UNIT 1 Personal financial planning process

Even though individual needs differ, the same steps in the personal financial planning process applies to all i.e.

- Analysing your current/present financial situation
- Setting future financial objectives
- Preparing a budget/plan for the achievement of such objectives

Steps in Financial planning process

Step 1: Gathering information

Information must be gathered in order to determine your current financial position. Typical information that will be gathered during this step will include details of family, matrimonial status, health, income statement and balance sheet, property details, etc. Beside this information listed before, a person's liquidity preferences, attitude towards risk, political views and views about the country's economic prospects must also be explored.

Step 2: Identification of objectives and needs

Before a person can decide what they want to achieve, they must consider what is important to them. The formulation of objectives is a statement by a person of their prospects for their financial future. Planning therefore centres on objectives and how to achieve them. Objectives should be linked to specific time periods, the reason being that different objectives can be achieved through employing different methods:

- Immediate or short term objectives: Short term objectives are aspired to in the early stage of the life cycle and should be very specific. Funds for such objectives are generated from current income and or savings.
- Medium term objectives: These objectives are usually present during the working years and stretch over the largest part of the life cycle. The achievement of these objectives is a prerequisite for the achievement of objectives over the long term. Spending patterns could be adjusted to provide for needs over the medium term.
- Long term objectives: These objectives provide the greatest flexibility during planning. Retirement planning is usually the most important planning component of the last stage of the life cycle.

It is advisable to list objective in order of importance in order to make a distinction between urgent and important. Higher priority must be given to important needs because of the negative financial implications of not being able to meet such objectives.

Step 3: Identification of constraints

We must also be aware of the fact that there will always be external influences or constraints that have to be taken into account in personal financial planning. These are factors that may restrict or even be entirely in conflict with the objectives and needs that have been identified.

Step 4: Comparison of current situation with identified needs

Information regarding a person's current situation shows what planning has been done. A comparison between the current situation and the identified future objectives indicates which needs have already been provided for and which not i.e. it identifies the "gaps".

Step 5: Analysis of investment opportunities

Before any decisions are made to meet certain needs, an analysis of existing investment opportunities is necessary. It is essential to examine the purpose of each alternative as well as the advantages and disadvantages involved in each.

Step 6: Development of the plan

During this phase, a person must decide which investment will provide for which needs. Needs are expressed in terms of the risk involved in the occurrence of certain events. Insurance options to counteract these events or provide for such risks are listed opposite each risk. In order to develop a plan, a person must choose e.g. an insurance company and decide on the specific amount required for life cover and the monthly premium they can afford.

Step 7: Balancing the budget

It is of cardinal importance that the budget should balance i.e. the income should be equal to expenditure plus savings. A surplus or a shortfall indicates that the plan needs further attention.

Step 8: Implementation of the plan

During this phase e.g. the specific insurance policy can be taken out. It is important to note that no plan can be implemented in the absence of sufficient funds.

Step 9: Review the plan

As with any other plan, personal financial plan cannot be expected to remain the perfect plan and as such periodic reviews are necessary to ensure that the plan keeps up with changing times and circumstances. It is recommended that the plan be revised at least once a year.

UNIT 2 Measuring and assessing of personal financial performance

Budget

In its simplest form a budget can be defined as the quantification of a plan in monetary terms. At the same time, it sets certain standards that have to be met in order to achieve certain objectives. In other words, it is a mechanism used to exercise financial control. This plan and control mechanism can benefit any household.

Purpose of a budget

As stated above, a budget is a financial plan for the household over a given period. Budgeting is the most important step in the personal financial planning process and thus your first step towards financial success.

Firstly your income and expenditure must be estimated over the given period. This forecasting is based on the expectations of the compiler regarding his/her future financial situation. The purpose of a budget, as stated earlier, is to enable individuals to achieve their objectives. A budget forces you to assess your current and future financial situations and to keep track of your income and expenses.

Principles involved in drawing up a budget

The following principles serve as a guide in the development of a budget which will increase the possibility that the predetermined objectives will be achieved.

i. ***Involvement***

All the people for whom the budget is going to serve as a plan and a control mechanism over a specified period should be involved in its preparation. The household budget should have the support of all the members of the family. This will inspire confidence in the budget and everybody will have a better understanding of the nature and purpose of the planning process.

ii. ***Efficient organization***

The authority within a family to incur certain expenses must be clearly stated. A framework should be created so that objectives can be achieved in a co-ordinated way. Each member of the family should know what is expected of him or her in the achievement of those objectives.

iii. ***Proper Administrative system***

An administration system that is directly linked to specific responsibilities concerning the budgeting process and its implementation is essential. A particular person should be responsible for administration of the budget. By administration it is meant that all documents reflecting income and expenditure should be filed in an orderly manner.

iv. ***Good communication***

Communication is a process of informing or reporting in order to achieve mutual understanding between two or more people. To achieve household's objectives, such objectives must be communicated to all stakeholders. Members of the family should know why their spending is restricted. To a large extent, effective decision making depends on effective communication. It should not be simply assumed that the family knows why certain discrepancies have occurred in the budget or why certain items can no longer be purchased.

v. ***A Realistic Budget***

A prerequisite for a budget is realism. To a large extent, the care with which budget figures are calculated determines the budget's future success. For a budget to be realistic, each variable that may occur should be anticipated in respect of:

a) Their specific time horizon

b) An acceptable internal and external environment that will reign during that period

The budget should also be flexible. Changing circumstances could result in certain expenses changing their patterns completely e.g. children may become sicker in winter time which can see medical costs increasing significantly over this period. In such case, the family's objectives could also change for that period.

Budgeted figures are based on pre-estimates or forecasts which means that certain assumptions are made about the future, and certain factors which could lead to alteration of the budget are taken into account. The forecast process serves as a basis for the budget and is therefore a pre-requisite for its preparation. No budget can be reliable if forecasts are not made. There is an important difference between forecasting and budgeting. Forecasting indicates whether or not a future plan is

feasible. Budgeting on the other hand indicates how and when the stated objectives can be achieved.

Planning and Time

Besides not having sufficient time to do everything we are also often restricted by our financial resources i.e. we are restricted by what we can afford and when we can afford it. This is why we need to plan and budget. We need to make sure that we achieve our objectives within the limited resources at our disposal. Two aspects of time become important during this process namely planning horizons and timetables.

i. Planning horizons

Planning horizons refer to those periods in the future for which you must budget. For the family, this horizon is usually one year.

ii. Timetables

A timetable indicates the specified time within the planning horizon at which a certain decision will be implemented.

There is a planning horizon and a timetable for every household decision. Periodic planning could for instance, pertain to day on which e.g. the telephone account has to be paid. Project planning on the other hand, involves for projects undertaken from time to time for e.g. an overseas trip. Each project plan has its own unique timetable and the nature and scope will determine the amount for which to budget

Flexible Application

A budget should never be applied in a rigid manner i.e. it should not make rational decisions impossible. If an unforeseen event occurs it must be included in the budget. As such, as budget must be flexible enough to allow for such changes which will lead to a variance budget that will reflect the change in circumstances.

The Appropriateness of a Personal Budget

The question that always arises is whether or not budgets are only useful to a business and the answer is always NO. The cost involved in having a budget is low and it is the best and simplest way to achieve personal financial objectives.

UNIT 4 Credit planning

The importance of credit planning

On a practical level, if you never make use of credit it will mean that you will need to save up enough money to be able to enter into a specific transaction and since the price of goods rises continuously, whatever purchases you have /had in mind might have to be deferred indefinitely.

Good reasons for incurring debt

- A good bargain may be available today which would most likely cost double the price at a later stage
- The cost of the article may be rising so rapidly that it would be impossible to save for it
- To finance an income-generating asset

Bad reasons for incurring debt

- Buying unnecessary items such as gifts
- Credit sometimes encourages people to buy beyond their means
- To create the impression of being rich

Applying for credit

The creditor will assess an application based on some or all of the following aspects:

- The applicant's gross income
- Career
- References
- Ownership of fixed property and other investments
- The age of the applicant
- The applicant's credit record
- Employment status

These aspects of the credit application are called credit standards. Once the applicant has been accessed on the basis of these standards, the creditor determines how much credit can be allowed. Credit institutions are concerned about the applicant's stability as far as credit standards are concerned and as such people with unstable lifestyles e.g. frequent changes in address and income, will experience difficulty in obtaining credit or their credit facilities will often be lower than normally.

The seven C's of Credit

- Character of the applicant
- Collateral offered as security
- Capacity to honour commitments
- Capital
- Conditions in the market and the country
- Credit history of the applicant
- Common sense

Handling a debt crisis

Many people find it difficult, at one time or the other, to meet their monthly expenses. The two most common reasons for this can be identified as a) the absence of a budget which leads some people to live beyond their means, and b) an unforeseen emergency e.g. a vehicle breakdown, operation with high medical costs, etc. Careful financial planning, with provision for such unforeseen events will assist you to prevent or limit a shortage of funds.

A debt crisis, on the other hand, is a completely different ball game. It refers to a long term problem which requires a huge amount of self-discipline and the meticulous implementation of action plans. A debt crisis occurs when a person has exhausted his or her creditworthiness and is no longer able to honour his or her financial obligations. Although some situations such as unemployment would most like result in liquidation

People often make use of their insurance instruments to escape from a debt crisis. Let's now consider the following:

Surrendering a policy

When an investor surrenders a policy it means that they decide to stop paying the premiums on the policy and requests the insurance company to repay the invested amounts. Unfortunately such a move almost always results in the investor losing a substantial amount of money.

The main reasons for surrendering a policy are the following:

- The investor is facing a debt crisis
- The loss of employment
- A non-investment such as a car may be seen as a suitable replacement for an insurance policy
- The monthly premium may have become too high
- The investor may be unable to afford the monthly premium because the policy was acquired injudiciously under sales pressure from the insurance broker

An investor must think twice before considering this action in response to a debt crisis although the reasons for surrender may be valid at the time. As an alternative to surrendering a policy, investors should consider the following instead:

- Decrease or remove the escalation clause
- Stop monthly payment and make the policy paid up
- Secure the surrender value of the policy from the insurance company and sell the policy in the second hand market
- Take a loan against the second hand market policy

Borrowing against a policy

Many people opt to borrow against their insurance policies in time of debt. This is however very costly to the policyholder and even more costly if a life insurance policy is involved. As premiums for life cover must be paid even when the policy is paid up. When this occurs it has an eroding effect on the amount of capital invested in the paid-up policy. It may be more beneficial to obtain fund by using the policy as collateral.

Ceding a Policy

To cede a policy means that the policy holder passes the rights to the policy proceeds to a natural or legal person e.g. a bank. The cession may be temporary in the case of a policyholder ceding a policy to a bank in order to obtain a loan. In this case, the bank will cancel the cession and hand the policy back to the policyholder as soon as the loan is repaid.

It is also possible to cede a policy permanently as:

- A gift to a child, spouse, friend, etc.
- Part of an antenuptial contract where one spouse cedes a policy for whatever reason to the other spouse.
- Part of a divorce settlement.

Apply debt self-management

Debt, as with other things in life, must be managed. It is of critical importance that we manage ourselves when it comes to incurring debt as well as the reasons for it which is often emotional and or psychological.

