protection and eliminate gaps and overlaps.
5. Determine the most advantageous method of taking distributions from the 401(k) accounts.

IV. FINANCIAL STATEMENTS

WILLIAM AND MARILYN MATHEWS

Statement of Financial Position

12/31/92

ASSETS		LIABILITIES AND NET WORTH	
Invested Assets			
Cash/Cash Equivalents	\$8,000	Auto Loan	\$6,000
Marketable Securities ¹	1,580,000	Mortgage ²	12,000
Business Interest ³	1,500,000	Mortgage ⁴	<u>74,000</u>
Life Insurance Cash Value ⁵	60,000		\$92,000
Annuity	<u>120,000</u>		
	\$3,268,000		
Use Assets			
Primary Residence	\$188,000		
Summer Home	126,000		
Personal Property	60,000		
Automobiles	<u>26,000</u>	Net Worth	<u>\$3,951,000</u>
	\$400,000		
Retirement Plan Assets⁶			
IRA (H)	\$27,000		
IRA (W)	28,000		
401(k) (H)	280,000		
401(k) (W)	<u>40,000</u>		
	<u>\$375,000</u>		
Total Assets	<u>\$4,043,000</u>	Total Liabilities and Net Worth	<u>\$4,043,000</u>

¹ See separate Investment Portfolio Supplement.

² Principal residence; originally, 30 years @ 7%.

³ Business is to be sold for \$1.5 million. Purchase price was \$700,000 in 1982. Terms of sale include \$300,000 down payment on July 1, 1993, with the balance to be paid over 120 months starting August 1, 1993, at 10% interest.

⁴ Summer home; originally, 15 years @ 9%.

⁵ Face Amount: \$200,000; Bill is insured, Marilyn is beneficiary.

⁶ Spouse is beneficiary for IRA and 401(k). The IRAs are invested in a common stock growth mutual fund. The 401(k) plans are invested in 3-year Treasury notes.

WILLIAM AND MARILYN MATHEWS
Projected Monthly Cash Flow Statement
1/1/93 through 12/31/93

(Incomplete)

Cash Inflows

Social Security (H)	\$820
Social Security (W)	\$410
Installment Payments (120 pmts @ 10%)	?
Interest Income (tax-exempt)	\$600
Dividend Income	\$540
Interest Income (taxable)	?
Other Investment Income	?

Outflows

Savings and Investment	?
Mortgage (residence: PITI)	\$600
Mortgage (summer home: PITI)	\$1,100
Food	\$300
Utilities	\$400
Transportation (gas, oil, maintenance)	\$200
Car Payment	\$600
Clothing	\$250
Entertainment	\$450
Travel	\$1,680
Family Gifts	\$1,666
Charitable Gifts	\$500
Life Insurance	\$300
Hospitalization (Medigap/Medicare)	\$100
Automobile Insurance	\$150
Miscellaneous	?
Federal Income Tax	\$5,800
State Income Tax	\$900
Other	?

V. INSURANCE AND ANNUITY INFORMATION

Life Insurance

Person Insured/Owner	Bill
Type of Policy	Whole Life
Face Amount	\$200,000
Dividend Option	Paid Up Additions
Issue Date	2/13/77
Beneficiary	Marilyn
Current Cash Value	\$60,000
Premium	\$300 per month

Person Insured/Owner	Bill
Type of Policy	Single Premium Deferred Annuity
Fixed or Variable	Fixed
Current Value	\$120,000
Current Interest Rate	6.5%
Issue Date	1/1/81
Purchase Price	\$40,000

Homeowners Policy

Type	HO-3
Amount on Dwelling	\$175,000
Personal Property Coverage	\$ 87,500
Personal Liability	\$100,000

Automobile Policy

Type	Personal Auto Policy
Bodily Injury/Property Damage	\$300,000 Combined Single Limit
Collision	\$250 Deductible
Comprehensive	Full, with \$100 Deductible
Uninsured Motorist	\$300,000 Single Limit

VI. INVESTMENT PORTFOLIO SUPPLEMENT

These securities were accumulated over a period of years and are essentially unmanaged.

<u>Common Stocks</u>	<u>Fair Market Value</u>
AT & T	\$30,000
Bell South	10,000
Bell Atlantic	9,000
Ameritech	8,500
NYNEX	7,000
Pacific Telesis	8,000
Southwestern Bell	8,000
U.S. West	7,000
Canon	22,000
Comerica Bank	29,000
Danko	7,000
de Beers	8,000
du Pont	29,000
Disney	12,000
Dow Chemical	9,000
Detroit Edison	24,000
General Motors	8,000
GM E	10,500
D&T, Inc.*	25,000
Common stock mutual fund (IRAs)	55,000
<u>Municipal Bonds</u>	
Franklin Intermediate Tax Exempt Fund	\$100,000
<u>Annuities & Insurance</u>	
Cash value life insurance	\$ 60,000
Single Premium Deferred Annuity	120,000
<u>Bonds</u>	
Treasury notes (401(k))	\$320,000
U.S. EE Savings Bonds	75,000
<u>Cash and Equivalents</u>	
Cash	\$8,000
Cash equivalents, incl. Money Markets	134,000
Treasury Securities (T-Bills)	<u>1,000,000</u>
TOTAL	<u>\$2,143,000</u>

*Small Business Corporation (1244 stock) solely owned by Bill and originally purchased for \$76,000 on 1/1/87.

Questions marked with an asterisk () are no longer accurate due to changes in the Federal Tax Code.

1. The tax treatment of the down payment made to Bill for the sale of his business is:
 - A. Not taxable as a return of basis.
 - B. Fully taxable as a capital gain.
 - C. Partially a return of basis and partially taxable as ordinary income.
 - D. Partially a return of basis, partially a capital gain, and partially ordinary income.
 - E. Partially a return of capital and partially a capital gain.

2. How much will Bill receive from the monthly installment payments during 1993 (rounded to the nearest dollar)?
 - A. \$79,290.
 - B. \$95,149.
 - C. \$190,297.
 - D. \$379,290.
 - E. \$395,149.

3. The amount of interest income from the installment sale for the year ending 12/31/93 is approximately:
 - A. \$49,000.
 - B. \$59,000.
 - C. \$60,000.
 - D. \$72,000.
 - E. \$120,000.

4. How will Bill's receipt of installment payments for the sale of his business affect his Social Security benefits?
- A. His Social Security benefits will be reduced because of his installment payments.
 - B. His Social Security benefits will not be taxable because installment payments are not wages.
 - C. Receipt of installment payments will increase the amount of Modified Adjusted Gross Income, causing some of the Social Security benefits to be taxable.
 - D. Because Bill is 65, his Social Security benefits will be subject to the excess earnings test applied to the installment payments. Benefits will be reduced \$1 for every \$2 earned over the base amount.
 - E. Because Bill is 65, his Social Security benefits will be subject to the excess earnings test applied to the installment payments. Benefits will be reduced \$1 for every \$3 earned over the base amount.
5. *Bill and Marilyn both have account balances in the 401(k) Plan, and they want to determine what options they can pursue.

