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SIX PILLARS IN PERSONAL FINANCIAL PLANNING

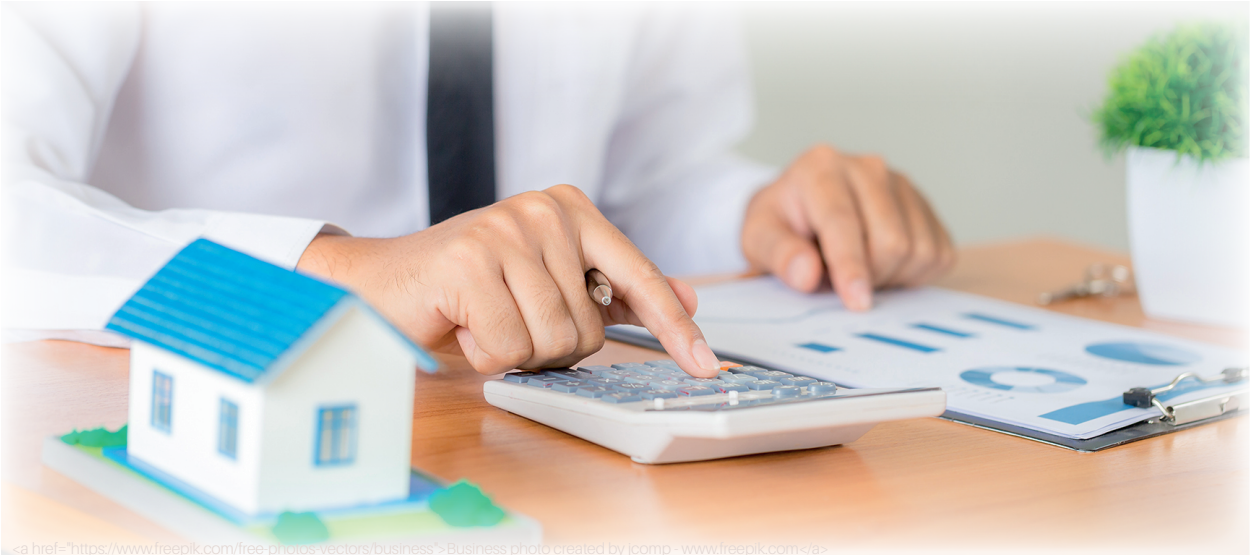
By Chong Tun Pin and William Choo Keng Soon | *3 April 2020*

Are you short of money? Do you always have a sense of being financially insufficient? If yes is your answer, then your finances would require planning. Personal financial planning is no longer applicable only for the wealthy but has become a need for everyone. However, what constitutes financial planning? There are six pillars in personal financial planning namely cash flows and net worth planning, investment planning, risk and insurance planning, retirement planning, estate planning, and tax planning, which shall be further discussed below.

Cash Flows and Net Worth Planning

Personal financial sustainability starts with a healthy cash flow management. Cash flow statement provides information with regards to personal financial position and it presents an individual's income (cash inflow) and spending (cash outflow) behaviour. It is a useful tool to gauge your financial status and progress in achieving financial goals and objectives. Apart from that, it provides a valuable insight of your personal financial activities. As such, it helps to monitor and keep track of your money flows. As a rule of thumb, cash inflow should outstrip cash outflow to sustain a healthy cash flow management. This will help to create a precautionary cash to cushion off incoming financial uncertainty such as the impact from the recent Covid-19 incident.

Net worth planning is a process of asset management by clutching, understanding and managing all items of value which comprise assets and liabilities. Net worth statement presents current financial status and it measures how great assets are to liabilities (surplus net worth statement). It is pivotal to understand the needs to acquire liabilities unless it has the potential to generate "positive future value". Otherwise, unwanted and unnecessary liabilities should be kept at bay. As conclusion, net worth planning aims at keeping and acquiring assets that are greater than liabilities.



Investment Planning

Investment planning is a process of establishing how the resources are employed in fulfilling one's financial objectives. There are no standard rules in justifying the suitability of an investment to any particular individual. Rather, it would be a trade-off between financial goals and risks associated with the investment. In the process of investment allocation, investment risk should be given due consideration to determine the consistency with your risk profile. The type of investment holding must augur well with risk appetite and financial objectives. Investment liquidity should also be considered in safeguarding the disposal valuation and catering for emergency needs.

Risk and Insurance Planning

Risk can be defined as an uncertainty concerning the occurrence of financial loss. Risk has become a pivotal concern in financial planning as it causes deviation of financial outcome from its objectives. It should be well managed without much compromising with financial goals. Insurance planning is one of the ways in minimizing personal financial risk and distress. There are five areas in insurance planning which cover but are not limited to life insurance, disability and critical illness, liability, property and health. However, some but not all risks are hedgeable with insurance instruments. In conclusion, one should get sufficient insurance coverage rather than be over insured as it would be a waste of resources. Remember, insurance instruments should serve as a tool for risk managing instead of speculating unless it is part of your financial objectives.

Retirement Planning

Retirement planning refers to the process of determining financial resources and retirement income goals for post-retirement. It is important to start early in the planning for retirement to generate the desired retirement funds. In an approaching retirement, seek a steady and secure income stream to generate the desired lump amount at the end of working life, an ability to access funds for emergency, access to government benefit and simplicity of financial arrangement. The main insidious force that devours retirement funds is inflation that is expected to rise every year. Therefore, it is important to incorporate the effect of inflation in preparing the retirement plan.

Estate Planning

Estate planning is the process of preparing and managing the financial administrative transitions related to a person's estate during life and after death. In estate planning, a person can soften the impact of his death by clearly documenting his wishes in regards to his estate, providing instruction as to the distribution of the assets and naming the person responsible for managing the distribution. The estate planning tools involve will writing, trust funds, beneficiary designations and powers of attorney to ensure that the provisions will be executed in accordance with the deceased's arrangement.

Tax Planning

Tax planning is defined as the development and implementation of appropriate strategies to reduce tax liability; thus, the analysis of a financial situation is crucial to identify the taxable income stream and tax relief by the government. Therefore, the three broad strategies in fulfilling financial planning goals with minimal tax consequences are reducing the income tax consequences of a transaction or arrangement such as deductible expenditures, shifting the timing or a taxable event to private retirement scheme, national education saving scheme or employees provident fund, and shifting income to another taxpayer such as non-working spouse. It's important to keep an eye out for potential opportunities in the government budget announcement which is dedicated to tax planning strategy.

Summary

The unexpected global pandemic has brought most Malaysians to a financial standstill. A comprehensive financial plan can mitigate the impact of any changes in economic situation. Unfortunately, there is no standard or golden rule in performing personal financial planning. You should consult with a Licensed Financial Planner to determine what may be best for your financial needs. It requires persistence, understanding, knowledge and communication with pertinent stakeholders in building a comprehensive and unique financial plan. In a nutshell, personal financial planning should be re-calibrated every two to three years or as needed due to changes of economic situation, investment objectives, investment horizon, life situation, age, and risk profile. This global pandemic could serve as a learning curve in ensuring financial preparedness for any eventualities.

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