- Debt self-management = Lifestyle management +Lifestyle discipline + Financial discipline

A person can change his or her lifestyle in order to escape the "debt jail" but it will require a sustained process over a long term in order to prevent yourself from falling victim to over indebtedness.

Debt and legal Remedies

We have looked at some aspects of debt self-management in order to "escape" the debt jail. However, if you find it impossible to escape this debt crisis there are still a few things you can do and we will briefly look at some of the remedies available to you:

Offer of settlement

In this area we can differentiate between conditional and unconditional settlement.

You may offer your creditors any amount of money, either as a lump sum or in instalments, as a settlement offer against your debt. This however also implies that the creditor can use such a settlement offer against you as an act of insolvency as this means that you admit that you are legally bankrupt. The settlement offer must be in writing in the form of a letter and the creditor must respond in writing. This is regarded as an Unconditional Offer of Settlement

A conditional settlement offer means that the settlement offer is made for the full and final settlement of all claims against you. The creditor will for example be advised that in the event that the offer is accepted it will be assumed that the debt has been cancelled and that your conditions have been accepted.

Selecting certain creditors above the other

You know the joke about the retail store that called the customer to enquire why his account wasn't paid for a few months. The customers replied that their name wasn't drawn when he choose who to pay by drawing name of creditor from a hat. Now this is basically just doing that. As another act of insolvency you may commit is to pick certain creditors above others and to pay them first. The other creditors then have to wait for their "turn".

Voluntary Distribution

This is defined as a settlement agreement with your creditors. This means that you choose a trustworthy person or institution to undertake the distribution among creditors on your behalf. You will a monthly amount and that person will distribute it, usually on a prorate basis, according to the available amount.

Friendly or voluntary sequestration

A friendly sequestration is a situation where sequestration is initiated by a "friendly" creditor. The creditor will be asked / requested by the debtor to lodge an application for sequestration in their name. When you find yourself in a position where you just can no longer service your debts you have two options. You can either allow your creditors to have you declare insolvent or you can have yourself declared insolvent - an act referred to as voluntary sequestration.

UNIT 5 Career Planning

The Importance of Career Planning

Career planning can be described as the process by which individuals determine short- and long term career goals. (Swart, N. 2003:58) These goals are determined through a process of obtaining self-knowledge and information about the ideal career role, the work environment and the life earnings that can be achieved.

Career Planning, Is an important aspect of personal financial planning, remembering that the ultimate goal is to achieve financial independence before and after retirement. Despite the different interpretations of financial independence, the role of career planning in this process cannot be over-emphasised.

Choosing a Career

It is said that a career is a way of life.

Choosing a career is by no means an easy task and involves a process that can extend over a person's entire life. Donald Super's theory on career choice is as follows: "A person expressed his/her idea of the kind of person he/she is in the kind of career he chooses. Wok then becomes a chosen life style which matches someone's abilities, interests and values."

The changing nature of jobs and organisations necessitates a perspective on career choice and planning that emphasises the need to experience personal meaning in work and to find a purpose in life. With this in mind it then also said that success is seen as embracing not only economic gain, but also spiritual and emotional development.

From the above, it becomes clear that your choice of career should "fit" the person that you are or hope to be someday e.g. if you not an organised individual with a love and passion for working with figures choosing a career as an accountant may be the worse decision you will ever make. Despite the fact that you might excel in your job and find it financially very rewarding, you will not gain spiritual and emotional satisfaction from it and therefore might be very unhappy in your job 5 to 10 years from now.

Your choice of career should "fit" you as a person. Block et al. (1988:13) suggests the following questions that you should ask yourself:

- Do I like working with people or do I prefer working by myself?
- Do I enjoy taking risks, or do I prefer stability and predictability in my work?
- Do I initiate my own work, or do I prefer well-structured work?
- Am I primarily motivated by money, or do other factors play a bigger role?
- Am I prepared to travel, or do I prefer working in one place?

- Do I prefer work which requires a degree as a prerequisite or not?

The influence of studies and continued education

The need for education cannot be overemphasised. Whether job opportunities are scarce or plentiful, candidates with the best marketable skills, knowledge and attitude will always be best equipped to achieve their career objectives.

Although education is very important it does not necessarily guarantee success as other factors also plays a role e.g. attitude, etc.

The cost of studying is one of the other important considerations as it represents a significant monetary investment. Before making a decision, the prospective student should consider the costs involved in a particular study direction and weigh it up against potential future earnings. When considering the cost of studying the following elements should also be considered:

- The distance between your home and educational institute (Transport costs)
- The number of classes to be attended which involves travelling
- The availability of transport
- The closeness to a library and or lectures
- The availability of financial resources from your current employer
- The availability of state subsidies
- The specific course to be followed
- The number of subjects to be taken at a given time, and
- The number of persons in the same household intending to study

Deciding on whether you should start your own business rather than to work for someone else

Choosing to start your own business is not a decision that should be taken lightly. For a school leaver or a person who has recently completed his/her studies, the decision to start your own business does not hold too great a risk. It is often said that this is the best time to start a business as the person does not have too many valuable assets that can be lost during the process in the case that the business is not successful. For a middle-aged person or someone who is about to retire, the risk may be very high as the person stands to lose everything he/she has collected over a number of years. But this is the two most extremes. People should decide for themselves whether they prefer to work very hard for themselves, are prepared to take big risks and pay for all the mistakes made in the business.

Unit 6: Income Tax Planning

Personal Income Tax

What is it?

Income tax is the normal tax which is paid on your taxable income.
Examples of amounts an individual may receive, and from which the taxable income is determined, include –

- Remuneration (income from employment), such as, salaries, wages, bonuses, overtime pay, taxable (fringe) benefits, allowances and certain lump sum benefits
- Profits or losses from a business or trade

- Income or profits arising from an individual being a beneficiary of a trust
- Director's fees
- Investment income, such as interest and foreign dividends
- Rental income or losses
- Income from royalties
- Annuities
- Pension income
- Certain capital gains

Who is it for?

You are liable to pay income tax if you earn more than R70 700 in the 2014 year of assessment, and are younger than 65 years of age. If you are 65 years of age or older, the tax threshold (i.e. the amount above which income tax becomes payable) increases to R110 200. For taxpayers aged 75 years and older, this threshold is R123 350.

Where taxpayers receive remuneration which is less than R250 000, they may elect not to submit an income tax return, provided the following criteria are met:

- Their remuneration is from a single employer;
- Their remuneration is for a full year of assessment (1 March – 28/29 February);
- No allowance was paid, from which employees' tax was not fully deducted;
- No further deductions need to be claimed or income declared.

The rates of tax chargeable on taxable income are determined annually by Parliament, and are generally referred to as "marginal rates of tax" or "statutory rates". The rate of tax levied on an individual is set on a sliding scale which results in the tax increasing as taxable income increases. Every year, the Minister of Finance announces the rates to be levied by publishing the applicable tax tables during the annual budget speech.

What steps must I take to ensure compliance?

Step one: You must register for income tax

If you earn a taxable income which is above the tax threshold (see above), you must register as a taxpayer with SARS.
To register for income tax, you must complete an IT77 registration form which can be obtained from the SARS website, namely www.sars.gov.za. The form can also be requested from any SARS branch or the SARS Contact Centre. Once it has been completed, it can be taken to any SARS branch for processing or the form can be posted to SARS. To find your nearest branch visit our branch locator.

Top tip: You must register for income tax at SARS within 60 days of becoming liable for tax.

Step two: You must submit a return

If you are registered for income tax, you will be required to submit an annual income tax return to SARS. See the 2014/2015 Tax Tables. The 2014 year of assessment (commonly referred to as a "tax year") runs from 1 March 2014 to 28 February 2015. Every year, SARS announces its Tax Season, a period during which you are required to submit your annual income tax return. The tax season for the 2014 tax year opens on 1 July 2014. The income tax return which should be completed by

individuals is known as the ITR12 form. For more information, see our ITR12 Comprehensive Guide, source codes and live stock values.

If you have forgotten your password, you can reset by calling our Contact Centre and following a simple procedure.

When should it be submitted?

- The deadline for all taxpayers will be published once this has been made available in the Goverment Gazette.

If you don't submit your income tax return on time, you may be liable for penalties.

How should it be submitted?

Online: The easiest and quickest way to file a tax return is online, by making use of SARS eFiling. You must, however, first register for eFiling on the SARS eFiling website. We have a page where we explain to you in detail how to register for eFiling. Once registered, you can complete the online form to create your return. Note that you will start by completing the first page of the form which contains several questions regarding the nature of your tax affairs (referred to as a return "wizard"). Completion of this part will automatically tailor the tax return to your specific tax requirements.

Once you have registered for eFiling, you can also file your return by making use of your cellular phone in linking with our mobisite. Alternately, you can download our eFiling App, after which you will be able to file your individual Income Tax Returns quickly and easily via your iPhone 4 or 4s, iPad, Android phone and Android tablet.

In a branch: The tax return can also be requested by visiting any SARS branch office. To find your nearest branch visit our branch locator. (Please note that there may be delays and queues during filing season, which is why SARS promotes the use of eFiling as a medium for return submission.)

Top Tip: When completing your return, you will require the following documentation in order to verify the existing, pre-populated information that appears in the return, as well as to complete any remaining portions:

- IRP5: This is the employees' tax certificate your employer issues to you.
- Certificates you received for local interest income earned.
- Any other documentation relating to income received or accrued, such as remuneration that has not been reported to SARS by your employer, or business or investment income, etc.
- Details of medical expenses paid and medical scheme contributions made.
- The relevant certificates reflecting your retirement annuity fund contributions made.
- A logbook and other documents in support of business travel expenses (if the travel allowance is part of your remuneration or if you have the right of use of a company car taxable benefit).
- Any other documentation relating to the allowable deductions you wish to claim.

2. Income tax

South Africa has a residence-based income tax system which has the effect that:

- A resident's worldwide taxable income is subject to income tax in South Africa.

- A foreigner's (a person that is not a resident) taxable income from sources within South Africa is subject to tax in South Africa.

The South African government has entered into agreements for the avoidance of double taxation with various countries, to prevent the same income from being taxed in both countries. Should the same income be taxed in both countries, a credit will normally be allowed in the country of residence for the tax paid in the other country.

What is the purpose of provisional tax?

The purpose of provisional tax is to allow a taxpayer to pay income tax during the tax year in which the income is earned.

By paying the amounts due in terms of the provisional tax liability, the taxpayer will prevent large amounts of tax due on assessment, as the tax load is spread over the relevant year of assessment.

When is an individual liable for income tax?

Individuals who receive taxable income in excess of a specific amount (known as the "tax threshold" amount) in a year of assessment are liable for income tax. The tax threshold amount for the 2013 year of assessment is R63 556 for individuals below the age of 65, R99 056 for individuals aged 65 years but under 75 and R110 889 for individuals aged 75 years and older. Once the tax threshold has been exceeded, tax is determined according to a sliding scale (known as marginal or statutory rates).

What is a year of assessment for an individual?

A year of assessment for an individual consists of 12 months beginning on the first day of March of a specific year and ending on the last day of February of the following year. The 2013 year of assessment therefore started on 1 March 2012 and ended on 28 February 2013.

What are some of the different kinds of income that an individual can be taxed on?