Which of the following statements describe options available for Bill and Marilyn?

- 1. Bill can make an IRA Rollover with his account; Marilyn can elect 10-Year Special Averaging for hers.
 - 2. Both Bill and Marilyn can make IRA Rollovers.
 - 3. Bill can elect a partial rollover and use 5-Year Special Averaging on the balance; Marilyn can roll over her entire amount.
 - 4. Both Bill and Marilyn can elect either 5-Year or 10-Year Special Averaging for their respective distributions.
- A. 1, 2 and 4.
 - B. 1 and 3.
 - C. 2 only.
 - D. 2 and 3.
 - E. 1, 2, 3 and 4.

6. The Mathews family is considering the purchase of a survivorship life insurance policy, payable on the second death of either Bill or Marilyn, for the primary purpose of providing liquidity for the payment of the federal estate tax. The ownership and beneficiary arrangements are being studied for the best overall result.

Which of the following options for ownership and beneficiary arrangements are viable?

1. Bill and Marilyn can purchase the policy and retain ownership; the proceeds will not be includible in either estate because of the unlimited marital deduction.
 2. Bill and Marilyn can purchase the policy, and then transfer ownership to one or both of their sons, so that the proceeds avoid inclusion in either Bill's or Marilyn's estate no matter when death occurs because they do not have any incidents of ownership.
 3. Ownership can be vested immediately in an irrevocable life insurance trust, with appropriate "Crummey" provisions, to avoid inclusion of the proceeds in either estate.
 4. The Mathews family Revocable Living Trust can be the initial owner and beneficiary, in order to avoid estate taxes in either estate, because life insurance death proceeds retain their tax-free character in the trust.
- A. 1, 3 and 4.
B. 2 and 4.
C. 3 only.
D. 2 only.
E. 1 and 4.
7. If Bill decides to make a partial withdrawal from his Single Premium Deferred Annuity, what income tax result will ensue?
- A. The withdrawal will be taxed as long-term capital gain, subject to a maximum rate of 28%.
 - B. The withdrawal will be subject to ordinary income tax, since there is no preference for long-term capital gain.
 - C. The withdrawal will be taxed according to the annuity rules, so that a portion will be taxable as ordinary income and the balance will be a tax-free recovery of capital.
 - D. The withdrawal will be tax free up to Bill's cost basis, since FIFO treatment applies to this annuity.
 - E. The withdrawal will be taxable on a LIFO basis to the extent of earnings in the contract.

8. Bill is contemplating selling his D&T, Inc. stock for the fair market value. Assuming he sold D&T on 12/31/92, the tax impact would be:
- A. A fully deductible capital loss of \$51,000.
 - B. A capital loss limited to \$3,000 assuming no other investment transactions; carryover \$48,000 long-term capital loss.
 - C. An ordinary loss of \$50,000 with a \$1,000 loss carryover.
 - D. An ordinary loss of \$51,000.
 - E. A short-term capital loss of \$51,000 because of Sec. 1244 status.
9. In view of the combined estate values for Bill and Marilyn, which of the following estate planning techniques may be appropriate?
- 1. Placing life insurance in an irrevocable trust.
 - 2. Making use of annual gift tax exclusion.
 - 3. Establishing a revocable living trust, using the unlimited marital deduction and the full unified credit.
 - 4. Arranging for a preferred stock recapitalization for Bill's business interest.
- A. 2 and 3.
 - B. 1, 2 and 3.
 - C. 1, 3 and 4.
 - D. 1, 2 and 4.
 - E. 1, 2, 3 and 4.
10. The Mathews currently own a number of tax-advantaged financial instruments. Which of the following statements is/are true with respect to these various instruments?
- 1. Interest income and capital appreciation from the municipal bond fund is federally tax exempt.
 - 2. An initial partial withdrawal from the single premium deferred annuity is fully taxable.
 - 3. When redeemed, the return on the savings bonds is not subject to state income taxes.
 - 4. The Treasury bills are federally taxed only upon maturity.
- A. 1, 2 and 3.
 - B. 2 and 4.
 - C. 3 only.
 - D. 3 and 4.
 - E. 1, 2, 3 and 4.

11. If Bill and Marilyn wish to limit the growth of their combined estate, which techniques may be advisable?
1. Use of the annual gift tax exclusion and split gift election.
 2. Current use of both unified credits.
 3. Payment of tuition for grandchildren.
 4. Payment of direct medical expenses for children and grandchildren.
- A. 1 and 2.
 - B. 2, 3 and 4.
 - C. 1 only.
 - D. 1, 2 and 3.
 - E. 1, 2, 3 and 4.
12. The CFP Board of Examiners has eliminated this question and answer.
13. Assume Bill provides consulting services for the new owner and is properly classified as an independent contractor. Which statements properly describe Bill's ability to shelter current taxable income?
1. Bill may take a nondeductible IRA for \$2,000.
 2. Bill may set up a profit-sharing Keogh.
 3. Bill can set up a money-purchase plan.
 4. Bill can set up a combined money-purchase and profit-sharing plan, but his contributions will be limited to 20% of Schedule C income.
- A. 2 and 3.
 - B. 1, 2 and 3.
 - C. 2, 3 and 4.
 - D. 1, 2, 3 and 4.
 - E. 1 and 3.

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14. In reviewing Bill and Marilyn's cash flow projections as well as the investment portfolio supplement, you question the appropriateness of some of the holdings. Which combination of portfolio weaknesses best summarizes a valid critique of their investments?
- A. Excessive liquidity, inadequate tax advantage, marginal equity diversification.
 - B. Inadequate tax advantage, excessive growth orientation, marginal equity diversification.
 - C. Excessive liquidity, excessive growth orientation, inadequate tax advantage.
 - D. Excessive reliance on Treasury Bills, insufficient growth opportunities, inadequate current income.
 - E. Insufficient growth opportunities, inadequate liquidity, excessive tax advantage.
15. Assuming that Bill reaches agreement with the new owner as to the installment payments for the business interest, what are the estate tax ramifications if Bill dies at the end of the third year of the ten-year payout schedule?
- A. The remaining value of the installments is not includible in Bill's estate, because the payments continuing to Marilyn qualify for the marital deduction.
 - B. Seventy percent of the original cash purchase price upon which the installments were based is includible in Bill's estate but qualifies for the marital deduction because payments will continue to Marilyn.
 - C. The present value of the future income stream to Marilyn is included in Bill's estate, but the continuing payments qualify for the marital deduction.
 - D. The present value of the future income stream to Marilyn is included in Bill's estate, but the continuing income payments do not qualify for the marital deduction because it is a terminable interest.
 - E. Nothing is included in the estate because the installment payments are not guaranteed.

