THE IMPORTANCE OF SAVING

If you don’t earn much and you can barely pay your bills, the idea of saving money might seem laughable. When you only have $5 left at the end of the month, why even bother to try saving? Because everyone has to start somewhere, and if you work at it, your financial situation is likely to improve over time. Saving money is worth the effort. It gives you peace of mind, it gives you options, and the more you save, the easier it becomes to accumulate additional savings.

Peace of Mind

Who hasn’t lain awake at 3:00 a.m. wondering how they were going to afford something they needed? If money is really tight, you might be wondering how you’re going to pay the rent next week. If you’re a little further up the financial ladder, you might be worried about how many months you could pay the bills if you lost your job. Later in life, the money thoughts that keep you up at night might center around paying for your kids to go to college or having enough money to retire. (Get help with college savings by reading Stop Procrastinating! Enroll In A College Savings Plan.)

As you accumulate savings, your financial worries should diminish, as long as you’re living within your means. If you already have next month’s rent taken care of by the first week of the current month, if you know you can get by without work for three to six months, if you have savings accounts for your children’s education and your own retirement that you’re regularly funding, you’ll sleep better at night. The reduced stress from having money in the bank frees up your energy for more enjoyable thoughts and activities. (Learn more in Banking: Savings Accounts 101 and Find The Best Savings Account Rates.)

Expanded Options

The more money you have saved, the more you control your own destiny. If your job has you on the verge of a nervous breakdown, you can quit, even if you don’t have a new job lined up yet, and take time off to restore your sanity before you look for new employment. If you’re tired of living in an unsafe neighborhood, you can move to a safer area because you’ll have enough for a deposit on a better apartment or a down payment on a nicer home. (Is buying a home in your future plans? Read How To Buy Your First Home: A Step-By-Step Tutorial.)

If you get sick and need expensive healthcare that your insurance doesn’t cover, you’ll have a way to pay for it even though you can’t work while you’re getting treatment. And knowing that you have options because of the money you’ve socked away can give you even more peace of mind.

No, money doesn’t solve every problem. If you are laid off, it might take as long as two years to find a new job. Some illnesses won’t go away no matter how many procedures you can afford, and random crime can happen even in a supposedly secure gated community. But with more money in the bank to deal with issues like these, you give yourself better odds of coming out on top.

Money Working for You

Most of us put in hundreds of hours of work each year to earn most of our money. But when you have savings and stash your funds in the right places, your money starts to work for you. Over time, you’ll need to work less and less as your money works more and more, and eventually, you might be able to stop working altogether.

What does it mean to have your money working for you? When you’re first starting to save, you’ll want to put your money somewhere safe, where you can access it right away for unforeseen expenses. That means an online savings account, where you might earn 1% interest annually and not even keep up with inflation, which tends to run around 2% to 3% per year. You’ll even have to pay taxes on your meager 1% earnings. Anything is better than earning 0%, though, or not having savings and going into credit card debt, which will cost you 10% to 30% in interest per year. (For related reading, see Why You Absolutely Need An Emergency Fund and How To Use Your Roth IRA As An Emergency Fund.)

Once you've saved three to six months' worth of expenses in your emergency fund, you can start saving money in a tax-advantaged retirement account. That's where the magic starts to happen. These accounts, such as a Roth IRA or 401(k), allow you to invest in the stock market. If you do it right, you'll earn about 8% per year on average over the long run. You won't pay any taxes on those investment gains along the way, which will help your money grow even faster. With a Roth IRA, you contribute after-tax dollars, and everything that's in the account after that is yours to keep. With a 401(k), you get to contribute before-tax dollars, giving you more money to invest up front; you'll pay taxes when you withdraw the money in retirement. (If you're not sure whether it's better to pay taxes now or later, you can hedge your bets and contribute to both your employer-sponsored retirement plan and a Roth IRA.) The third choice, a traditional IRA, allows you to contribute before-tax dollars as you do with a 401(k).

If you have a high income and low expenses, you might accumulate enough to retire in 10 years. For most people, it takes closer to 40 years. But at some point, if you save and invest regularly, you should be able to live off the income generated by your investments – the saved money that's working for you. The earlier you start, the more time a small amount of money has to grow large through the miracle of compounding. (Feel like you don't make enough to save anything meaningful? Read Why Small Retirement Savings Count.)