Examples of an individual's taxable income include –

- income from employment, such as, salaries, wages, bonuses, overtime, fringe benefits, and certain lump sums
- income from a business or trade
- income or profits arising from an individual being a beneficiary of a trust
- director's fees from companies or close corporations
- investment income, such as interest and foreign dividends
- rental income
- income from royalties
- annuities
- pensions; and
- Certain capital gains.

Do all individuals have to register as taxpayers and submit income tax returns?

Registration

An individual who becomes liable for any income tax or who must submit an income tax return must, within 21 business days of becoming liable, apply to SARS for registration in the prescribed form and manner.

SARS may require further particulars or documents from an individual in order to finalise the registration.

In the event of a failure to provide all particulars and documents requested, SARS may regard that person as not having applied for registration until all the required details have been submitted. SARS is also permitted to register a person for tax if that person fails to apply for registration. A taxpayer who has not yet registered with SARS must complete an IT 77 registration form, obtainable from any SARS branch office.

Submission of income tax returns

Income tax returns must be submitted to SARS on an annual basis. This is carried out during a period known as "Tax Season", which is the period during which tax returns can be obtained and submitted for assessment. The income tax return applicable to individuals is known as the ITR12 form. The tax season for the 2013 year of assessment opened on 1 July 2013.

Tax returns may be submitted –

- manually and mailed or placed in a SARS drop box
- electronically at a SARS branch office; or
- Through eFiling.

An individual must submit an income tax return if, during the 2013 year of assessment, he or she –

- receives income from employment (salary, wages etc.) from more than one employer and which exceeds the tax threshold
- has a capital gain or capital loss exceeding R30 000
- receives any taxable allowance or advance (such as a travel, subsistence, public office, computer or cellular telephone allowance);
- receives an income tax return from SARS or is requested in writing to furnish an income tax return regardless of the amount of income received or accrued
- is resident in South Africa, and who –
  - ✓ Held or owned any funds in foreign currency or assets outside South Africa, if their total value exceeded R100 000 at any time during the year of assessment;
  - ✓ Had income or capital gains from foreign currency or assets outside South Africa that could be attributed under the Act;
  - ✓ Held a participation right in a controlled foreign company;
- Receives local interest in excess of the exemption thresholds, being R22 800 if the taxpayer is below the age of 65, and R33 000 if the taxpayer is 65 years or older; and
- Receives income from any trade (irrespective of what the taxable income or assessed loss is), unless that individual's trade consists solely of employment.

Calculating your income tax liability

Calculation of final income tax liability

The Act provides for a series of steps to be followed in arriving at a taxpayer's final income tax liability.

The first step

Determine the normal tax by applying the applicable rate of tax to the "taxable income".

The second step

Deduct from normal tax the sum of the tax rebate(s) in the case of a natural person and the medical scheme fees tax credit in the case of a natural person below the age of 65 years

The third step

Determine the final income tax liability by –

- Deducting the sum of all tax credits, that is, PAYE, foreign tax credits on income and provisional tax payments made by the taxpayer for that specific tax year, from net normal tax; and
- Add any outstanding balance of account as at the date of assessment to net normal tax.

Tax and retirement

Tax Treatment of lump sums paid by retirement funds

When you retire and you are a member of a provident fund or provident preservation fund, your retirement interest is usually paid by way of a lump sum unless the rules of such a fund provide for the payment of an annuity on a member's retirement.

When you retire and you are member of a pension fund, pension preservation fund or retirement annuity fund and you wish to take a portion of your retirement interest as a lump sum, you are allowed to take a lump sum (commute) up to a maximum of one-third of the retirement interest in that fund, unless the entire value of the fund does not exceed R75,000 in which case you take the full retirement interest as a lump sum.

If you are already retired and in receipt of an annuity income from a living annuity arrangement, you are allowed to commute your retirement interest, with reference to that living annuity arrangement, if at any time the retirement interest becomes less than R50 000.

Tax treatment of annuity income

As indicated above, the two thirds of the retirement interest in respect of pension, pension preservation or retirement annuity is received in the form of an annuity (regular pension). If the income from your annuity exceeds the tax threshold, tax is payable on the amount. The tax threshold for the 2015 tax year (i.e. 1 March 2014 to 28 February 2015) is as follows:

- Person below 65 – R70 700 per annum
- Person 65 and above but not yet 75 – R110 200
- Person 75 and above – R123 350

So just as when you were working you might still continue paying tax. Each year you will have to declare your income from your annuity and any other income (e.g. investments income) you may have on your tax return (ITR12).

Unit 7: Entrepreneurship

What is meant by the concept entrepreneurship?

It is the entrepreneur who decides what, by whom and for whom products and services should be produced. An entrepreneur is someone who starts a business with the intention of making a profit and assumes the risk of losing all of his/her resources if the business venture fails. In contrast to this concept, managers assume very little risk for the success or failure of the business.

The entrepreneur is the source of one of the four factors of productions i.e. natural resources, human resources, financial resources and entrepreneurship.

Entrepreneurship is the process by which individuals pursue opportunities without regard to resources they currently control.

Forms of business

The South African system makes provision for a number of business forms and we will briefly discuss them now.

The first and most simple form of business is the Sole Proprietor. This business form is owned and managed by one individual. This is a very popular business form because it is fairly easy and inexpensive to set up. A sole proprietorship is not a separate legal person and does not exist independently of the owner or proprietor.

The second form of business is the partnership. In many respects this form is similar to the previous as it shares several of the same disadvantages. A partnership may be described as a contractual relationship between two or more people, who operates a lawful business with the objective of making a profit.

The Close Corporation has characteristics of both a partnership and a company. It has the advantage of being a legal person that exists separately from its members. In terms of the Companies Act of 2008 however this form of business is no longer available to new entrepreneurs.

The Company was developed to meet business's needs to obtain more capital that could be contributed through any of the other business forms. A company as business forms also bridges many of the deficiencies and undesirable features of partnerships. The company is characterized by the separation of ownership and control. This means that a formal distinction is made between members or shareholders of the company and its managers or directors. The Companies Act, 2008 further allows for two types of companies namely companies with share capital and companies limited by guarantee.

The Business Plan

The business plan is a written document that accomplishes certain basic objectives. The most important of this is to identify and describe the nature of the business opportunity or new venture.

The second objective is to present a written plan of how the entrepreneur plan to exploit the opportunity. Here, the business plan explains the key variables for the success or failure of the new venture.

Apart from the previous two objectives, a business plan provides many other benefits, a few of which are:

- systematic, realistic evaluation of the new venture's chances of success in the market
- a way of identifying the key variables that will determine the success of the new venture, as well as the primary risks that may lead to failure
- a game plan for managing the business successfully
- a management instrument for comparing actual results against targeted performance
- a primary tool for attracting money in the hunt for financial resources

There are eight main reasons for the entrepreneur to develop a business plan:

- To "sell" the business concept to the entrepreneur
- To obtain bank financing
- To obtain investment funds
- To arrange strategic alliances
- To obtain large contracts
- To attract key employees
- To complete mergers and acquisitions
- To motivate and focus the management team

The content and format of the generic business plan will include the following aspects

- The executive summary
- General description of the venture
- The products and Services Plan
- The Marketing Plan
- The Management Plan
- The Operating Plan
- The Financial Plan, and
- All supporting documentation

Unit 8: Buying a Business

The decision to buy a business boils down to an investment decision and you will enter the business arena with the same goal as you would with any investment and this is to be PROFITABLE.

Let us look at a few important aspects when it comes to buying an existing business.

How do I assess the financial performance of the business?

Before acquiring an existing business the potential buyer will need to assess the past financial performance as it will provide information on the business's ability to achieve its objectives. In the simplest form, this financial analysis will seek to merely present the financial information in a more understandable format in or for the buyer to interpret the information correctly. This is important as much of the decision to purchase or not will depend on the financial information which will indicate the business's historical performance.

Now, there are different methods or conducting this analysis and we will discuss some of them below.

a. The ratio method

A ratio indicates the relationship between two items in the financial statements. When ratios are calculated a year is usually divided into 360 days instead of 365 in order to avoid having to deal with fractions. Some of the most popular ratios are Liquidity Ratios which calculates the business's ability to meet its short term financial obligations. This ratio measures the relationship between short term debtors and the current assets of the business. An empiric value of 2:1 will show a healthy position but the business should also be careful not to have too much liquid assets as they might be missing out on other investment opportunities.

The second group of rations is Activity Ratios which measures the rate at which various items e.g. inventory and debtors can be converted to cash. It can also indicate whether the investment in fixed or current assets is too big or too small. A low stock turnover may for example result in a great amount of working capital being tied up in stock which increases the risk of "carrying" obsolete or "dead" stock.

b. The Break-even Analysis

No business plan will be complete without this critical analysis. The break-even analysis determines for example how many units must be sold in order for the business to "cover" its fixed costs. At the break-even point the business does not produce a profit but covers its costs. One should at this stage remember that total costs consists of two elements namely fixed costs and variable costs.

For the purpose of this discussion we will briefly look at the algebraic approach to this analysis. The formula for the break-even point is as follows:

$$\text{Break-even point (Units)} = \frac{\text{Fixed Costs}}{\text{Selling price per unit - Variable cost per unit}}$$

What potential problems can be associated when buying a business?

As stated in the text book on page 161, the absence of audited or prepared annual financial statements. When no financial statements are available then potential buyer should attempt to obtain as many records from the business as possible. Some of the potential problems are as follows:

- ***Bank statements***

It must be understood and a healthy bank balance does not necessary indicate the profitability of the business and many unknowledgeable buyers might be misled by this.

- ***Insufficient knowledge of the market***

A potential buyer should determine whether the location of the business is of such a nature that existing and potential customers are attracted to it. The products as well as the prices, at which they are sold, should also be compared with those of competitors. It is not sufficient to merely compare

the prices but it is also necessary to determine the kind of credit policy that applies to the sale of products.

- ***Standard of Staff***

Unhappy and dissatisfied employees are not assets and it should be determined if the current staff will be available after the business is purchased and if it will be necessary to renegotiate salaries etc. As your personal is the most important asset of any business this is a crucial aspect to consider.

- ***Valuation of goodwill***

Goodwill is defined as the added value that a business has because of:

The length of time that the business has existed and made a profit and the fact that a certain owner has run the business. An investor does not always know the extent of the owner's contribution to sales etc. Many sellers usually place a huge value on goodwill although it is commonly accepted that goodwill usually leaves the business with the previous owner together with the years of experience, knowledge and client relationships.

- ***Insufficient financing capital***

A potential purchaser does not always have sufficient financing capital with security for the acquisition of additional loan capital. If an investor is not financially capable of maintaining at least the same standards in respect of products, price, staff salaries, etc. he or she should not acquire the business as this will place the profitability of the business at risk.

Determining the purchase price

A very important part in the decision to buy a business revolves around the purchase price.

Various methods can be used determined the market value or purchase price of a small business.

One of the most common methods used to determine the market value or purchase price is the discounting of future cash flows. This method uses the time value of money principles in order to determine the current value of all expected future cash flows i.e. all expected future profits are discounted by the desired growth percentage of the interest that can be earned from another investment opportunity.