16. The inadequacies in their estate planning can be summarized as follows:
1. Failure to take full advantage of each unified credit.
 2. Failure to avoid probate.
 3. Lack of proper documents to address the potential problem of incapacity.
 4. Failure to coordinate titling of assets with documentation.
- A. 1 and 2.
 - B. 1, 2 and 3.
 - C. 2, 3 and 4.
 - D. 2 and 4.
 - E. 1, 2, 3 and 4.

Regarding questions 17 and 18 and given the current economic conditions, you recommend allocating the Mathews' investment funds into three asset categories: equity, debt, and cash.

17. Which of the following statements describe(s) action(s) that you would recommend in order to meet the Mathews' goals?
1. Because of the economic environment, the Mathews should immediately increase the proportion of equity investments to provide for growth for the estate.
 2. This is the opportune time to lengthen the maturity of the fixed-income proportion of the portfolio.
 3. Because of the current economic scenario and their retired status, the Mathews should liquidate the equity portion of the portfolio.
 4. The Mathews should gradually increase the equity proportion of the portfolio over the next 3 years to provide for growth in their estate.
- A. 3 and 4.
 - B. 1 and 2.
 - C. 2 and 4.
 - D. 4 only.
 - E. 2, 3 and 4.

18. In order to meet their goals, the Mathews should:
1. Reduce cash level, expand fixed-income securities.
 2. Expand fixed-income securities.
 3. Increase cash level, decrease equities.
 4. Expand fixed-income securities, decrease equities.
- A. 1 only.
 - B. 1 and 4.
 - C. 2 and 3.
 - D. 2, 3 and 4.
 - E. None of the above.
19. You are considering liquidating the individual equity holdings and moving this amount into equity mutual funds. The following alternative allocations have been proposed:

Choice A		Choice B	
Market index fund	40%	Growth fund	33%
Growth fund	20%	International equity fund	33%
Value-oriented fund	20%	Value-oriented fund	34%
International equity fund	20%		
Choice C		Choice D	
Market index fund	30%	Small company fund	25%
Gold stock fund	50%	Aggressive growth fund	45%
Equity-income fund	20%	Growth fund	30%

- A. Choice A is preferred because it includes multiple management styles and market diversification.
- B. Choice B is preferred because it employs both active and passive funds.
- C. Choice C is preferred because it best meets the Mathews' goals.
- D. Choice D is preferred because it maximizes growth while meeting the Mathews' goals.
- E. Do not liquidate the current portfolio.

Instructions: Read the information provided about Marilyn and Stuart Kincaid and choose the best answer to the multiple-choice questions that follow.

MARILYN AND STUART KINCAID
Case Scenario and Multiple-choice Questions
Released as of December 1996

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I. PERSONAL DATA

Marilyn Kincaid

- 53 years old, physician.
- For the past 17 years Marilyn has been a staff physician and employee of Nopaine Hospital where she currently earns \$200,000/year.
- She also operates a private practice clinic with Schedule C net income of \$100,000. The practice has three employees.

Stuart Kincaid

- 55 years old, recently taken his company's early retirement option.

Stuart and Marilyn Kincaid

- Married 31 years, have always lived in a state that is not a community property state.
- Marilyn plans to retire in 7 years.
- Four daughters, ages 28 (married, 1 child); 26 (married, 2 children); 24 (single) and 22 (single); the two youngest children are not living at home and have just started working as independent consultants.
- Own a vacation home in another noncommunity property state.
- Have simple wills. Stuart leaves his estate to Marilyn and Marilyn leaves her estate to Stuart. After the death of the survivor, the estate is left to their issue in per stirpes (by right of representation). The Kincaids estimate they save \$2,000 per month (after retirement plan contributions).

II. INSURANCE DATA

- Marilyn's health insurance provided by Blue Cross/Blue Shield. Monthly \$600 premium paid by Nopaine Hospital. Deductible of \$250 per person, Kincaid family copayment of 20%, and out-of-pocket per family cap is \$1,000/year. Lifetime maximum on major medical is \$500,000 per person.
- Marilyn's disability coverage is a group disability contract provided by Nopaine Hospital that pays a \$5,000 monthly benefit for two years. The contract has a liberal "own occupation" definition. The elimination period is 30 days.
- Marilyn has a \$500,000 universal life policy with XYZ Insurance Co. She pays the annual premium. Stuart is the primary beneficiary and Marilyn is the owner. At the time of the purchase, policy projections were based on the 5-year Treasury rates of 6%.
- Marilyn has a \$350,000 annual renewable group term through the American College of Physicians. The \$760 annual premium is paid through the Kincaids' personal checking account. Stuart is the beneficiary and Marilyn is the insured and has all incidents of ownership.
- Marilyn has a \$100,000 group term policy provided by the hospital. The hospital pays the entire premium. The beneficiary is Marilyn's estate.
- Stuart has a \$200,000 whole life policy converted at retirement from his former group term; annual premium is \$4,000, and there is no cash value at this time. Stuart is the owner and Marilyn is the beneficiary.

III. OTHER FINANCIAL DATA

- Nopaine Hospital sponsors a 403(b) tax-sheltered annuity (TSA) program but does not contribute to the plan.
- Marilyn makes the maximum contributions from her salary to the TSA.
- The current TSA account balance is \$375,000. Marilyn has chosen a fixed-rate option with these funds, and the present rate is 8%.
- Marilyn has a self-employed retirement plan which incorporates both a 10% money-purchase program with a profit-sharing option. Marilyn has chosen fixed-rate investments for these assets, and the total for the plan equals \$800,000.
- Stuart is the beneficiary of all Marilyn's qualified retirement plans.
- The average after-tax rate of return on invested assets is 7%.

- The Kincaid's current annual disposable income is \$55,000.
- Additional investment data is included on the attached balance sheet.
- The Kincaids are in the marginal 31% federal tax bracket and a 4% state bracket.
- The Kincaids rent their vacation home for \$2,000 to their neighbors for ten days during December each year. During the year, the Kincaids spend every weekend, outside of December, at the home.
- Marilyn and Stuart recently completed a refinancing of their vacation residence and obtained a \$400,000 mortgage amortized at 10% for 30 years. The financing was arranged through an independent mortgage broker for two points.

IV. FINANCIAL OBJECTIVES IN ORDER OF PRIORITY

1. Marilyn wants to retire in seven years, and they expect to retain both residences.
2. They would like to be able to spend \$10,000 (after-tax) per month in today's dollars during retirement years.
3. They want to reduce income and estate taxes.