The Bottom Line
Saving money is incredibly important. It gives you peace of mind, expands your options for decisions that have a major effect on your quality of life and eventually gives you the option to retire. Most people who are wealthy got there through a combination of their own hard work and smart savings and investment decisions. You can become one of those people, too.

RETIREMENT ANNUITY

Just for clarity, an RA, or retirement annuity, is usually the terminology used for the accumulation of retirement funds—in other words you save into a retirement annuity while you are working. When you retire from the fund, two-thirds of the retirement annuity must be used to purchase an annuity, which will pay you an income in retirement. With a fixed annuity (or life annuity) your lump sum buys you a set income. It all depends on the type of annuity you purchase as to when it will stop paying out. The two most common are a single life annuity and a joint life annuity.

A single life annuity will pay you an income for as long as you live. So if you die in the second year, the life company retains the money but if you live to 100, they have to keep paying. With a joint life annuity you can insure your spouse, so if either of you die the other will still receive the income. Life companies will offer variations of these with different guarantees, and these vary from company to company, so it is worth finding out exactly what you are buying.

Below are definitions from Alexander Forbes of some of the most common options:

Fixed annuity
Increases: No annual increase. However, you have an option to choose a flat annual increase e.g. 3%, 5% or 10%, this will reduce the initial income you receive.
Pension is paid for as long as you are alive.

Advantages: If no annual increase is chosen, the initial pension is higher. The pension is paid for
life. Your spouse will receive a pension when you pass away*.
Disadvantages: Income doesn’t increase unless chosen—therefore doesn’t keep up with inflation.
You are not able to adjust your income level as time goes by.

With-profit annuity
Increases: The insurance company decides on annual increases—depending on investment performance.
Pension is paid for as long as you are alive.
Advantages: Initial pension and increases declared by insurer are guaranteed for life.
Insurance company takes the risk of poor investment performance. The pension is paid for life. Your spouse will receive a pension when you pass away*.
Disadvantages: You have no say in where your money is invested. The pension increases can be low or even 0% if markets are performing badly.

Inflation-linked annuity
Increases: Increases are based on inflation during the year.
Pension is paid for as long as you are alive.
Advantages: Your income keeps up with inflation and is protected against increases in the cost of living. Your spouse will receive a pension when you pass away*.
Disadvantages: The pension increases can be low or even 0% if inflation is low or 0% respectively.

Living annuity
Increases: You decide on the level of income you need to get every year with a financial adviser (within 2,5% and 17,5% of the investment value).
Advantages: Flexibility. You decide where to invest your money and you choose your own income level.
Disadvantages: You carry the risk of poor market performance—no guarantees. There is a risk of outliving your money, that is the risk of you living much longer than expected and drawing too much income early on.

EMERGENCY FUNDS

What Is an Emergency Fund?
An emergency fund is an account for funds set aside in case of the event of a personal financial dilemma, such as the loss of a job, a debilitating illness, or a major repair to your home. The purpose of the fund is to improve financial security by creating a safety net of funds that can be used to meet emergency expenses as well as reduce the need to draw from high-interest debt options, such as credit cards or unsecured loans.
Understanding an Emergency Fund
An emergency fund should contain enough money to cover at least three months of income, according to most financial planners. Note that financial institutions do not carry accounts labeled as emergency funds. Rather, the onus falls on an individual to set up this type of account and earmark it as capital reserved for personal financial crises.

KEY TAKEAWAYS
An emergency fund is a financial security for future mishaps and/or unexpected expenses.
Financial planners recommend that emergency funds should typically have 3 to 6 months' worth of income in very liquid form so that it is instantly accessible.
Use tax refunds and other windfalls to build up your fund.
A married couple who earns R108,000 annually after taxes should set aside a readily accessible minimum of R27,000 (three months) to R54,000 (six months) to address unexpected financial surprises. The funds should be highly liquid, remaining in checking or savings accounts. These vehicles allow quick access to cash for satisfying household expenses during an emergency situation.