Advantages of buying a business

When buying a business some advantages can be as follows:

- Annual financial statements often exists for a number of years so that it is possible to measure financial performance over a period of time
- Less time will be spent on aspects such as market and product research
- Existing business methods are in place.
- A well trained and effective group of employees might be presents

Disadvantages include the following:

- Obsolete stock might be hidden from the buyer
- the new owner often creates numerous unnecessary problems by wanting to "change" everything
- Conflict with existing staff

- Financing in the form of bridging finance often creates cash flow problem for the new business owner.

Unit 9: Buying a Franchise

The franchisor is the person who owns the rights to the business. These rights are sold together with training and continuous support. The franchisor therefore owns the existing enterprise in which potential entrepreneurs can invest.

The franchisee on the other hand, is the person who owns the right to purchase and run the business under the name of the franchisor.

Our text book lists the following types of franchising that are available, namely:

- Product and trade name franchising - the right to use a widely recognized product or name
- Business format franchising - franchisee obtains an entire marketing system and ongoing guidance from the franchisor
- Mater license - the individual is acting as a sales agent with the responsibility for finding new franchisees within a specified territory
- Multiple unit ownership - the franchisee owns more than one franchise from the same company
- Area developers - individuals or firms that obtain the legal right to open several franchised outlets in a given area
- Piggyback franchising - operation of a retail franchise within the physical facilities of a host store.

The franchise package contains all the elements of the franchise and can include the following:

- The franchise agreement
- The Operating and Procedure Manual, and
- Other training material

Before we turn our attention to the main discussion for tonight, namely evaluating a franchise opportunity, let us briefly list some advantages and disadvantages of franchising.

Advantages to the franchisee

- There is less risk than with the start of a new business
- Support is received and training provided
- The Franchisor's successful business model is used and thus the chance of success is increased
- Clients are familiar with the product and or services
- Continuous managerial advice is provided
- The franchisor has a permanent and direct interest in the success of the business

Disadvantages to the franchisee

- The franchisee can become too dependent on the franchisor and lose initiative
- Strict control for the sake of uniformity can lead to the franchisee's loss of autonomy

- The selling rights of the franchisee are restricted to a specific area
- The cost of starting a franchise are high
- The personal character of the franchise disappears as all units look the same

Advantages to the franchisor

- Less capital is needed in order to expand
- Each franchisee manages his or her franchise
- More time is available to pay attention to the management of expansion rather that to management of each individual franchise
- Bulk buying becomes possible and this reduces costs as a whole
- Profit margins increase because franchisees work for themselves and are not merely managing someone else's business.

Disadvantages to the franchisor

- Every new franchise increase the franchisor's risk
- The initial cost of expansion is relatively high
- It can take a long time to recover the cost of such expansion
- The wrong franchisee can be chosen
- The location of the franchise may be poor

Is franchising for you?

Before you can start to evaluate the actual opportunity, some introspection is required in order to determine if this type of business venture will suite your character as franchising is not for everyone. A thorough self-evaluation is a prerequisite for every potential franchisee. The following are some of the question that should be asked and answered:

- Do you have enough ambition?
- Is the franchise concept challenging enough for you?
- Will you use your abilities?
- Do you have the mental strength to cope?
- Do you really want to be the boss and a manager?
- Do you have the required financing?
- Do you know what the capital requirements are?

(You can read the rest of them on page 176)

The franchisee should not choose only the franchise that can satisfy their financial needs in the short term but look at long term sustainability as a key success factor. In this, the continuous support from the franchisor is therefore of the utmost importance. The franchisee wants to know that the franchisor's concept is a blueprint for success and that the trademark speaks positively to the target market as well as other franchisees.

The franchisor's plans for expansion must also be evaluated and for this you might want to obtain the assistance of a professional person. You should also consult other franchisees in the network to obtain and evaluate their views and experiences.

Determine the type of franchise

Just like any other type of business, it should not be assumed that the franchise is viable/feasible because of financial results. All aspects regarding the business should be investigated thoroughly and the follow questions will guide you in that:

- What is the record and history of the specific type of franchise?
- Is it a local of a global franchise?
- Is it a new franchise or one with a well-established trade name?
- Does the franchise possess a competitive advantage?
- How long can or will this advantage last?

On the other important elements that must receive serious consideration is the franchisor's mitigation in terms of the risk of insolvency and also in this regard it will be advisable to obtain the services of a professional person.

The franchise agreement

As with any other legal document it is advisable to obtain the services of a legal professional and no agreement should be signed without such. The agreement is a legal documents and will include aspects such as operating guidelines, rights and obligations, the sale of the franchise unit, specific trade areas, pricing policy, etc. It is possible to conclude from the agreement that a franchise is GRANTED and NOT SOLD. The intellectual property rights will always belong to the franchisor.

The franchise agreement also usually spans over a specific period which may or may not be extended, depending on the terms of the agreement. To exercise this provision i.e. extension the franchisee would have had to comply with certain conditions during the previous or present period. These conditions will also form part of the final agreement.

The disclosure document

In conclusion, the FASA's code requires all franchisors to provide prospective franchisees with a disclosure document which must inform the franchisee on all aspects of the franchise opportunity. Potential franchisees also have a "cooling-off" period to think about and decide whether they want to invest in the franchise opportunity or not.

Unit 10: Estate Planning

- All activities leading to the accumulation of, as well as the management of assets and other possessions.
- These activities takes place during a person's lifetime and also applies to the transfer of such assets after death.

The phases in a person's life, in terms of estate planning, can be categorised as follows:

- Building up an estate
- Preserving the estate
- Transferring the estate

No Estate Planning

This does not mean that the person has not accumulated an estate, but implies rather that the person did not provide for the transferring of the estate after death. This means, for example, that the person does not have a will which implies that according to the Interstate Successions Act (Act 81 of 1987) the estate might not be dealt with in terms of the wishes of the owner. It is therefore critical that every person draws up a will.

Elementary Estate Planning

In cases of relatively small estates only an elementary estate plan e.g. a will is required and ensure that the owner's wishes are carried out after death.

Comprehensive Estate Planning

This area involves far more that merely drawing up a will and relates to fairly large estates. According to Abrie and Graham (1989:6) it can be divided into the following:

Timely Planning - during the life of the estate owner e.g. the trust inter vivos technique. [Inter vivos (Latin, between the living) is a legal term referring to a transfer or gift made during one's lifetime, as opposed to a testamentary transfer (a gift that takes effect on death)].

The term is often used to describe a trust established during one's lifetime, i.e., an Inter vivos trust as opposed to a Testamentary trust which is established on one's death, usually as part of a will. An Inter vivos trust is often used synonymously with the more common term Living trust, but an Inter vivos trust, by definition, includes both revocable and irrevocable trust.

The term ***inter vivos*** is also used to describe living organ donation, in which one patient donates an organ to another while both are alive. Generally, the organs transplanted are either non-vital organs such as corneas or redundant vital organs such as one of the two kidneys or part of a liver

- Testamentary Planning
- Other planning e.g. insurances, etc.

The Estate Planning Process

Estate planning is a continuous process during which particular attention should be given to a person's changing profile or circumstances. The text book identifies six steps in the estate planning process, namely:

- Set Objectives
- Take Stock
- Establish the estate's liabilities
- Choose estate planning techniques
- Implement the estate plan
- Review and revise the plan

Step 1: Set Objectives

As with all other areas in our lives, we need to set objectives in order to ensure that we achieve what we set out to achieve and with estate planning it is no different. Table 10.1 in the text book,

identifies eight of the most important factors that people consider when considering estate planning. (Notes that this information is based on research that was conducted in 1985)

From the table it can be seen that the most important factor that people consider is the care of dependants. We can also see that factors 2-8 deals with the protection and retention of estate assets. It should however be noted that all eight factors are interrelated and are aimed at protection.

Under the setting of objectives the following should be considered:

Identifying heirs

- The estate owner must decide who is going to inherit the estate.

Decide what each heir should inherit

- Having identified one or more heirs, the owner must decide in what proportion the estate must be divided between the heirs.

Decide how should control the assets

- It is important that the estate owner should be aware of the fact that only competent heirs should be entrusted to control the estate. Certain estate planning techniques can be used to solve this problem e.g. a trust could be created in which the inheritance are held and controlled by trustees. These trustees could then control the trust on behalf of the heirs, subject to the conditions attached to the trust.

Step 2: Take stock

In this step, the asset side of the estate is calculated.

Identify estate property

- All property, fixed as well as current assets belonging to the estate owner must be identified taking the Estate Duty Act (Act 45 of 1955) into account.

Establish the value of the estate

- Estate duty is calculated on the net value of an estate. During this step the gross value of the estate is calculated. A registered valuer is normally used to determine the market value of the estate. In terms of the Expropriation Act of 1975, market value means the amount of money that could be obtained for the asset if it were sold on a specific date by a willing seller to a willing buyer on the open market. Book value or replacement value are not taken into account for this purpose. In addition this the latter, an estate owner can also have an interest in property e.g. right of use, usufruct, etc. A formula is used to calculate the value of an interest in property where the annual value of interest or right over the interest is capitalised over the expected life of the beneficiary or the term for which the interest or right applies.

Step 3: Establish the estate's liabilities

Very few estates are completely unencumbered. Inevitably, some debts are outstanding at the time of the death of the owner. For example a residential home often has a mortgage bond attached to it,

etc. All outstanding loans and accounts must be listed and the amounts added up in order for it to be subtracted from the gross value of the estate. It is important to note that a person's matrimonial property dispensation can greatly affect the value of an estate.

Allowable deduction

Once the estate liabilities have been deducted there are certain allowable deductions which can be added in terms of section 4 of the Estate Duty Act of 1995. These are as follows:

- Funeral and death expenses
- Debt owed to persons residing in South Africa
- Administration and liquidation costs
- Donations to charities, educational and religious institutions on condition that the value of these donations has not already been deducted
- Donations to political parties registered in terms of the Electoral Act of 1998
- The amount equal to the accrual of the spouse of the deceased, where they were married with inclusion of the accrual system.
- Assess estate duty liability

Estate duty is payable on the net value of the estate which is currently set at 20%.

- Assess other estate costs

The winding up of the estate may result is other costs e.g.

- The cost of providing security
- Advertising costs
- Transfer fees in the case of immoveable property
- The cost of liquidating assets
- Executor's remuneration

Step 4: Choose estate planning techniques

There are various estate planning techniques, some of which can be used during a person's lifetime while others have to be provided for in a person's will. For the purpose of our discussion tonight we will briefly consider the following techniques:

The trust inter vivos technique

The purpose of this trust is to transfer certain assets to a trust while still retaining control over the assets. The assets are administered in favour of a third party and are not created for the benefit of the founder. The legal requirements for setting up a trust as well as the different uses of a trust, are listed on pages 198 and 199 of the text book.

Because the trust is flexible as an estate planning technique it can easily be adapted to changing circumstances. The flexibility of a trust lies in the stipulations of the deed of trust.

Company based techniques

A company can be use in several ways for purposes of estate planning. This includes to use it in the form of a business enterprise or to protect the growth of the estate from estate duties. The estate

owner establishes a company and ensures that his/her heirs retain the ordinary shares in the company. The growth in share value increases the value of the heir's estate and not that of the estate owner.

Testamentary Techniques

The Will

It is possible to use a will as an effective estate planning instrument. The larger the estate, the more effective the use of a will as an estate planning technique can be. It is also possible to use a will for purposes of elementary estate planning. A will contains a person's wishes with regards to the disposal of his/her estate after death.