**STUART AND MARILYN KINCAID
BALANCE SHEET**

ASSETS AT FAIR MARKET VALUE

Cash/Cash Equivalents

Checking Account (J) ¹	\$5,000
Bank X Money Market (W)	110,000
Bank X Money Market (H)	90,000
Credit Union Acct (H) ²	175,000
Savings Bank Acct (H)	50,000
XYZ Insurance Cash Value (W)	<u>50,000</u>
TOTAL Cash/Cash Equivalents	\$480,000

Invested Assets

Clinic Bank Account(W) ³	\$150,000
Bank X CD (H)	82,000
Stocks-six companies (W)	99,000
Muni Bonds (H) ⁴	235,000
Series E Bonds (W)	3,000
SPDA Annuity One (purchased in 1981) (W) ⁵	175,000
SPDA Annuity Two (purchased in 1988) (W) ⁵	85,000
IRA Bank X Money Market (W)	3,000
IRA Growth Mutual Fund (W)	12,000
Retirement Plan Bank X CD (W)	125,000
Retirement Plan Bank Z CD (W)	75,000
Retirement Plan US T-Bill (W)	300,000
Retirement Plan Bank X CD (W)	50,000
Retirement Plan Bank X Money Mkt (W)	50,000
Retirement Plan Bank Z CD (W)	100,000
Retirement Plan US T-Note (W)	100,000
403(b) TSA (W)	<u>375,000</u>
TOTAL Invested Assets	\$2,019,000

Personal Use Assets

Personal residence (J)	\$1,000,000
Vacation home (J)	400,000
Automobiles (W)	25,000
Personal property (J)	<u>25,000</u>
TOTAL Personal Use Assets	\$1,450,000

Total Assets \$3,949,000

LIABILITIES AND NET WORTH

Vacation home mortgage (J) \$400,000

Total Liabilities \$400,000

Net Worth \$3,549,000

**Total Liabilities
and Net Worth** \$3,949,000

- 1 J = joint tenancy with right of survivorship, W = Marilyn as owner, H = Stuart as owner
- 2 Stuart's distribution from his former company's qualified retirement plan.
- 3 Consists of \$20,000 Bank X checking account and \$130,000 Bank X money market.
- 4 Double-tax exempt
- 5 Single premium deferred annuity, current rate is 7½%; the beneficiaries are the children
SPDA 1 cost: \$50,000; SPDA 2 cost: \$50,000

1. The Kincaids would like to retire in seven years. Excluding assets devoted to personal use, if their current portfolio can earn an annual rate of return of 7% (after-tax), what is the closest estimate of the value of that portfolio at retirement?
 - A. \$3,300,000.
 - B. \$3,500,000.
 - C. \$3,700,000.
 - D. \$4,000,000.
 - E. \$5,700,000.

2. If the Kincaids expect to earn 7% (after-tax) annually and anticipate annual inflation to be 5%, what future monthly income will the Kincaids need when they retire in 7 years to meet their first-year retirement expenditures? (rounded to the nearest \$100)
 - A. \$11,400.
 - B. \$11,500.
 - C. \$14,100.
 - D. \$15,000.
 - E. \$16,100.

3. Which combination of the following estate planning actions or techniques is most appropriate for the Kincaids at this time assuming that their marriage is stable?
 1. Transfer additional assets from Marilyn to Stuart to equalize estates.
 2. Create demand trusts (Crummey) for the children.
 3. Inclusion of a bypass/credit shelter trust for both.
 4. Irrevocable life insurance trust.
 - A. 1 and 3.
 - B. 1 and 4.
 - C. 2, 3 and 4.
 - D. 1, 2 and 3.
 - E. 2 and 4.

4. Which of the following is the nearest estimate of Marilyn Kincaid's gross estate, if she were to die at this time?
- A. \$2,600,000.
 - B. \$3,300,000.
 - C. \$3,500,000.
 - D. \$3,800,000.
 - E. \$4,300,000.
5. If Marilyn Kincaid were to die at this time, what is the total value of her probate estate?
- A. \$387,000.
 - B. \$487,000.
 - C. \$1,002,000.
 - D. \$1,202,000.
 - E. \$1,337,000.
6. Upon initial review of the Kincaids' situation, what are the three most apparent areas of concern?
- 1. Too much deposited in Bank X.
 - 2. Too much life insurance on Marilyn.
 - 3. Investment portfolio provides a poor inflation hedge.
 - 4. Too few assets owned by Stuart.
 - 5. Underutilization of available estate tax savings opportunities.
- A. 1, 2 and 3.
 - B. 2, 3 and 4.
 - C. 1, 4 and 5.
 - D. 1, 3 and 5.
 - E. 2, 4 and 5.

7. The Kincaids are concerned that they are paying too much tax. Dr. Kincaid is contributing \$20,000 of her Schedule C net income to the combination qualified retirement plan and she is contributing \$9,500 to the 403(b) TSA plan. What is the most significant step the Kincaids can take to defer tax on current income?
- A. Marilyn increases the self-employed plan contribution to 25% or \$30,000.
 - B. Stuart can open a deductible IRA.
 - C. Marilyn can increase the 403(b) contribution to \$12,500.
 - D. Marilyn can establish a Rabbi Trust to defer an additional 12.5% of income.
 - E. The Kincaids can prepay real estate and state income taxes.
8. With respect to Stuart's need for life insurance, he should:
- A. Purchase additional whole life insurance to provide estate liquidity.
 - B. Purchase no additional life insurance because the asset will be included in his gross estate.
 - C. Purchase single premium whole life insurance because it provides inflation protection.
 - D. Purchase no additional life insurance because he has no need for additional coverage.
 - E. Purchase variable life insurance to reduce the overall risk level of his current portfolio.
9. Dr. Kincaid agrees with your recommendation that she needs to supplement her group disability program with a separate policy. Which combination of the following provisions are the most appropriate for any additional disability coverage?
- 1. A presumption of total disability if the policyholder tests positive for HIV.
 - 2. A 4% COLA rider on the benefit.
 - 3. Lifetime benefit versus one that terminates at age 65.
 - 4. A proportionate partial disability benefit that does not first require total disability.
 - 5. A contract that is guaranteed renewable.
- A. 1 and 5.
 - B. 3 and 5.
 - C. 2 and 4.
 - D. 2 and 3.
 - E. 4 and 5.