Emergency Funds and Investing
Financial advisers view an investment strategy as a pyramid. A strong base is fundamentally important to support the levels of risk an investor bears as securities with varying levels of volatility layer over the foundation. Before an individual ventures into intermediate- or long-term investment vehicles, the first step toward creating stability and minimizing risk should be establishing an emergency fund.

3 to 6 Months
The amount of your income you should stash in an emergency fund.

Stashing three—or even better, six—months' income in a highly liquid account, such as a money market, should preclude the purchase of any instrument that holds risk to principal or requires lock-in periods during which penalties are assessed for early withdrawal. As more volatile securities sit atop above the base of savings accounts or Treasury bills, overall portfolio volatility is minimized and necessary access to risk-free capital is optimized.

Prudent advice should deter a new investor from immediately placing savings in an investment vehicle, such as a growth mutual fund, before that individual creates sufficient liquid capital on which to rely in the event of income loss. Growth funds, while less volatile than individual stocks, hold risk to principal that is best mitigated by increased time horizons. Furthermore, managed growth funds often charge a front-end sales load up to 5.75% or a contingent deferred sales charge (CDSC) against redemptions that would further impact principal needed in the event of an emergency.

Strategies to Set Up an Emergency Fund
Starting early is key to setting up an emergency fund because it helps you build up a comfortable cushion against unexpected emergencies (or mishaps) later in life. Getting a start on emergency funds is not complex. Here are two simple ways to begin saving for an emergency fund:

Set aside a comfortable amount from your salary each month. This amount should be calculated keeping an eventual goal for savings that will contribute to your fund. As you move up (or down) through your career, you can revise this figure. Once the fund is built up to the level you need, invest extra savings for the long term or for other goals, such as the down payment on a mortgage.
Save any tax refund you receive. The tendency for most of us is to consider a tax refund as "extra" cash, which can splurged on luxuries. Instead of spending the tax refund, save it as a contribution toward your emergency fund.

MAINTAINING A GOOD CREDIT RECORD SCORE

There are many benefits of having a good credit score, such as enjoying a lower interest rate on your credit cards and loans. A good credit score also allows you to save money on insurance and security deposits on new utilities and cell phone service. Using your credit wisely and responsibly is what helps you to maintain a good score.

01 Know What Goes Into a Good Credit Score
The more you know about what goes into your credit score, the easier it will be to maintain a good one. Five key pieces of information are used to calculate

your credit score—your payment history, level of debt, credit age, mix of credit, and recent credit. Some things do not affect your credit score. For example, checking account overdrafts and utility payments won’t automatically help (or hurt) your credit score.

02 Pay Your Bills on Time

That goes for all your bills, not just your credit cards and loans. While certain bills don’t get reported to the credit bureaus when you pay on time, they could end up on your credit report if you fall behind. Even a small library fine could wind up on your credit report if it's left unpaid and sent to a collections agency. Continue to pay all your bills on time to maintain a good credit score.

03 Keep Your Credit Card Balances Low

The higher your credit card balance in relation to your credit limit, the worse your credit score will be. Your combined credit card balances should be within 30 percent of your combined credit limits to maintain a good credit score. That’s $300 on credit cards with combined limits of R1,000. Charging more than 30 percent of your credit limit is risky even if you plan to pay off the balance when your billing statement arrives. Card issuers typically report the balance when your statement closes, so that's the number that will be reflected on your credit report. It's a good idea to keep tabs on your accounts online and pay enough to reduce your balances to less than 30 percent just before the billing month closes.

04 Don't Close Old Credit Cards

When you close a credit card, your credit card issuer no longer sends updates to the credit bureaus, and the credit scoring formula places less weight on inactive accounts. After 10 years or so, the credit bureau will remove that closed account's history from your credit report, and losing that credit history will shorten your average credit age and cause your credit score to drop. Closing a credit card also reduces your available credit. For example, if you have three cards with a combined credit limit of $10,000 and you close one with a R3,000 limit, your combined credit limit will be reduced to R7,000. Since your goal is to keep your credit card balances at less than 30 percent of your available credit, closing that card reduces your threshold by R900.