Testamentary Trusts

As the name indicates this type of trust arises from the will of a deceased. The testator will stipulate in the will that a trust must be established in favour of one or more beneficiaries.

Other techniques

An estate owner can use various techniques to make provision for dependants. These techniques can also form part of their protection and retirement planning and can be supplementary to timely estate planning techniques.

Investments

Investment can be made for your own use, a rental income, capital appreciation and for speculative profit.

Insurance

An estate owner can take out insurance in the form of endowment and or life policies and nominate his/her heirs as beneficiaries.

Rental Income

In this instance, estate owners attempt to protect an asset they have bequeathed to someone. It is almost similar to the Inter Vivos trust where the estate owner retains control over the asset.

Step 5: Implement the estate plan

Once the estate plan has been designed it must be implemented.

The estate owner must ensure that the necessary documents are prepared to ensure that the plan is implemented. It will also be advisable for the estate owner to inform and discuss the plan with all role-players e.g. heirs, executor, etc.

Step 6: Revise the estate plan

The plan must always be modelled on the personal and financial position of the estate owner and his family. Any significant change in such positions should be an indication that the estate plan requires attention and possible amendment.

Estate planning pitfalls and how to avoid them

Pitfall 1: No estate planning

Every person should have a valid will. Without a will your assets are disposed of in terms of the Intestate Succession Act which means that your family or other persons may inherit your estate contrary to your wishes.

Pitfall 2: Insufficient estate planning

As soon as your estate increases in value you should consider doing comprehensive estate planning which involves the use of various estate planning techniques. Among other things, you may decide to set up a trust and or establish a company. As comprehensive estate planning requires knowledge of n number of specialised fields, such as law, investments, tax, etc if would be advisable to consult professionally qualified people such as lawyers, accountants and financial advisors.

Pitfall 3: Insufficient liquid assets for transferring the estate

It is important to ensure that sufficient funds are available to wind up the administrative processes. In this case, financial investments such as life policies will play a significant role

Pitfall 4: Building your estate without doing continuous planning

An estate owner should make deliberate efforts and follow specific strategies to reduce the value of the estate. A few such strategies could be the following:

- Sell property to your heirs but lend them the money to make the purchase. Bequeath this loan to the heirs in your will.
- Donate an amount of R100 000 to your child every year. Then deduct an amount of R100 000 every year from the loan that is bequeath to him/her.
- Never include the accrual system in your antenuptial agreement
- Use a trust to buy fixed assets with an expected high capital growth
- Buy further fixed assets in the names of the heirs or a trust

Study Unit 11 - Investment Planning

Investment planning is one of the most important areas of personal financial management as it is an integral part of retirement planning and a direct inducement to protection planning. Financial independence after and during retirement, and with a view to your estate is largely dependent on your ability to invest effectively.

Important concepts in investment planning

- Investment Management involves the employment of funds with the purpose of earning an income from it.
- Assets consists of everything a person can purchase, whether capital, financial or current in nature.
- Productive assets include fixed property and machinery that are purchased in order to generate income from
- Current assets include e.g. stock, cash and short term debtors
- Financial assets refers to investments on the capital market as well as e.g. bank acceptance, treasury bills and trade bills in the money market.
- The money market refers to an abstract market, where the supply and demand for funds over the short term come together
- The capital market on the other hand refers to an abstract market where the supply and demand for funds over the long term come together
- Negotiability is a concept that indicates whether a financial asset can be bought and sold
- The concept of listing means that a company's shares has been granted a listing on the stock exchange which in turn means that the can be traded on the exchange.
- Institutional investors are bodies such as insurance companies, bank and pension funds
- An offer refers to an offer to purchase a given listed share or security and a specific price. An offer is usually made through a stockbroker.
- A Stockbroker refers to a member of the securities exchange who acts as a trader in stocks and shares
- Brokerage refers to the commission a stockbroker receive for services rendered
- A portfolio refers all an individual's financial investments/assets and includes listed or unlisted and marketable and unmarketable investments.
- Savings refers to money a person has at his or her disposal that he or she does not spend. Such money will be readily accessible and increases the owners liquidity.

Different pitfalls which threatens individual’s investment

- **Pitfall 1: Comparing the return of the investment with the purpose**

The most common pitfall is to compare the return of a specific investment with the purpose of such an investment. A person should never compare the return of an investment in your home, for example with the return on a risky investment such as share trading. When it comes to money matters, surely the most basic right is the right to do what you like with your money.

- **Pitfall 2: Misconceptions about investing in a life policy**

A common misconception these days revolves around the thinking that investments in e.g. shares will yield a higher return than e.g. a life policy. Your investment aims and financial need should never be confused with the return on your investment on e.g. a life policy or on another investment such

as shares. A life policy for example may be used in various fields of personal financial planning. As an investment alternative it is the most flexible investment instrument.

- **Pitfall 3: Underestimating the negative effect of inflation**

The effect of inflation is calculated by using the factor 72 formula. Suppose the rate of inflation is 12% then 72 ÷ 12 = 6.This means that the value of the investment halves every 6 years. The effect of inflation can however be countered if an investment produces an after tax return that is higher than the inflation rate. For those individuals who do not have sufficient investments for retirement, inflation will continue to increase the income shortfall and if an individual lives for a long time after retirement inflation will steadily reduce the person's buying power of his or her money. Retirement then becomes a race between inflation and death which is something that nobody looks forward to.

- **Pitfall 4: Having insufficient knowledge of investment principles**

As a potential investor you should have knowledge of the basic investment principles. One such principle is that the higher the potential return, the higher the risk will be. In other word "high risk, high return - low risk, low return".

- **Pitfall 5: Being uninformed about the investment criteria**

Another pitfall is to be uninformed about the various investment criteria. Compare these criteria with your own financial objectives and financial resources before you choose an investment. Choosing a specific investment can be determined by a combination of some of the following criteria:

- Do you need income from the investment or do you require capital growth?
- Do you want a guarantee that your investment amount will be paid out or do you want to speculate with it and risk losing it or only receiving a portion of it.
- Do you require liquidity in the investment?
- Do you already pay the maximum tax or do you require a tax free investment
- Do you want to manage your investments or are you comfortable leaving it to a fund manager.
- Do you like taking risks?
- Do you have a lump sum to invest and what amount do you need for the investment
- For what period do you want to investment and when will you need it.
- Spread your investments to lower your risk exposure
- Protect yourself against the effect of inflation - invest for capital growth

Study Unit 12 - Buying a residence

The reasons or motivation behind buying a residence

- ***Self and family needs***

Underlying self- and family orientated needs are psychological and economic motivations. The following are some psychological motivations for buying a residence:

- A place to live in
- Provide for the safety of you family
- Independence and freedom
- Creativity
- Adventure - finding the right house
- The expansion of knowledge i.e. learning about contracts, dealing with banks and financing arrangements

- ***Economic motivations***

- The buyer's credit position improves and he/she will, if the current agreement is honoured, be able to negotiate better terms the next time he/she requires credit because a track record is established
- Appreciation i.e. the value of property normally increases over time whereas the value of other assets decreases
- Peace of mind that you house will also serve as financial security

- ***Group Orientated needs***

These needs usually revolve around a person's position in the community and his/her participation in politics. Having a position in the community implies that a person:

- Is a respectable resident
- Shares in the interest of the community
- Have a positive attitude about the area and a vested interest in improving the area

- ***Other factors***

Some other factors may include the following:

- Transferred to another town
- The need for a larger house
- Divorce
- The prospects of a more profitable investment

- The death of a spouse
- Insolvency

The cost items involved in buying a house

t is of critical importance that buyers know and understand exactly what they are getting them into. Buyers and sellers need sound financial information before they proceed to purchase a house. Prospective buyers often respond to misleading advertisements which tend to emphasize the low monthly installments as a prerequisite for home ownership. They often neglect to mention the numerous hidden costs involved in a transaction.

First, we will take a look at the general costs

- ***Transfer Duty***

On Immovable Property (on or after 1 March 2015)

Payable by natural persons and legal entities:

TRANSFER

Property value	**Rates of tax**
R 0 - R 750 000	Nil
R 750 001 - R1 250 000	3% on the value above R 750 000
R1 250 001 - R1 750 000	R15 000 + 6% on the value above R1 250 000
R1 750 001 - R2 250 000	R45 000 + 8% on the value above R1 750 000
R2 250 001 +	R85 000 + 11% on the value above R2 250 000

- No transfer duty is payable if the transaction is subject to VAT
- If a registered vendor purchases property from a non-vendor, the notional input tax credit is limited to the VAT fraction (14/114) applied to the lower of the selling price or the open market value. A notional input tax credit is only claimable to the extent to which the purchase price has been paid and the property is registered in the Deeds Office
- As from 10 January 2012, the notional input tax credit is no longer limited to the transfer duty paid
- Certain exemptions apply to corporate restructuring
- The acquisition of a contingent right in a trust that holds a residential property or the shares in a company or the member's interest in a close corporation, which owns residential property, comprising more than 50% of its CGT assets, is subject to transfer duty at the applicable rate
- Liabilities of the entity are to be disregarded when calculating the fair value of the contingent right in the trust, the shares in the company or the member's interest in the close corporation
- Residential property includes dwellings, holiday homes, apartments and similar abodes, improved and unimproved, zoned for residential purposes. It excludes a structure of five or more units, rented by five or more unconnected persons. It also excludes immovable property forming part of the enterprise of a VAT vendor.

- ***Conveyancing Costs***

This refers to the cost levies for the transfer of the property from one person to the next. The amounts levied are prescribed by legislation and levied by the transferring attorney. Please see the Additional Resources section for a comprehensive guide on this matter.

- ***Occupational Interest***

This applies in cases where the buyer occupies the house before the transfer has been registered in his/her name. Similarly, if the seller remains in the house after the transfer has been registered in the name of the buyer occupational interest, also sometimes referred to as occupational rent, is payable. It is normally calculated on the on the current bond interest rate on the full purchase price and payable monthly in advance.

- ***Loss of Interest on Capital***

Estate agents should notify buyers of a possible loss of interest in capital. Cash buyers usually invest their funds with a financial institution where it earns interest. If they wish to pay the full purchase price to the seller, it is suggested that the buyer does not supply the funds before the registration in order to avoid a loss of interest.

- ***Estate Agent's Commission***

The seller is normally responsible for paying the estate agent's commission, unless the buyer acts as principle for the estate agent. The relevant estate agency determines the commission and receives payment after the seller has received the purchase price.

- ***Deeds Office Registration***

An amount, based on the purchase price, is levied by the Deeds Office

- ***Rates and Taxes***

The registered home owner is responsible for paying municipal rates and taxes on the property.

- ***Rates Clearance Certificate***

As no transfer of property is possible when there is outstanding rates and taxes owed to the municipality, a clearance certificate must be obtained and submitted together with all other registration documents. A fee is usually levies for the issuing of such a certificate.

- ***Valuation Costs***

A potential buyer may voluntarily opt to have the property valued by an independent valuer in order to accurately determine the market value. If a person however finances the property through a

bond, this cost becomes compulsory and are usually arranged by the bank of other financial institution.

- ***Moving Expenses***

This expenditure normally arises when occupation is taken on the property and should not be underestimated as it can be significant especially for first time buyers.