10. The other major weaknesses of the Kincaids' insurance program are:
1. The medical insurance out-of-pocket cap of \$1,000 is too high.
 2. The lifetime maximum on the major medical is inadequate.
 3. The Kincaid's liability coverage is inadequate.
 4. A portion of the premium for medical insurance paid by the hospital is taxable to Marilyn.
- A. 1 and 2.
 - B. 1, 2 and 4.
 - C. 2 and 3.
 - D. 2, 3 and 4.
 - E. 3 and 4.
11. Which combination of the following statements supports the Kincaids' current portfolio allocation in the qualified plans?
1. Since the Kincaids have a very small percentage of their present total portfolio in equities, it would not be appropriate to emphasize equities in their pension funds.
 2. Since fixed-income assets held to maturity have low correlation with equities, a portion of fixed-income assets is appropriate.
 3. A projection of higher income tax in 7 years reduces the benefit of investing in high potential growth assets in a tax-deferred account.
 4. Retirement will necessitate the Kincaids making major changes in their asset allocation in seven years.
- A. 1, 2 and 3.
 - B. 1 and 3.
 - C. 2 and 4.
 - D. 2 only.
 - E. 1, 2, 3 and 4.
12. Dr. Kincaid's SPDA Annuity One has no surrender charges. What should she do?
- A. Cash in the annuity and pay taxes and reinvest the net proceeds.
 - B. Exchange the annuity under Section 1035 of the Internal Revenue Code to another annuity paying a similar rate.
 - C. Annuitize over her life with a 10-year certain and continuous payment.
 - D. Annuitize over a joint life expectancy.
 - E. Leave the annuity intact.

13. If the Kincaids had a personal emergency need for \$50,000 in excess of their cash/cash equivalents, their best source of funds from invested assets would be to draw from the:
- A. Retirement plan Treasury bills.
 - B. SPDA Annuity One.
 - C. Stock portfolio.
 - D. SPDA Annuity Two.
 - E. 403(b) TSA.
14. The Kincaids wish to reduce the overall purchasing power risk of their portfolio. Which of the following investment vehicles is best suited for this purpose?
- 1. International equity funds.
 - 2. Precious metal funds.
 - 3. Treasury Bills.
 - 4. Municipal bonds.
 - 5. Variable annuities.
- A. 1, 2 and 5.
 - B. 1, 3 and 4.
 - C. 1, 4 and 5.
 - D. 2, 3 and 5.
 - E. 3, 4 and 5.
15. Which of the following is/are correct concerning the vacation home?
- 1. The \$2,000 must be included as rental income.
 - 2. The mortgage interest is deductible as an itemized deduction except that 10/365^{ths} is deductible as an itemized deduction subject to 2% of adjusted gross income (AGI).
 - 3. All the interest is deductible as an itemized deduction on Schedule A.
 - 4. The mortgage interest and rental income offset each other on Schedule E.
- A. 1 only.
 - B. 1 and 2.
 - C. 1 and 3.
 - D. 3 only.
 - E. 4 only.

Directions: This part consists of one case problem followed by a set of questions or incomplete statements. Four or five suggested answers or completions follow each question or incomplete statement. Select one best answer or completion for each question. Each question should be answered independently.

JAMES AND PAT CLARKE
Case Scenario and Multiple-choice Questions
Released as of January 1999

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I. PERSONAL DATA

Husband: James Clarke, age 44, college professor
Wife: Pat Clarke, age 43, college professor
Child: Kim Clarke, age 14
James' parents: In good health, in mid to late 70s
Pat's parents: Deceased

II. FINANCIAL DATA

James and Pat Clarke have the following assets at fair market value (FMV):

- Single premium deferred annuity (Pat) \$ 50,000
- Cash (JTWROS*) 250,000
- Stock in the XYZ Corporation** (JTWROS) 50,000
- IRAs
 - Pat 20,000
 - James 30,000
- Home (JTWROS) 100,000
- Their simplified income statement is presented as follows:

Salary (combined)	\$82,500
Interest income	12,500
Living expenses & taxes	90,000

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- They have no liabilities and no company-sponsored retirement plans.
- They have no wills and they live in a noncommunity property state.
- James' parents can meet all current expenses from current cash flow but have very limited reserve funds and still live in their own paid-for mobile home.

*Joint tenancy with right of survivorship.

**XYZ Corporation is an S-corporation for which James worked before he started teaching.

III. OTHER PERTINENT DATA

- The tax basis of the home is \$90,000; the tax basis of the stock is \$55,000.
- The Clarkes are in a 30% marginal combined state and federal tax bracket.
- They are inexperienced investors, but they are willing to take reasonable and normal investment risk if appropriate, but they do not wish to invest aggressively.
- Both James and Pat have purchased term life insurance policies with \$250,000 death benefit on each; they own their own policies, and Kim is the contingent beneficiary on both policies.
- James is the primary beneficiary of Pat's single premium deferred annuity; Kim is the contingent beneficiary.
- You have found their disability insurance inadequate. The Clarkes have indicated they could fit your proposed \$1,600 annual premium for an adequate policy into their living expenses.

- You have reviewed their auto, homeowner's, liability, and life insurance and found their policies adequate. James and Pat are responsible for their medical expenses.

- Kim is a trustworthy high school honor student who earns \$2,000 annually and has a \$500 savings account.

- The "cash" is invested in a variety of money market funds and insured savings accounts.
- Their IRAs are invested in money market funds. James and Pat are the primary beneficiaries on each other's IRA account; Kim is the contingent beneficiary.

- They do not plan additional children and they have no other dependents.

- The Clarkes currently can save \$5,000 per year out of current salary and can continue to do so (in inflation-adjusted dollars) until they retire in 20 years. This savings rate assumes that all planned asset acquisition and replacements are paid out of income before savings (except the three goals shown below).

IV. GOALS (IN ORDER OF PRIORITY)

1. College education for Kim. They expect to spend a total of \$50,000 (present value) for her entire education.
2. Retirement in 20 years, which maximizes their standard of living at retirement. Their IRAs, Social Security, and personal retirement savings form a basis for retirement.
3. Pat and James plan to take 6 months off from work (“sabbatical”) in 4 years for travel and research and to spend \$50,000 (after tax and in current dollars).

V. ECONOMIC ENVIRONMENT

The economy has been in a period of modest economic growth for about 2 years. Inflation, as measured by the CPI, was at a 4.9% annual rate over the last year. Ninety-day T-bill rates are currently 6%, while the yield to maturity on 20-year government bonds is 7.5%. During the last quarter, unemployment was at 4.8% and real economic growth was about 0.75%. Most forecasts call for little change in these conditions over the short and long term.

VI. PLANNER'S ASSUMPTIONS

Investment	Pretax Expected Return	Beta with S & P 500
Biotech mutual fund	20.0%	1.75
Leveraged commercial real estate	8.5%	1.40
Small cap stock mutual fund	10.0%	1.10
S&P 500	9.0%	1.00
Taxable zero-coupon bonds	9.0%	1.00
Zero-coupon municipal bond fund	7.5%	0.80
Treasury bonds (30-year)	7.5%	0.70
Long-term municipal bond fund	5.0%	0.70
International stocks	11.0%	0.40
Treasury notes (7-year)	7.0%	0.25
Treasury bills	6.0%	0.10
Precious metals	5.0%	(0.25)
R&D partnership	14.0%	N/A
Certificate of deposit	7.0%	N/A

You are doubtful anyone can "beat the market" through asset selection or timing.

