Personal Finance

THIRTEENTH EDITION

The McGraw-Hill Education Series in Finance, Insurance, and Real Estate

FINANCIAL MANAGEMENT

Block, Hirt, and Danielsen
Foundations of Financial Management
Seventeenth Edition

Brealey, Myers, and Allen
Principles of Corporate Finance
Thirteenth Edition

Brealey, Myers, and Allen
Principles of Corporate Finance, Concise
Second Edition

Brealey, Myers, and Marcus
Fundamentals of Corporate Finance
Tenth Edition

Brooks
FinGame Online 5.0

Bruner
Case Studies in Finance: Managing for Corporate Value Creation
Eighth Edition

Cornett, Adair, and Nofsinger
Finance: Applications and Theory
Fifth Edition

Cornett, Adair, and Nofsinger
M: Finance
Fourth Edition

DeMello
Cases in Finance
Third Edition

Grinblatt (editor)
Stephen A. Ross, Mentor: Influence through Generations

Grinblatt and Titman
Financial Markets and Corporate Strategy
Second Edition

Higgins
Analysis for Financial Management
Twelfth Edition

Ross, Westerfield, Jaffe, and Jordan
Corporate Finance
Twelfth Edition

Ross, Westerfield, Jaffe, and Jordan
Corporate Finance: Core Principles and Applications
Fifth Edition

Ross, Westerfield, and Jordan
Essentials of Corporate Finance
Tenth Edition

Ross, Westerfield, and Jordan
Fundamentals of Corporate Finance
Twelfth Edition

Shefrin
Behavioral Corporate Finance: Decisions That Create Value
Second Edition

INVESTMENTS

Bodie, Kane, and Marcus
Essentials of Investments
Eleventh Edition

Bodie, Kane, and Marcus
Investments
Eleventh Edition

Hirt and Block
Fundamentals of Investment Management
Tenth Edition

Jordan, Miller, and Dolvin
Fundamentals of Investments: Valuation and Management
Eighth Edition

Stewart, Piros, and Heisler
Running Money: Professional Portfolio Management
First Edition

Sundaram and Das
Derivatives: Principles and Practice
Second Edition

FINANCIAL INSTITUTIONS AND MARKETS

Rose and Hudgins
Bank Management and Financial Services
Ninth Edition

Rose and Marquis
Financial Institutions and Markets
Eleventh Edition

Saunders and Cornett
Financial Institutions Management: A Risk Management Approach
Ninth Edition

Saunders and Cornett
Financial Markets and Institutions
Seventh Edition

INTERNATIONAL FINANCE

Eun and Resnick
International Financial Management
Eighth Edition

REAL ESTATE

Brueggeman and Fisher
Real Estate Finance and Investments
Sixteenth Edition

Ling and Archer
Real Estate Principles: A Value Approach
Fifth Edition

FINANCIAL PLANNING AND INSURANCE

Allen, Melone, Rosenbloom, and Mahoney
Retirement Plans: 401(k)s, IRAs, and Other Deferred Compensation Approaches
Twelfth Edition

Altfest
Personal Financial Planning
Second Edition

Harrington and Niehaus
Risk Management and Insurance
Second Edition

Kapoor, Dlabay, Hughes, and Hart
Focus on Personal Finance: An Active Approach to Help You Achieve Financial Literacy
Sixth Edition

Kapoor, Dlabay, Hughes, and Hart
Personal Finance
Thirteenth Edition

Walker and Walker
Personal Finance: Building Your Future
Second Edition

Personal Finance

THIRTEENTH EDITION

JACK R. KAPOOR
College of DuPage

LES R. DLABAY
Lake Forest College

ROBERT J. HUGHES
Dallas County Community Colleges

MELISSA M. HART
North Carolina State University

PERSONAL FINANCE, THIRTEENTH EDITION

Published by McGraw-Hill Education, 2 Penn Plaza, New York, NY 10121.

This book is printed on acid-free paper.