- ***Other General Costs***

Other general costs includes the following:

- Telephone and dataline installations
- Water and Electricity
- Miscellaneous expenses
- Property improvements

The costs related to the bond.

When a house is financed through a mortgage bond, there will be costs which are not applicable during a cash transaction. It should however be noted that some of the costs, discussed below, will be applicable to both types of transactions.

- ***Deposit***

Once the offer to purchase has been accepted and signed, it becomes an agreement of sale. Usually a deposit is then required which are kept in trust by the estate agent. This deposit is then release once all the suspensive conditions have been met.

- ***Bank Initiation Fee***

The bank charges this fee for setting up the loan. Most banks currently charges a fee of approximately R5 700,00 for this.

- ***Bank Administration Fees***

The bank charges a monthly loan administration fee.

- ***Bond Instalments***

A potential buyer who wishes to apply for a bond requires information on the monthly instalments.

- ***Bond Registration Costs***

This mainly consists of the amount payable to the attorney (bond) of the financial institution.

- ***Inspection Fee***

This fee is payable to a financial institution that endeavours to determine whether the property provides sufficient security for the bond.

- ***Interim Interest***

Once a house has been registered in the buyer's name, the financial institution pays the bond to the seller and from this day interest is charged.

- ***Homeowner's Insurance Policy***

This policy provides protection to the security of the mortgage. If a house burns down for example the mortgagor will lose the security on the house. Consequently, the mortgagee requires that the mortgagor take out homeowners insurance according to the replacement value of the house.

- ***Decreasing Term Life Insurance Policy***

Also called a mortgage protection policy, this policy ensures that, in case of death or permanent disability, the amount owned in a mortgage bond is paid.

- ***Cancellation Cost for an Existing Mortgage Bond***

The costs involved in cancelling an existing mortgage bond vary among financial institutions with some institutions imposing a further penalty if the mortgage bond is repaid within a year. It is advisable for the buyer, who has an existing bond, to notify his/her financial institution of the intension to settle the bond as this will decrease the penalty charges and interests.

General Concepts

- ***Open Mandate***

In an open mandate, the owner as well as estate agents markets the property. This mandate does not establish any kind of binding agreement with a chosen estate agent and the principal may appoint as many agents as they wish to market the property. In the case of this type of mandate, agents are less inclined to advertise the property as intensively as in the case of for example a sole mandate. An open mandate can be recommended if the seller is not in a hurry to sell the property , wants a specific price and wishes to retain the option/right to sell the property him/her self.

- ***Sole Mandate***

A sole mandate is an agreement between a seller and an estate agent whereby the agent obtains the exclusive right, for a limited period, to market and sell the property. This agreement excludes all other estate agents as well as the seller from selling or marketing the property. This means that the seller's actions are restricted in terms of selling the house. It becomes therefore important that estate agents properly inform their clients of the rights and obligations that arise from a sole mandate.

- ***Estate Agent***

An Estate Agent is someone who represents buyers and sellers in order to serve their interests during the conclusion of buying and or selling property transactions. The agent receives compensation in the form of commission for the successful completion of the transaction.

- ***Right of first refusal***

A person obtains the right from the owner of the property, should the owner wish to sell, to be granted the first opportunity to purchase the property. The price and terms will be the same for the holder as for a bona fide third party. The holder of the right is not obligated to purchase if the opportunity should arise. Similarly, the owner is not obligated to sell to the holder, but is merely required to give the holder the first right to purchase.

- ***Suspensive Condition***

A condition in the contract is suspensive in nature when the commencement of the intended operation of the contract depends on something happening in the future or something that should not happen. Once these conditions have been fulfilled, the purchase contract takes effect or else the contract becomes null and void. The following is examples of suspensive conditions:

- Where the buyer want to sell his/her house first
- Where the buyer has to wait for a bond to be approved in order to purchase the house

- ***Resolutive Condition***

On the other hand, a resolutive condition terminates a right or obligation once the condition has been fulfilled. A buyer may include a resolutive condition in the purchase agreement which may be the occurrence of one or more of the following events, for example.

- the erection of a prison in the vicinity of the house which the buyer wishes to purchase
- the development of a freeway or industrial area

- ***Convenience network***

This relates to aspects such as the proximity of your house to shopping centres, schools and other facilities.

- ***Exposure network***

The exposure network in turn refers to sensory aspects that will affect your "enjoyment" of living in your house. These include a noisy factory or busy road, smelly chemical factories close to your house as well as unsightly features such a visible refuse damp.

- ***Mortgage (Bond)***

A mortgage bond is a legal action through which property is pledged in order to obtain a loan. Once the financial institution obtains the right to a buyer or seller's house, a bond is raised as security for the money lent to such parties by the financial institution.

- ***Matrimonial Property System (ANC)***

The Matrimonial Property Act of 1984 was introduced to create legal equality between spouses and to provide financial protection to both spouses entering into marriage after the Act, whether they were married in or out of community of property. The accrual system was also introduced, but in order to offer couples the widest possible choice they were give the opportunity to marry with or without the application of the accrual system. Although community of property was retained, marital powers were abolished in all marriages entered into after 1 November 1984. The accrual

system was introduced to avoid the previous financial disadvantages associated with marriages out of community of property.

Study Unit 13 - Buying fixed property

The Investment Process

Potential investors should compare the features and income potential of the property they intend purchasing with their personal investment objectives and needs before reaching a decision. They should also diligently compare the proposed investment with other similar investments. Investment in property is usually made with the idea of generating rental income and to achieve capital growth, as the property appreciates over time. In addition, an investment in fixed property also offers a hedge against inflation meaning that the value of the property increases annually at more or less the same rate as inflation.

The type of property an investor would consider usually depends on one or more of the following factors:

- The amount of capital available
- Creditworthiness
- Attitude towards risk
- Knowledge of the type of property
- Income tax position
- The management requirements of the property

The goals, as stated, are to match the needs and requirements of the investor with a suitable property. We will continue with a discussion of the factors/areas listed in the "Maritz Investment Process Diagram.

The Investor's Resources

Because investment in property usually requires a significant capital layout, an investor might be obligated to use other financial assets or to find co-investors. The entire investments process will have to be an attractive proposition to these co-investors before they would be interested in investing. The special features of the investment (property) have to meet and suit the investor's needs and objectives.

The Investor's needs, requirements and objectives

Before making an investment, investors should provide answers regarding their motive for making the investment. The property will have to meet certain criteria, which will be discussed as follows:

- **Return on Capital**

The return on investment is probably the most important consideration when making any investment. As oppose to an investment for the investor's own use i.e. a residence where the convenience and utility value of the home becomes more important that the return on investment

an investment for of this nature is usually done with a view of ensuring regular income or capital growth.

- **Liquidity considerations**

Liquidity refers to the speed and ease with which a investment can be converted into cash. Fixed property cannot be sold overnight due to the fact it might be difficult to find a buyer with sufficient funding. Fixed is therefore not liquid assets although it must be considered that although property is not liquid it can be used as security in order to secure a loan, etc.

- **Risk**

Risk is described as the chance that a loss may be suffered or that the actual results of the investment may be different from the anticipated results. In the case of fixed property, a distinction must be drawn between operational and financial risks.

- **Operating risk**

Operating risk, in this case, refers to the risk that a fixed property may not be capable of realizing its fixed operating costs. This means that the income might be too low to cover the operating costs.

- **Financial risk**

Financial risk refers to the risk that investors may not be able to honour their financial obligations. If they e.g. borrowed money to make the investment they will have certain financial obligations. The higher the mortgage bond sum, in relation to the market value of the property, the higher the financial risk will be.

- **Management Requirements**

An investment in fixed property demands management. Prospective investors should decide and consider whether or not they have the necessary expertise to manage the property or whether they need to find a suitable party to manage the investment.

Investigate all financing possibilities

Once an investor has identified his/her resources, objectives and needs, they need to conduct an investigation in all possible ways of financing the property, noting that using their own funds might not always be the best option as they would be losing income over the short term.

Inspect the Property

According to the prescribed book, the following are value producing features of a property.

- The physical nature of the property

This refers to the following:

- The size and shape of the land
- The slope
- Kind of soil
- Available services
- The size of the building

- Durability of the structure
- Functional effectiveness of the building

- **Location**

The location of the investment refers to its convenience and exposure networks which were discussed in Study Unit 12.

- **Institutional characteristics of the property**

These characteristics refer to any regulations pertaining to private and public circumscription of property rights. These pertain to the right of use of the property or the maximum lawful and economic use that may be made of a property. For example, an investor may purchase a plot with the intention of constructing a block of flats on it, and then find out that it has been zoned as industrial land.

Quantification of the Productivity of the Property

To quantify, means to attach a value or amount to something. Productivity in turn, refers to the income derived from the investment. A prospective investor should therefore determine the income that is expected from the investment. Please study the methods that are discussed on pages 339 - 343 in the prescribed book.

Calculating the Investment Value of the Property

The prescribed book emphasizes the important distinction between the utility or utilitarian value of a property and its market value. The utility value of a property is the value it has for a specific investor at a given stage. This value therefore only has a bearing on prospective investors, given the following:

- Their attitude towards the risk involved in the investment
- The funds available to them
- The cost of financing the investment
- Their age
- The return on their current investment portfolio
- Their liquidity and solvency
- Their creditworthiness

The utility or investment value a property holds for specific investors can influence their willingness to pay more or less for the property than the market value. If the investment value were higher that the market value, an investor would willingly buy the property at market value believing that it was a bargain, but if the market value were higher than the investment value, the investor would not want to buy the property.

Evaluation of the market and external factors that may affect the value of an investment

It is very important that a prospective investor should analyse the market for the proposed type of fixed property before he/she purchases. The investor should ensure that there is a demand for the

services which the property is able to offer. The best investment would be the one where the demand increases as a result of growth in the area in which the property is located. Future demand is as important as current demand. A market analysis will demonstrate the supply of and demand for services similar to those offered by the property.

Economic factors also play a role. The demand for a certain service in a certain area is determined by factors such as resident population, as well as their income. Obviously, people in a higher income bracket will be in a position to pay more.

The availability of credit is another factor to be considered. Low interest rates would increase the demand for sectional title flats and townhouses. The investment value of such properties would also rise.

Lastly, the political situation in a country is a factor that may increase or decrease investment values. A new political order for example could undermine the general confidence in the economy.

Making the final decision

A decision to invest is made when a buyer and seller reach agreement on the price of the property as well as the conditional attached to the sale. The price will be significantly influences by the parties' knowledge of the property market.

A prospective investor should make sure that his financing arrangements correspond with the price and conditions of sale.

Study Unit 14: Offshore Investment

Offshore investments are not necessarily more risky that local investments but are clouded with a lot more uncertainty and confusion. For this reason, it is imperative that the potential investor does thorough homework/research before venturing into the offshore market.