1. Which one of the following statements most accurately describes the risk exposure of the Clarkes' portfolio?
 - A. The portfolio has excessive market risk.
 - B. The portfolio should be unaffected by changes in interest rates.
 - C. The portfolio contains an excessive level of business risk.
 - D. The portfolio contains excessive liquidity risk.
 - E. The portfolio contains excessive purchasing power risk.

2. With respect to the Clarkes' risk tolerance, which of the following statements is true?
 - A. Because of their lack of investment experience, equity investments are inappropriate.
 - B. Because of their stated risk preferences, investment in an R&D partnership is inappropriate.
 - C. Regardless of their specific goals, a portfolio with a weighted average beta close to 1 is appropriate.
 - D. Because of their stated risk preferences, a biotech mutual fund is appropriate.
 - E. Regardless of their risk tolerance, leveraged commercial real estate is appropriate.

3. To diversify the Clarkes' investment portfolio, which of the following investments would be most appropriate?
 1. S&P 500 Index Fund.
 2. Zero-coupon municipal bond fund.
 3. International stocks.
 4. Leveraged commercial real estate.
 - A. 1 and 3 only.
 - B. 1 and 4 only.
 - C. 2 and 3 only.
 - D. 2 and 4 only.

4. What would you advise James and Pat regarding James' parents' estate planning documents?
- A. Transfer the parents' assets to a pooled income fund.
 - B. Establish a charitable remainder annuity trust.
 - C. Transfer the parents' assets to a revocable trust.
 - D. Set up durable power of attorney for healthcare.
5. With regard to funds earmarked for the education goal, which type of investment makes the most sense and why?
- A. A series of taxable zero-coupon bonds owned by Kim because they can provide appropriate funds at the correct times and are taxed at the child's rate.
 - B. A variable life insurance policy owned by Kim because it saves taxes and it contains life insurance.
 - C. A certificate of deposit owned by James and Pat because CDs are very safe.
 - D. A small cap stock mutual fund owned by Kim because it provides the best return at a modest level of risk consistent with the time horizon.
 - E. Treasury notes with a 7-year maturity owned by James and Pat because the 7-year maturity Treasury notes have little interest rate risk.
6. Which type(s) of investment(s), to be held in their IRA accounts, would be consistent with their retirement goal and why?
- 1. A small cap mutual fund, because it provides growth with reasonable risk.
 - 2. A municipal bond fund, because it provides tax advantages and relative safety.
 - 3. An international stock fund, because it provides an element of diversification and growth.
 - 4. Precious metals, because they provide diversification and tax advantages.
- A. 1 only.
 - B. 1 and 3 only.
 - C. 2 and 4 only.
 - D. 1, 2 and 3 only.
 - E. 1, 3 and 4 only.

7. With regard to the funds earmarked for the Clarkes' "sabbatical" goal, which type of investment is most appropriate?
- A. S&P 500 index fund.
 - B. Zero-coupon municipal bond.
 - C. 7-year Treasury notes.
 - D. Biotech mutual fund.
 - E. Small cap stock mutual fund.

8. Assume the following additional facts:

The Clarkes have purchased a homeowner's policy (HO3-comprehensive) covering 100% of the replacement cost of their residence. This policy has a \$500 deductible. Also, they have purchased a disability income policy with a 30-day elimination period and an any-occupation definition of disability.

What actions should the Clarkes consider in order to improve the quality of the insurance program described above?

- 1. Purchase an endorsement to the homeowner's policy providing all risk/replacement cost (all perils) coverage for personal property.
 - 2. Decrease the homeowner's policy deductible to \$250.
 - 3. Reduce the homeowner's policy coverage to 75%.
 - 4. Purchase an own-occupation disability policy.
- A. 1 and 4 only.
 - B. 2 and 4 only.
 - C. 1, 2 and 4 only.
 - D. 1, 3 and 4 only.

9. One commonly used method of calculating the total retirement fund necessary on the first day of retirement is to use the present value of an annuity due. The Clarkes anticipate that their annual retirement income will need to increase each year at the rate of inflation. Based on the following assumptions, calculate the total amount needed to be in place when James and Pat retire. (Round to the nearest \$1,000.)

First-year annual income	\$90,000
Social Security annual income, assumed to increase at the rate of inflation	\$45,000
Annual after-tax rate of return on invested assets	7%
Joint life expectancy during retirement	25 years

- A. \$878,000.
 - B. \$887,000.
 - C. \$896,000.
 - D. \$1,773,000.
 - E. \$1,792,000.
10. Assume that James has predeceased Pat by 1 year. If Pat died yesterday, which combination of the following financial assets would be included in her probate estate?
- 1. James' life insurance policy.
 - 2. Pat's SPDA.
 - 3. XYZ stock.
 - 4. Home.
 - 5. Pat's life insurance policy.
- A. 4 only.
 - B. 1 and 5 only.
 - C. 3 and 4 only.
 - D. 1, 2 and 5 only.
 - E. 2, 3, 4 and 5 only.
11. Which of the following tax forms or schedules will XYZ Corporation provide to James and Pat on an annual basis?
- A. Schedule E.
 - B. Form 1099-S.
 - C. Form 1099.
 - D. Form W-2.
 - E. Schedule K-1.

Directions: This part consists of one case problem followed by a set of questions or incomplete statements. Each question or incomplete statement is followed by four suggested answers or completions. Select one best answer or completion for each question. Each question should be answered independently.

SUSAN DAVIS

Case Scenario and Multiple Choice

Released as of August 2004

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Susan Davis, a new client, has requested that a CFP[®] certificant assist her in evaluating her personal and business financial situation. Susan is the founder and sole stockholder of Exclusively Unique Gifts, Inc., a C corporation. Her children work part-time in the shop as permitted by state law. Susan is a recent divorcee and realizes that her finances may need to be revised now that her divorce has been settled. Her former husband, Richard, is the father of her two children and the major stockholder of Davis Manufacturing, Inc. Davis Manufacturing has been in business 15 years, is financially stable, and currently has a book value in excess of \$1,400,000.

I. PERSONAL INFORMATION

<u>Name</u>	<u>Age</u>	<u>Health</u>	<u>Occupation</u>
Susan Davis	39	Good	President - Exclusively Unique Gifts, Inc.
Mary Beth Davis	14	Excellent	Student
Nathaniel Davis	9	Excellent	Student
Richard Davis	42	Excellent	President - Davis Manufacturing, Inc.

Wills were last completed 5 years ago. They live in a common-law state.

II. ECONOMIC ENVIRONMENT

Currently, the economy is in a recovery phase with decreasing unemployment and increasing economic growth. Inflation and interest rates are currently low. It currently costs \$12,000 per year to attend college, and this cost is expected to increase at 5% each year. Susan prefers to save monthly and can earn 9% (after taxes) on the college account.