05 Manage Your Debt

Credit card balances aren’t the only accounts that influence your credit score. Loan balances and lines of credit also impact your level of debt. Having too much debt can cost you points on your credit score. The lower your debt, the easier it will be to maintain a good credit score.

06 Limit Your Applications for New Credit

Too many credit inquiries—whether they be for a credit card or a loan—also can have a negative impact on your score, so make sure you're only applying for credit when it really is necessary. Opening a new credit account also lowers your average credit age.

07 Watch Your Credit Report

Just because you do everything right with your credit doesn’t mean everyone else will. Errors could end up on your credit report leading to a drop in your credit score. Identity theft and credit card fraud also can lead to inaccurate information on your credit report. Checking your credit report throughout the year helps you detect these mistakes sooner so you can correct them and maintain a good credit score.

BUDGETING PRINCIPLES

Meaning of Budgeting:

Budgeting is the process of designing, implementing and operating budgets. It is the managerial process of budget planning and preparation, budgetary control and the related procedures. Budgeting is the highest level of accounting in terms of future which indicates a definite course of action and not merely reporting. It is an integral part of such managerial policies as long-range planning, cash flow, capital expenditure and project management. It must be remembered that budgeting is not forecasting. It is true that budgeting does involve some sort of forecasting particularly in the area of sales budget. But the process is physically one of detailed analyses and planning not merely prognosticating future results.

Forecasting is a process of predicting the future state of world, in connection with those aspects of the world which are relevant to and likely to affect on future activities. Any organized business cannot avoid anticipating or calculating future conditions and trends for the framing of its future policy and decision. Forecasting is concerned with probable events whereas budgeting relates to planned events. Budgeting should be preceded by forecasting, but forecasting may be done for purpose other than budgeting. Thus, in forecasting an estimate of what is likely to happen is made whereas budgeting is the process of stating policy and programme to be followed in future. Further, forecasting does not connote any sense of control while budgeting is a tool of control since it represents actions which can be shaped according to sweet will so that it can be suited to the conditions which may or may not happen.

In sum, budget is an operating and financial plan spelling out a target which the management seems to attain on the basis of the forecasts made. A forecast denotes some degree of flexibility while a budget denotes a definite target.

Purpose and Objectives of Budgeting:
The overall purpose of budgeting is to plan different phases of business operations, coordinate activities of different departments of the firm and to ensure effective control over it. To accomplish this purpose, a budget aims at attaining the following objectives:

1. To prognosticate the firm’s future sales, production cost and other expenses in order to earn desired amount of income and minimise the possibility of business losses.
2. To anticipate the firm’s future financial condition and future need for funds to be employed in the business with a view to keeping the firm solvent.
3. To decide the composition of capitalisation in order to ensure availability of funds at reasonable cost.
4. To coordinate the efforts of different departments of the firm toward the common objectives.
5. To accelerate efficiency of operations of different departments, divisions and cost centres of the firm.
6. To fix responsibilities of different departmental heads.
7. To ensure effective control over the firm’s cash, inventory and sales, and
8. To facilitate centralised control over the firm through the budgetary system.

The Budgeting Process:
The budgeting process usually begins when managers receive top management’s forecasts and marketing project objectives for the coming year, along-with a time-table stating when budgets must be completed. The forecasts and objectives provided by the top management represent guidelines within which departments budgets are prepared. Usually, the work on budgeting begins with the task of estimating sales because the total activity of a firm depends on the sales. Preparation of sales estimate demands assessment of the existing market situation and projection of one’s ideas as to what would be the market position in the ensuing period for which the budget is proposed. Several internal as well as external factors are taken into consideration. The sales estimate prepared by the marketing manager is then submitted to the budget committee for consideration. The budget committee comprising of the top management carefully considers the forecast in the light of the past results and the estimates of the future as recommended by economists and statisticians and wherever necessary recommends for changes in estimate or if necessary asks for complete restudy and revision.