Before we get to the research that is required, let's look for a minute at the reasons why people want to invest offshore. The following are some of the main reasons cited in the prescribed material:

- Protection against fluctuations of a single currency and market.
- Many new investment opportunities
- The expertise of offshore fund managers who know the foreign markets
- A balanced portfolio
- The possibility of increasing the return of a portfolio on an after-tax basis

Research before investing of foreign countries

Before investing in a foreign country the potential investment must make sure that his/her decision is backed up by thorough research as one incorrect decision can have devastating effects on a portfolio. As stated earlier, offshore investments are not by implication more risky but is overshadowed by uncertainty. The prescribed book lists a few aspects to consider in conducting your research, namely:

- Remember that you want to invest you funds in a manner that will ensure that you are financial independent after retirement
- Make sure to consult various, and as many as possible, sources of information including brokers and other investment experts
- Make sure that you know why you want to invest in a foreign country
- Determine your risk profile and make investments according to that
- Determine whether or not your investment objectives fit in with your retirement objectives

- ***Offshore investment pitfalls***

It is important for a potential investor to have a sound knowledge of the local investment pitfalls in order for him/her to have an understanding of the possible pitfalls relating to offshore investments. Only proper research, knowledge of personal financial planning and assistance from experts in foreign legislation can result in purposeful offshore investments.

- ***Money Laundering***

The process whereby illicit money becomes part of the mainstream money system and is invested in legal products is called money laundering and is illegal. Investors must be very careful in this regard as they face serious legal action if found guilty of this.

- ***Where can I get information about foreign investments***

The following sources are listed in the prescribed book, although there are many more that you can consult.

- Information pamphlets issued by brokers
- Newsletters of financial institutions, insurance companies and brokers
- The internet
- Local and overseas newspapers and magazines
- Computerized investment analysis such as Micropal and Money Mate

How much can I invest?

A tax-payer in good standing and over the age of 18 years, can invest up to R4 million in his/her name outside the Common Monetary Area (CMA-Lesotho, Swaziland and Namibia), per calendar year. A Tax Clearance Certificate (in respect of foreign investments) must be obtained. These funds may not be reinvested into the CMA countries thereby creating a loop structure or be re-introduced as a loan to a CMA resident. (ii) In addition, up to R1 million, within the single discretionary

allowance facility, can be transferred abroad, without the requirement to obtain a Tax Clearance Certificate, but provided a Form M.P.1423 is completed.

In the case where a person wants to invest more that the allowed amount, his/her bank must submit an application to the Financial Surveillance Department of the South African Reserve Bank for approval. A Tax Clearance Certificate, in the prescribed format, must always accompany the aforementioned application.

- **How much should I invest?**

It is impossible to determine a fixed percentage as it will depend on the unique financial position of each investor. As a rule of thumb however one can argue that an average investor should not invest more that between 20% and 30% of his/her portfolio in an offshore portfolio.

➢ ***Your International Investment Strategy***

- Decide how much money to have to invest
- Determine whether you are going to invest a lumpsum or make monthly investments
- Decide whether you want to invest locally or internationally
- Choose one or more investment products
- Diversify by not investing in only one unit trust for example but in several different ones
- Your investment choice must meet your needs for income or capital growth
- Choose safe countries and in particular tax free countries
- Use the internet and personal references by brokers and choose a management company for your investments
- Make sure that you understand the investment risk
- Use the internet to monitor your investment's performance on a regular basis
- Never make impulsive or emotional decisions about your long term investments
- Always keep your investment objectives in mind
- Compare your international investment strategy with your retirement planning process and make sure that you will achieve your retirement goals
- Beware of only investing on emerging markets because they are all influenced by more or less the same factors which you are already faced with in South Africa, and
- Regard your investment in emerging markets as being of a medium to long term nature
- **How do South African companies handle offshore investments?**

Local companies that market unit trusts have added an overseas component to their companies in the following ways:

- Some have opened offices in overseas countries

- Others have formed partnerships with overseas institutions
- Alliances have been formed between local and overseas institutions with the local institution acting as an agent for their counterparts overseas
- Various offshore fund managers have been appointed to handle offshore investments in a specific product as the need arises

➢ **What are the costs of investing in a foreign country?**

It would be impossible to specify the costs involved in offshore investments as various factors such as initial costs, annual fees, management fees, etc. needs to be considered. It will however be safe to assume that the cost associated with offshore investments will always be higher than that of local investments and as such you are more likely to receive a lower return on investment, particularly in the initial stages of the investment. One should however not lose sight of the benefits of offshore investments and as such each case should be compared in terms of its accompanying benefits and costs.

➢ **Which factors determine the return on offshore investments?**

Firstly, the type of investment will, to a great extent, determine the return on the investment. Over the long terms however shares seems to be beating other instruments such as cash, government securities and fixed property.

➢ **An international currency exchange guide**

If you want to find out what the currency of other country is worth you can consult the international exchange guide which can be obtained from the Reserve Bank or any other bank. The guide will enable you to calculate what your investment is worth in the currency of that specific country.

- **Tax on offshore investments**

You will have to consult an international tax expert in order to evaluate and accept or reject the tax implications relating to an offshore investment. If you invest in a country which has not entered into an agreement with South Africa to avoid the payment of double tax you will probably have to pay taxes in both countries. We can look briefly at the tax position of the following offshore investments:

- Interest earned overseas - interest will be taxed in the hands of a South African citizen unless it is earned by an offshore trust in a tax haven
- Interest of a local foreign exchange account - Interest will be taxable
- Exchange rate profit is taxable
- Income from the leasing of immovable property - rent is taxable in the hands of a South African citizen unless it is received by an offshore trust in a tax haven
- Dividends from unit trusts and shares are taxable
- Capital growth is taxable
- Capital profit is taxable unless received by a trust in a tax haven

It is important to note that the tax base differs from country to country so offshore investment income will be treated differently by various tax authorities. Always remember that you should give due consideration to the tax implications of local as well as offshore investments, after-all you expect positive after-tax returns on any investment. Any capital gain or taxable income will be payable in South Africa and should be declared in your tax return. Please consult the Additional Resources area for documents regarding the taxation of offshore investment income and capital gains.

- **The global investment process**

The following steps must be followed by an investor in terms of the South African exchange controls:

- Complete and submit the "Declaration of Good Standing". This form must be completed and handed in at the bank who will be approved if the applicant's tax affairs are in order.
- Complete the SA Reserve Bank form. The bank that will make the investment must complete this form and notify the Reserve Bank as soon as the investment is made.
- Complete form MP1423 which indicates where the investment will be made and in which bank account
- Complete the investment application form
- Hand in the documentation

Study Unit 15: Protection Planning

Uncertainty and risk have formed part of the human environment from the earliest times. To help us protect ourselves against all kinds of risks, financial institutions and insurance companies are prepared to carry part of the burden in return for a certain sum of money, paid in premiums.

Types of Risks

There are various types of risk. Some of them are "insurable" while others are not. The following types of risks can be identified.

Financial and non-financial risks

In the insurance industry, the risks for which insurance is provided are restricted to financial losses. Such risks are called financial risks. A non financial risk refers to e.g. emotional loss involved in the demise of a loved one. In turn, financial risks can be divided into Speculative Risks and Pure Risks.

Speculative Risk

A speculative risk is one in which either a profit or a loss may occur. Investment in shares is a good example of such a risk. The various insurance alternatives do not cater for this type of risk.

Pure Risk

In this case, there is not possibility of a profit of any kind of benefit and the risk only leads to losses. For example, when a home is destroyed by fire, the owner would not derive any financial benefit from such event. In these cases insurance companies do provide cover for these types of events.

Fundamental and Specific Risks

Fundamental risks have an impersonal source such as war and acts of God. These risks affect the community as a whole and it is generally accepted that the community should bear the burden of such risks. On the other hand, specific risks have a personal origin and insurance provides protection against these.

Needs and Insurance

It is important to choose the most suitable or appropriate risk protection as a household is exposed to risk of all kinds. It is essential to analyze the features of the different kinds of needs since these features will determine the extent of the needs as well as the type of product best suited to the circumstances.

Before we get into the various types of insurance products, let's take a look at some of the concepts that we will be dealing with.

An income need relates to the monthly salary a person would require e.g. in the event that he/she becomes disabled and unable to work further. A capital need, on the other hand, refers to the need e.g. to redeem a person's mortgage bond after his/her death.

A need is temporary when it is time bound. A permanent need will arise after a person's death, when estate duty becomes payable. Although there is uncertainty about the period, there is certainty about the event. In the case of a future need, parent could for example begin saving to cover the costs of their childrens' study fees, etc.

Various methods or products are available to meet the different kinds of needs. The most suitable products for each kind of need should be chosen within the within the constraints of the individual's financial resources.

We will now look at the various insurance products that are available on the market today.

Long Term Insurance

By definition long terms insurance means insurance for a period longer than a year. Long terms insurance provides protection as an investment and against risks as a result of death or disability. The following types of long term insurance products are available:

Endowment Policies

This is probably the most common long term investment instruments. Although several uses exists for endowment policies, the best and most common use thereof is probably to provide capital at retirement and to supplement the provision for retirement. Investors contribute on a monthly basis to this investment and receive the lump sum tax free after five years. Life cover can also be added to this policy but if it is excluded the entire monthly premium is invested in an investment account.

Single Premium Endowment Policies

It is possible to invest a single premium or lump sum in an endowment policy on condition that, to be tax free, such an investment may not be surrendered for a period of at least five years. During the term of investment, it has a very low surrender value but after the five year period monthly cash withdrawals are tax free. It is also possible to invest the lump sum and receive a monthly which is also tax free. In this case, the following is applicable.

- The amount of interest for the five year period is added to the capital amount
- Interest and capital are divided into equal amounts over the period of five years
- Payments received have to be declared on the investor's income tax return because the interest component is taxable in the hands of the investor
- The capital portion of the payment is tax free
- Income received after five years will also be tax free
- Capital growth is therefore tax free

Second Hand Policies

Policyholders often borrow against their policies in order to fulfill needs and desires and these "loans" are interest free. Whatever the reason, the time comes in many policyholders' lives when they have borrowed as much as the policy was worth resulting in the surrender value being nil or very low after five years. The holder would like to dispose of the policy, preferably at a profit. On the other hand, many investors would like to invest in an insurance policy but do not want to wait five years for tax free returns. This brings about what is called second hand policies. A potential investor could invest a lump sum in the second hand policy which he/she buys from the insurance company. The advantages and disadvantages of this can be read on page 392 of the text book.

Life Insurance

A life insurance policy is probably one of the most underrated insurance products. The truth is however that there is no other investment that can provide more for human needs and goals as this type of policy. A life policy is an asset, whereby a person's greatest financial risks cab be transferred to an insurance company. Besides peace of mind, the policyholder also receives a high return on their investment with a relatively low risk as compensation for monthly premiums. The primary goal of every individual's personal financial affairs is to achieve financial independence after retirement. Having a life insurance policy has far reaching financial implications for the family in the case of policyholder's death. Some of these are as follows:

- A life policy can make provision for a child who might have university expenses when he/she leaves school
- An event such as death could result in a person's assets having to be liquidated if the deceased did not have life insurance in place to cover his/her debt
- A life policy can be used to make provision for retirement as the policyholder can request that the policy should pay out. This should however only be done in an absolute emergency or where no other provision has been made for retirement.
- A basic need of all individuals is to protect themselves and their possessions. To be rid of this burden, the risks are transferred to an insurance company that is willing to carry it.
- A life policy can also be used to good advantage to pay estate duty and other estate administration costs. This can be done by using the proceeds of the policy.

Term Insurance

As with whole-life insurance, an individual can take out term insurance to protect against the financial consequences of death and disability. If often happens that someone requires the coverage or protection for a specific period for example 20 years to cover a mortgage bond, etc.