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III. CLIENT OBJECTIVES

1. Ensure financial security for herself and her children by:
 - Planning for her portion of the 4-year funding for the children's college education.
 - Retiring at age 55.
 - Using direct deposit from her paycheck at the end of each month to fund education and retirement.
2. Develop a plan that will provide for the care of her children without passing any of her assets to Richard.
3. Review all insurance coverages and make adjustments necessary to provide proper risk management.
4. Review and develop proper strategies for her business to provide both current and retirement income for herself. Susan tends to be conservative and prefers to assume only moderate risks. Safety of principal and risk diversification are primary concerns now that she is divorced. The reduction of taxes is of secondary importance.
5. Retain and reward current full-time employees of the business while maintaining cash flow flexibility.

IV. FINANCIAL STATEMENTS

SUSAN DAVIS

Statement of Financial Position

12/31 Prior Year

ASSETS		LIABILITIES AND NET WORTH	
Invested Assets		Credit cards ¹	\$ 6,000
Cash/Cash equivalents	\$ 2,000	Mortgage ²	60,000
Business interest	<u>286,000</u>	Auto loan	<u>3,000</u>
Total	<u>\$288,000</u>	Total Liabilities	<u>\$ 69,000</u>
Use Assets			
Residence ^{3,4}	\$330,000		
Personal property	50,000		
Auto	<u>15,000</u>		
Total	<u>\$395,000</u>	Net Worth	<u>\$638,000</u>
Retirement Plan Assets			
IRA (growth mutual funds)	<u>\$ 24,000</u>		
Total Assets	<u>\$707,000</u>	Total Liabilities and Net Worth	<u>\$707,000</u>

¹ Variable rate, currently 16.9% APR.

² Fixed rate of 9.5% in the name of Richard and Susan Davis; 4 years, 7 months are remaining on the loan.

³ Originally purchased 15 years, 5 months ago for \$110,000. Excellent condition with no major repairs foreseen in the near future.

⁴ Lot valued at \$50,000; dwelling valued at replacement cost, which is approximately the same as fair market value.

SUSAN DAVIS

Projected Monthly Cash Flow Statement

Current Year

Cash Inflows

Gross salary	\$4,300
Child support	<u>1,400</u>
Total	<u>\$5,700</u>

Cash Outflows

Savings and investments	\$ 0
Mortgage (P & I)	1,350
Property taxes	300
Homeowners insurance	100
Insurance (other insurance)	50
Maintenance and repairs on the home	100
Food and supplies	500
Utilities	350
Transportation (gas, oil, repairs)	200
Car payment	150
Clothing	200
Travel and entertainment	250
Credit card payments	250
State and local income tax (flat 4%)	160
Federal income tax ¹	800
FICA	<u>300</u>
Total	<u>\$5,060</u>
Surplus/(Deficit) Cash Flow	<u>\$ 640</u>

¹ Susan is in the 25% federal marginal tax bracket.

V. INSURANCE INFORMATION

SUSAN DAVIS

Insurance Information

Homeowners Policy

Type	HO-3 (open-peril)
Amount on dwelling	\$270,000
Personal property coverage	\$145,000
Personal liability	\$100,000

Automobile Policy

Type	Personal auto policy
Bodily injury/property damage	\$300,000 combined single limit
Collision	\$300 deductible
Comprehensive	\$250 deductible
Uninsured motorist	\$300,000 single limit

Employee Benefits Provided by Exclusively Unique Gifts, Inc.

Life insurance	Employee - two times earnings Dependents - \$2,000
Medical	\$300 deductible, 80/20 coinsurance Out-of-pocket maximum \$5,000 Lifetime limit \$500,000 Coverage on employees only
Disability	Company pays 50% of salary for 6 months Waiting period - 5 working days

EXCLUSIVELY UNIQUE GIFTS, INC.¹

Year-End Balance Sheet

12/31 Prior Year

Assets		Liabilities	
Cash/Cash equivalents	\$ 33,000	Accounts payable	\$128,000
Accounts receivable	110,000	Loan ²	<u>150,000</u>
Inventory	250,000		
Furniture and fixtures, net of depreciation	127,000	Total Liabilities	<u>\$278,000</u>
Prepaid expenses & other	<u>44,000</u>		
Total Assets	<u>\$564,000</u>		
		Stockholder Equity³	<u>\$286,000</u>
		Total Liabilities and Shareholder Equity	<u>\$564,000</u>

¹ All assets are listed at fair market value (FMV)

² \$4,000 a month payable to Richard Davis at 10% interest, which is the going market rate on similar loans.

³ The company has experienced increasing profits over the last 7 years.

EXCLUSIVELY UNIQUE GIFTS, INC.
Projected Monthly Income and Expenses

	Current Year
Total Sales¹	<u>\$125,000</u>
Expenses	
Cost of goods sold	\$ 75,000
Advertising and promotion	1,500
Depreciation	2,400
Interest on loan	1,250
Insurance - business	250
Payroll taxes and benefits	3,400
Rent	4,700
Salaries ²	16,300
Supplies and miscellaneous	3,500
Utilities	1,200
Income taxes, fed and state (estimated)	<u>5,600</u>
Total Expenses	\$115,100
Net Income	<u>\$ 9,900</u>

¹ Sales vary directly with the local economy and are projected to increase/decrease at twice the rate of change in the local economy. This year's sales and economic growth was estimated at 8%.

² Employee data:

<u>Name</u>	<u>Monthly Salary</u>	<u>Date of Hire</u>	<u>Age</u>	<u>Status</u>
Susan Davis	\$4,300	1/01/94	39	100% stockholder/full-time employee
Kate Jackson*	\$3,000	6/01/95	28	Full-time employee
Cindi Smith	\$2,500	2/15/97	47	Full-time employee
Sandy Wise	\$2,500	8/15/97	34	Full-time employee
Tom Mitcham	\$2,200	3/01/99	36	Full-time employee
Jack Young	\$500	7/15/01	20	Part-time employee less than 1,000 hours
Steve Jones	\$500	7/15/02	17	Part-time employee less than 1,000 hours
Sue Jackson	\$500	8/01/02	19	Part-time employee less than 1,000 hours
Amy DeLong	\$300	8/15/02	22	Part-time employee less than 1,000 hours
Mary Beth Davis	\$200	1/01/03	14	Part-time employee less than 1,000 hours
Nathaniel Davis	\$200	1/01/03	9	Part-time employee less than 1,000 hours

* Kate has expressed an interest in investing up to \$100,000 in the business at this time and would like to acquire 100% ownership should Susan ever decide to sell. If Kate did acquire partial ownership, she would become the corporate secretary and vice-president.