1 2 3 4 5 6 7 8 9 0 LWI 21 20 19 18 17 16

ISBN 978-1-260-01399-3 (bound edition)
MHID 1-260-01399-5 (bound edition)

ISBN: 978-1-260-79978-1 (loose-leaf edition)
MHID: 1-260-79978-6 (loose-leaf edition)
Portfolio Manager: *Charles Synovec*
Product Developer: *Jennifer Lohn Upton*
Marketing Manager: *Trina Maurer*
Content Project Managers: *Fran Simon/Angela Norris*
Buyer: *Laura Fuller*
Design: *Jessica Cuevas*
Content Licensing Specialists: *Abbey Jones/Shawntel Schmitt*
Cover Image: *Upper left - ©oatawa/Getty Images; Lower left - ©Cultura/Image Source; Top right - ©Uber Images/ Shutterstock; Middle right - ©PhotoInc/Getty Images; Bottom right - ©oliveromg/ Shutterstock*
Compositor: *SPi Global*

Library of Congress Cataloging-in-Publication Data

Names: Kapoor, Jack R., 1937- author. | Dlabay, Les R., author. | Hughes, Robert James, 1946- author.
Title: Personal finance / Jack R. Kapoor, College of DuPage, Les R. Dlabay, Lake Forest College, Robert J. Hughes, Dallas County Community Colleges, Melissa M. Hart, North Carolina State University.
Description: Thirteenth Edition. | Dubuque, IA: McGraw-Hill Education, [2019] | Revised edition of Personal finance, [2017]
Identifiers: LCCN 2018055023 | ISBN 9781260013993 (alk. paper)
Subjects: LCSH: Finance, Personal.
Classification: LCC HG179 .K37 2019 | DDC 332.0024—dc23 LC record available at https://lccn.loc.gov/2018055023

mheducation.com/highered

To the memory of my parents, Ram and Susheela Kapoor; and to my wife, Theresa; and my children, Karen, Kathryn, and Dave

To my wife, Linda Dlabay; and my children, Carissa and Kyle, and their spouses, Doug Erickson and Anne Jaspers

To my wife, Robin; and to the memory of my mother, Barbara Y. Hughes

To my husband, David Hart; and my children, Alex and Madelyn

Brief Contents

About the authors

Jack R. Kapoor, EdD

College of DuPage

Jack Kapoor has been a professor of business and economics in the Business and Technology Division of the College of DuPage, Glen Ellyn, Illinois, where he has taught business and economics since 1969. He received his BA and MS from San Francisco State University and his EdD in Business and Economic Education from Northern Illinois University. He previously taught at Illinois Institute of Technology's Stuart School of Management, San Francisco State University's School of World Business, and other colleges. Professor Kapoor was awarded the Business and Technology Division's Outstanding Professor Award for 1999–2000. He served as an assistant national bank examiner for the U.S. Treasury Department and has been an international trade consultant to Bolting Manufacturing Co., Ltd., Mumbai, India.

Dr. Kapoor is known internationally as a coauthor of several textbooks, including *Business: A Practical Approach* (Rand McNally), *Business* (Houghton Mifflin), *Business and Personal Finance* (Glencoe), and *Focus on Personal Finance* (McGraw-Hill). He served as a content consultant for the popular national television series *The Business File: An Introduction to Business* and developed two full-length audio courses in business and personal finance. He has been quoted in many national newspapers and magazines, including *USA Today, U.S. News & World Report,* the *Chicago Sun-Times, Crain's Small Business,* the *Chicago Tribune,* and other publications.

Dr. Kapoor has traveled around the world and has studied business practices in capitalist, socialist, and communist countries.

Les R. Dlabay, EdD

Lake Forest College

"Learning for a life worth living" is the teaching emphasis of Les Dlabay, professor of business emeritus, who taught at Lake Forest College, Lake Forest, Illinois, for 35 years. In an effort to prepare students for diverse economic settings, he makes extensive use of field research projects related to food, water, health care, and education. He believes our society can improve global business development through volunteering, knowledge sharing, and financial donations. Dr. Dlabay has authored or has adaptations of more than 40 textbooks in the United States, Canada, India, and Singapore. He has taught more than 30 different courses during his career, and has presented over 300 workshops and seminars to academic, business, and community organizations. Professor Dlabay has a collection of cereal packages from more than 100 countries and banknotes from 200 countries, which are used to teach about economic, cultural, and political elements of international business environments.

His research involves informal and alternative financial services, cross-cultural exploration methods, and value chain facilitation in base-of-the-pyramid (BoP) market settings. Dr. Dlabay previously served on the board of Bright Hope International (www.brighthope.org), which emphasizes microenterprise development, and currently serves on the board of Andean Aid (www.andeanaid.org), which provides tutoring assistance and spiritual guidance to school-age children in Colombia and Venezuela. Professor Dlabay has a BS (Accounting) from the University of Illinois, Chicago; an MBA from DePaul University; and an EdD in Business and Economic Education from Northern Illinois University. He has received The Great Teacher award at Lake Forest College three times.