Universal Policies

In this case, an endowment policy is combined with both life and disability cover. It has the same characteristics as the endowment and life policy with basically the same application possibilities.

Credit / Debt life assurance

This type of life insurance offers coverage for present debts. If a person dies after incurring debts, the debts are repaid with the amount provided in the policy. Credit life insurance includes both life and disability cover. It is also called decreasing life insurance, because the cover amount decreases with the debt period.

Disability Assurance

This insurance can be taken out to provide for loss of income due to disability but does not cover medical expenses or medical cover. It protects the family from loss of income if the breadwinner suffers a prolonged period of illness or becomes occupational disability. Please study table 15.11 on page 396 in order to be able to identify the features of a good disability policy.

New generation products

Insurance companies also offers products that will not only cover you in the case of financial risks as a result of death or disability but also investment products known as new generation products. These products may be combined for maximum returns or capital growth or for spreading local or international risks.

Funeral Assurance

A funeral policy is taken out to cover funeral costs. The costs of a funeral policy varied on the basis of age, number of insured people and the type of policy required.

Medical Insurance

The financial risks involved in medical expenses may be handled in various ways. The medical insurance that is referred to has to do with additional cover or what is also sometimes referred to as "top-up" cover. The reason for this is that the cover is taken out in addition to a medical aid fund and it meant to assist or cover additional medical and related costs. The benefits of this cover may be used as the insured wishes as it is paid directly to the policyholder. On the other hand, there are also specific cover in which cases benefits are only paid in specific cases e.g. a hospital plan.

It is suggested that the following aspects be examined before purchasing such medical cover:

- Most medical policies offer a period of 10 to 14 days to decide whether the policy is acceptable or not. This period should be used to examine the policy contract thoroughly.
- Note the policy's renewability, directions concerning cancellation, the waiting period, as well as which medical conditions are excluded.
- Make sure that the policy will cover you world-wide.
- Not all policies cover children once they have achieved independence. A specified age is usually established during which the dependants of a policyholder still receive medical cover.
- Find out whether the policy covers medical conditions existing at the time of the date of commencement.

- Make sure that medical expenses will be covered every time they occur, irrespective of the number of times a year.
- Avoid a situation in which various policies exist, with each covering a single medical condition. Rather purchase a policy offering comprehensive cover.
- It is usually in the policy applicant's interest to purchase a policy through a professional agent

Short Term Insurance

As the name indicates, this type of insurance is taken out to meet short term needs i.e. for periods less than a year. This does not however mean that the risk disappears after a year. Let us look at some specific types of short term insurance:

Homeowners' Insurance

This insurance protects a house or building against risks such as damage or destruction.

Household Insurance

This insurance covers the contents of a dwelling such as furniture and other personal belongings against various types of damage. It is important to ensure that the contents is insured for the full replacement value or else another method e.g. the averaging method will apply in cases where you are over or under insured.

Motor Vehicle Insurance

You may insure your vehicle in the following three ways:

Comprehensive - covers your own car and another car in the case of an accident and also covers you against theft, fire and damage.

Third party , Theft and Fire - covers you against damage to another vehicle and for theft and fire damage to your own vehicle

Third party only - covers you against damage to another vehicle only

Travel Insurance

This insurance is a must for frequent travelers and covers against loss of luggage, costs of a delayed flight, medical costs and legal costs. This becomes particularly important as most medical aid funds does not always cover your medical costs abroad.

Self-Insurance

Because some people consider the monthly premiums on short term insurance as a wasted "investment" and is of the opinion that their money can be worth more when invested in unit trusts of kept in a savings account. In such cases people establishes "emergency funds"

When you establish an emergency fund, money is invested so that the accumulated amount will be available in an emergency situation. The owner of the emergency fund must be disciplined and deposit a premium in the fund every month. The aim of the fun is make your own provision for possible future losses. The assumptions for a successful emergency fund include the following:

- A financial disaster, such as car theft, car accident or your house burning down will never happen to you
- When disaster does occur, the fund will be large enough to cover the damage
- It is unlikely that more than one disaster will occur in a short space of time
- No disaster will occur in the first 10 years and this will allow the fund to grow
- You will pay many small claims yourself and will not use the money in the fund

You can also go through the possible advantages and disadvantages of this option on page 401 in the text book.

Study Unit 16: Healthcare Planning

Most people neglect their health especially when they are young, with the result that the quality of their lives after retirement leaves much to be desired. One should consider your health to be your greatest asset and warrant that you should do everything in your power to protect and safeguard it.

Considering the many uncertainties surrounding our health and the medical expenses, it is clear that financial provision is essential. It is extremely risky not to make provision for medical expenses, for the following reasons:

- Medical and health expenses crop up constantly
- The possibility of an unexpected accident or operation exists, which could destroy you financially.

Of course, you could provide for medical expenses in various ways for example by making use of an existing investment. However, this is would be the wrong way because of the fact that you can actually transfer the risk relating the medical expenses to a medical aid fund or an insurance company. Furthermore, investments should be rather used for short, medium and long term goals such as retirement planning.

The financially correct method to provide for medical expenses is:

- A medical aid fund
- Top-up medical cover
- A hospital plan

The exam guidelines require us to differentiate between Medical Schemes and Medical Insurance.

Medical Schemes / Medical Aid Funds

It is important to belong to a medical aid fund that will survive in the long term. If you belong to a medical aid fund that is suffering from insuperable financial problems you might or will be held personally liable for all medical costs. You will furthermore have to pay for expense surgery yourself and this will have serious financial implications for you and your family. So the question that arises is "How to I evaluate a medical aid fund?"

It must be understood that this is not the easiest thing to do and it would probably be advisable to obtain professional help in this regard. You can for example refer to the fund's credit rating in terms of the Duff and Phelps ratings in order to determine the rates creditworthiness of the specific fund.

Medical aid funds are provided for mainly by:

- Medical schemes
- The first provider relates to the traditional employer based schemes
- New generation schemes which divides medical costs to create a separate savings account for members.
- Any medical scheme and top up cover from an insurance company
- Insurance Companies
- Private schemes including both new generation schemes and health insurance
- Private schemes and top up cover for medical shortfall

We also find terms referring to so called "open" and "closed" funds. IN the case of a "closed" fund, membership is regarded as compulsory and employers provide subsidies to its employees. In this case only the employees may belong to the medical aid scheme. On the hand we get an "open" fund in which case any person may become a member. The premium paid by members of this type of fund is usually higher because they are not subsidized by an employer.

Medical Insurance

On the other hand we get Medical Insurance which refers to additional medical cover in the form of medical insurance products. This type of insurance does not cover day to day medical expenses and is used to supplement existing medical aid cover in order to:

Cover a specific medical condition for example an specific operation of organ transplant, by taking out long term medical insurance (top-up cover) or a long term hospital pan or

Cover a particular daily cost e.g. a specific rate per day in hospital, by taking out short term medical insurance or a short term hospital plan

Please see figure 16.2 on page 415 for the basic difference between a medical aid and medical insurance.

Study Unit 17: Retirement Planning

The ultimate aim of personal financial planning is to enable a person to be financially independent after retirement and by financial independence we refer to the ability and freedom to make financial decisions. As stated however in popular literature, only 6% of all retired people are able to make independent financial decisions.

Retirement Pitfalls

- Lack of knowledge about the importance of early personal financial and retirement planning
- The absence of investments which lead to capital growth in the long term
- The tendency some people have to spend all their money because they want certain possessions immediately and then do not have enough funds left to provide for retirement
- Tendency to borrow money for non-essential possessions, which decrease in value such as motor vehicles, etc
- The absence of planning according to objectives, which have to be achieved sometime in the future

- The erroneous impression that you can earn a good living for the rest of your working life, which will ensure a good standard of living after retirement
- The uncertainty of the future causes people with a negative attitude to be wary of investing their money
- People regard retirement planning as an event to be tackled after retirement, and not before.

Methods of providing for retirement

There are many methods of providing for retirement and any combination of methods may be used to enable a person to retire financially independently. The important thing to remember is that you should invest with a view of capital growth in the long term. In this way we are utilising the principle of compounding whereby you earn interest on interest as well as capital.

Investments that are made for retirement purposes must be protected as they are expected to last until your death i.e. LEAVE YOUR RETIREMENT INVESTMENTS ALONE!

You must therefore invest for capital growth, protect your investments and continue making investments for retirement.

Without listing all the methods of providing to supplement your income over and above your employer's retirement fund please see these items listed on page 427.

A Fixed Benefit Pension Fund

This type of pension fund functions briefly as follows:

- Members' contribution form a fixed percentage or remuneration for the retirement funding service
- The employer's contribution varies according to actuarial advice. The employer's contribution covers costs, as well as death and disability benefits.
- Benefits are promised and defined according to a formula based on the member's years of service and average final salary
- Years of membership plus salary at retirement, therefore determine retirement benefits

The following advantages and disadvantages can be sited:

Advantages

- Monthly contributions are tax deductable
- The pension is protected against the insolvency of the member
- Life and disability cover are included at a low cost
- The lump sum is tax free up to an amount of R315 000
- The investment risk does not go over to the member because the employer still has to pay the pension contribution irrespective of the investment return

Disadvantages

- Employees lose the employers contributions as well as the growth when they resign
- Two thirds of retirement benefits must be taken in the form of an inflexible pension, irrespective of good fund performance.

- Employees are not protected against their own indiscretions, because they can take their pension lump sum and squander it before retirement age in the case of resignation.
- Monthly pensions do not keep up with inflation

A Fixed Contribution Provident Fund

This type of fund functions briefly as follows:

- Retirement benefits are based on total contributions made by the member plus growth
- Employees bears the risk
- It favours younger fund members
- The retiree receives 100% of benefits as lump sum or less if the member prefers
- Members receives a lump sum only

The following advantages and disadvantages can be sited:

Advantages

- A member can take all relevant benefits in the form of a single lump sum
- Members are in control of the retirement amount of their benefits, although this can also be considered to be a disadvantage
- Flexible retirement and estate planning is possible
- Members can make additional contributions in order to increase their retirement provisions

Disadvantages

- Lump sum benefits may be squandered or invested in "wrong" investments
- The rules of the fund does not allow members to buy back years
- Contributions by members are not tax deductible
- Lump sums received are taxable in total
- The investment risk rests with the employee or member

Retirement Annuities

An annuity is a series of payments or investments that are made in equal instalments. A retirement annuity is a tax friendly way of making provision for retirement. The annuity's option must be exercised when you are between 55 and 70 years old:

- The investor must take one-third of their total investment as a lump sum and reinvest it
- The remaining two-third must be used to buy a compulsory annuity

Preservation Funds

A preservation fund is a type of retirement fund in which retirement benefits from a pension or provident fund are kept. Insurance companies have preservation funds.

With a lump sum annuity you may not touch your benefits in the fund until the age of 55 which is not the case with a preservation fund. Money may be withdrawn once before retirement and it is possible to withdraw the entire amount. This can thus be seen as an advantage as well as a disadvantage for financially undisciplined people.

For the purposes of this fund, the retirement age is described as the age at which you leave the services of the employer which may be an age before 55 or even after 70.

An advantage of this fund is that the employee's years of membership of the employers' fund can be transferred to the preservation fund. The years of membership are still taken into account when the tax free lump sum is calculated.