RICHARD AND SUSAN DAVIS

**Summary of Divorce Agreement, incorporated into the divorce decree
Prior Year**

Custody	Joint, with the children residing primarily with their mother. Both children will reside with their father in the event of their mother's death.
Tax Returns	Susan will claim the children as dependents.
Child Support	Richard is to pay \$700 per month per child until each child reaches age 18.
College Support	College costs are to be divided evenly in thirds, with 1/3 being paid by Richard, 1/3 by Susan, and 1/3 by the student.
Insurance	Richard is to provide adequate health insurance on the children until after their graduation from college and also \$10,000 of life insurance on each child. In addition, Richard must carry \$175,000 life insurance on himself with the children named as the beneficiaries until the younger child reaches age 23.
Assets	Susan is granted 100% equity in both the residence and Exclusively Unique Gifts, Inc., while Richard receives all of the invested assets and also 100% equity in Davis Manufacturing, Inc. and his retirement plan. Susan is to refinance the mortgage on the personal residence to remove Richard's name as a debtor. Richard will continue to hold the business loan for Exclusively Unique Gifts, Inc., provided that no additional loans are acquired.
Alimony	Five-year payment schedule to Susan from Richard: Year 1 \$10,000 Year 2 \$30,000 Year 3 \$15,000 Year 4 \$15,000 Year 5 \$15,000

1. Which of the following is the most appropriate strategy to improve Susan's financial security?
 - A. Establish and borrow on a home equity line of credit.
 - B. Sell her current residence, buy a less expensive home, and invest the net proceeds in municipal bonds.
 - C. Increase her salary for personal debt reduction and investments.
 - D. Sell 50% of the business to Kate for \$100,000 in cash.

2. Which of the following statements regarding Susan's insurance coverages is correct?
 1. The disability insurance on Susan is adequate.
 2. The property section of her homeowners insurance is adequate at the present levels of coverage.
 3. Susan's personal liability coverage is adequate.
 4. Susan needs additional life insurance.
 5. The medical insurance is inadequate since Susan does not have dependent coverage on her policy.
 - A. 2 and 4 only.
 - B. 1, 2 and 3 only.
 - C. 2, 3 and 4 only.
 - D. 3, 4 and 5 only.

3. Susan wants to start investing \$600 monthly to achieve her stated objectives. Which of the following monthly investments is most appropriate for Susan at this time?
 - A. \$200 in a money market account, \$200 in a Roth IRA account funded with short-term Treasury bills, and \$200 in a Roth IRA international growth fund.
 - B. \$500 in a growth mutual fund and \$100 in a municipal bond fund.
 - C. \$100 in a money market account and \$500 in a long-term U.S. Government bond fund.
 - D. \$100 in a money market account, \$150 in a Roth IRA global balanced mutual fund, and \$350 in a short-term bond fund.

4. Which of the following statements about investment risks is true?
 - A. Susan's investment liquidity is appropriate for her goals.
 - B. Susan's current investments are subject to unsystematic risk.
 - C. Richard's risk exposure would benefit from having the business loan paid off early if interest rates decrease.
 - D. Susan will reduce her interest rate exposure if she refinances her home with a 30-year, 9.5% fixed-rate mortgage.

5. Susan has asked the CFP[®] certificant to recommend an employee benefit plan to fulfill her objectives. Which of the following types of plans would be most appropriate?
- A. SIMPLE IRA.
 - B. Simplified employee pension (SEP).
 - C. Profit sharing.
 - D. Target benefit.
6. Susan has decided to improve the benefits provided to all full-time employees of Exclusively Unique Gifts, Inc. Due to financial constraints, she can implement only three of the following options over the next 3 years. Which three of the following options should the CFP[®] certificant recommend as the most beneficial?
- 1. Increasing the life insurance to a maximum of five times earnings.
 - 2. Decreasing the medical out-of-pocket maximum to \$2,500.
 - 3. Increasing the medical insurance lifetime limit to \$1,000,000.
 - 4. Increasing the disability benefit to 70% of salary for 6 months.
 - 5. Providing long-term disability coverage equal to 50% of earnings.
- A. 1, 2 and 5.
 - B. 2, 3 and 4.
 - C. 2, 3 and 5.
 - D. 3, 4 and 5.
7. If Susan decides to move into a less expensive home and has approximately \$200,000 to invest from the sale proceeds of her home, which of the following portfolios would be most appropriate for her, given her goals and current investments?
- A. \$50,000 certificate of deposit, \$50,000 money market account, and \$100,000 Treasury bill.
 - B. \$50,000 money market account, \$50,000 Standard & Poor's 500 (S&P 500) index fund, and \$100,000 balanced mutual fund.
 - C. \$120,000 aggressive-growth stock fund and \$80,000 U.S. Government long-term bond fund.
 - D. \$150,000 growth mutual fund and \$50,000 Standard & Poor's 500 (S&P 500) index mutual fund.

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8. Which of the following actions would be most appropriate for Susan to take now to plan for her estate liquidity?
- A. Purchase a life insurance policy.
 - B. Establish an unfunded IRC Section 303 corporate stock redemption plan.
 - C. Arrange for a 10-year installment sale of the business to Kate.
 - D. Use a grantor retained income trust (GRIT) to remove assets from the taxable estate.
9. Susan's company adopts a profit sharing plan for the company with the following characteristics: the plan requires 1 year of service and attainment of age 21 and, in practice, is not top heavy. True statements about the plan include which of the following?
- 1. Both Susan and Kate would be classified as highly compensated employees.
 - 2. The plan would meet the minimum eligibility requirements.
 - 3. This year, all part-time employees would be excluded.
 - 4. A 7-year, graded vesting schedule would best fulfill Susan's objectives.
- A. 4 only
 - B. 2 and 3 only
 - C. 1, 2 and 4 only
 - D. 2, 3 and 4 only
10. True statements regarding Susan and Richard's 5-year alimony payment schedule include which of the following?
- 1. To qualify as alimony, payments must be made as part of a written divorce agreement, signed by Susan and Richard.
 - 2. To qualify as alimony for income tax purposes, payments must be in cash, the couple must live in separate households, and payments must cease upon Susan's death.
 - 3. The alimony payment schedule constitutes excess alimony.
- A. 1 only.
 - B. 3 only.
 - C. 1 and 2 only.
 - D. 2 and 3 only.

11. Susan wants to establish a trust to provide for her children in case of her death. Which of the following should the CFP[®] certificant recommend as the most appropriate trust given Susan's overall situation and objectives?
- A. An irrevocable life insurance trust granting Crummey powers to the children.
 - B. A grantor retained income trust (GRIT) with Mary Beth and Nathaniel named as beneficiaries.
 - C. A revocable living trust naming a third party as successor trustee, with Susan as the primary beneficiary while living and the children listed as contingent beneficiaries.
 - D. A revocable living trust naming the children as beneficiaries and Richard as the trustee.
12. If Susan sells her current residence for \$367,000 and she purchases a new residence for \$180,000 in the same calendar year, the amount of proceeds subject to capital gains tax is:
- A. \$0.
 - B. \$7,000.
 - C. \$187,000.
 - D. \$257,000.

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