Upon the recommendation of the budget committee, the President of the organization accords his approval to the sales estimate which then becomes sales budget of the organization. The sales budget is accompanied by budget covering selling and distribution expenses. The two budgets together give the net sales revenue expected to arrive in the coming year. After the preparation of the sales budget and selling and distribution cost budget, Production Budget of the firm is prepared. The production budget is based on the production forecasts which are made after taking into consideration sales budget, the maximum and minimum stock of finished goods to be maintained, the plant capacity and availability of various factors of production. When targeted production for the budget period has been decided, the production budget (expressed in quantities to be produced) can be converted into a Production Cost Budget. Production Cost budget is composed of Materials Cost Budget, Labour Cost Budget and Overheads Budgets. Materials cost budget shows expected cost of materials required for budgeted production and sales purpose. Determination of material cost involves quantities to be used and the rate per unit. The task of determining the quantities required is that of the production engineering department while the purchasing department has the responsibility of deciding the rate. Labour Cost Budget prognosticates the direct labour cost expected to be spent on carrying into effect the targeted production. Preparation of this budget requires information regarding the time required to do one unit of work and the wages to be paid for it. Overheads Budget is a statement of expected overheads (comprising fixed and variable overheads) which the firm will have to incur during the budget period. This budget is prepared on the basis of overhead forecasts of all the departments of the firm. Once materials cost budget, labour cost budget and overheads budget are prepared, a full production cost budget can be drawn. This budget is generally presented in the form of a cost sheet. In order to achieve competitive edge over its rivals on sustainable basis, an organization will have to develop new products or new processes for producing existing products at minimum cost. Thus, the organization has to incur expenditure on research and development effort.

The Research and Development Budget is drawn up into two parts:

(i) Fixed or constant expenses necessary to maintain research and development work at the irreducible level; and

(ii) Costs to be incurred on completing the projects in hand or on those to be taken up. It is the management to decide which new projects are to be taken up and whether any of the existing projects in hand is to be given up.

Capital Budget is prepared to estimate receipts and payments on capital account as opposed to revenue account. Following the decision of the management about the capital expenditure to be made during the budget period, capital budget is drawn up to show month-wise receipts and payments on capital account.
A Cash Budget showing expected receipts and payments on revenue account is prepared separately. Once separate budgets for sales, production finance and other activities have been prepared and finalised and the targeted sales, cost of sales, expenses are determined, the targeted profit and loss account and balance sheet can be drawn. These statements together are known as Master Budget.

Budgeting Framework

Fundamental Principles of Budgeting:
So as to ensure that budget serves as an effective technique of managerial decision making, certain cardinal principles must be kept in view.

These principles are:

1. Management Support:
Top management’s support and cooperation is essential for successful implementation of the budget. It should take interest not only in setting the

targets and finalising the budgets but also constantly monitoring the actual performance to find out the deviations if any and take curative steps, motivate the personnel and reward the good performers.

2. Employees Involvement:

The budget should be established on the highest possible level of motivation. All levels of management should participate in setting targets and preparing budget. This will result in defining realistic targets. Participation of employees in budgeting process will not only make them carefully think about the likely development in the forthcoming period and prepare budget accordingly, but will also motivate them to strive hard to achieve budget levels of efficiency and activity.

3. Statement of Organizational Goal:

The organizational goal should be quantified and clearly stated. These goals should be set within the framework of corporate objectives and strategies. A well defined corporate policy and strategy is a pre-requisite for budgeting.

4. Responsibility Accounting:

Individual employees should be informed about expectations of the management. Only those costs over which an individual has predominant control should be used in evaluating performance of that individual. Responsibility reports often contain budget to actual comparisons.

5. Organizational Structure:

There should be well-planned organizational structure with clearly defined authority and responsibility of different levels of management. Role and responsibilities of Budget Committee and its President must be made known to the people in the organization.

6. Flexibility:

If the basic assumptions underlying the budget change during the year, the budget should be restated. This will enable the management to compare the actual level of operations with the expected performance at that level.

7. Communication of Results:

Proper communications systems should be established for management reporting and information service so that information pertaining to actual performance is presented to the concerned manager timely and accurately so that remedial action is taken wherever necessary.

8. Sound Accounting System:

Organization should have good accounting system so as to generate precise, accurate, reliable and prompt information which is essential for successful implementation of budget system.