Robert J. Hughes, EdD

Dallas County Community Colleges

Financial literacy! Only two words, but Bob Hughes, professor of business at Dallas County Community Colleges, believes that these two words can change people's lives. Whether you want to be rich or just manage the money you have, the ability to analyze financial decisions and gather financial information are skills that can always be improved. In addition to writing several textbooks, Dr. Hughes has taught personal finance, introduction to business, business math, small business management, small business finance, and accounting since 1972. He also served as a content consultant for two popular national television series, *It's Strictly Business* and *Dollars & Sense: Personal Finance for the 21st Century,* and is the lead author for a business math project utilizing computer-assisted instruction funded by the ALEKS Corporation. He received his BBA from Southern Nazarene University and his MBA and EdD from the

University of North Texas. His hobbies include writing, investing, collecting French antiques, art, and travel.

Melissa M. Hart, CPA

North Carolina State University

Melissa Hart is a permanent lecturer in the Poole College of Management at North Carolina State University. She was inducted into the Academy of Outstanding Teachers. She has been nominated for the Gertrude Cox Award for Innovative Excellence in Teaching and Learning with Technology as well as the Alumni Distinguished Undergraduate Professor Award. She teaches courses in personal finance and corporate finance and has developed multiple ways to use technology to introduce real-life situations into the classroom and online environment. Spreading the word about financial literacy has always been a passion of hers. Each year she shares her commonsense approach of "No plan is a plan" with various student groups, clubs, high schools, and outside organizations. She is a member of the North Carolina Association of Certified Public Accountants (NCACPA). She received her BBA from the University of Maryland and an MBA from North Carolina State University. Prior to obtaining an MBA, she worked eight years in public accounting in auditing, tax compliance, and consulting. Her hobbies include keeping up with her family's many extracurricular activities and traveling.

Preface

Dear Personal Finance Students and Professors,

Question: Why take a Personal Finance course?

Before you answer this question, imagine what your life will be like in 10, 20, or even 30 years. Decisions you make today can affect not only your life now, but have an impact on your future. If you make wise financial decisions, life can become a more joyous experience. On the other hand, if you make bad decisions, life may not turn out so well. As authors, we wrote ***Personal Finance*** with one purpose: To provide the information you need to make informed decisions that can literally change your life. Just for a moment consider the following questions:

- How will rising interest rates and inflation affect your ability to pay for college, buy an automobile, or purchase a home?
- How will the Tax Cuts and Jobs Act of 2017 affect your ability to obtain employment or start a business?
- How can you balance your current needs with saving and investing for the future?
- How can you obtain your career goals and personal goals to create the type of life you really want?
- How will the need for health insurance, employer-sponsored retirement plans, and Social Security affect your financial future?
- How will presidential policy, tariffs and trade wars, deregulation, environmental concerns, and social unrest affect the economy, consumer spending, and your financial future?

For most people, answers to these questions affect not only their quality of life, but also their financial security. While the 13th edition of ***Personal Finance*** does not guarantee that you will get the ideal job or become a millionaire, it does provide the information needed to take advantage of opportunities and to help manage your personal finances.

This new edition of ***Personal Finance*** is packed with updated information and examples that will not only help you get a better grade in this course, but also help you plan for the future and achieve financial security. For example, we have revised important topics like taxes, college loans, health care, and investments to provide the most current information available. Other important topics including credit, housing, legal protection, retirement planning, and estate planning have also been revised in this edition.

For 13 editions, we have listened carefully to both students and professors. With each revision, we have incorporated these suggestions and ideas to create what has become a best-selling personal finance textbook. For example, we've moved the appendices from the back of the book to the main text and revised both content and examples throughout the text. We've also included important content on Education Financing, Loans, and Scholarships in Chapter 7—Choosing a Source of Credit. *For all your suggestions, ideas, and support, we thank you.*

A text and instructional package should always be evaluated by the people who use it. We encourage you to e-mail us if you have comments, suggestions, or would like more information about the new edition.

Finally, we invite you to examine the visual guide that follows to see how the new edition of ***Personal Finance,*** the McGraw-Hill Connect learning software, and our SmartBook technology can help you obtain financial security and success.

Welcome to the new 13th edition of ***Personal Finance***!

Sincerely,

Jack Kapoor	Les Dlabay	Bob Hughes	Melissa Hart
kapoorj@att.net	dlabay@lakeforest.edu	Hughespublishing@outlook.com	mmhart@ncsu.edu

ACKNOWLEDGMENTS

The extensive feedback and thoughtful comments provided by instructors in the field have greatly contributed to the quality of the 13th edition of *Personal Finance.*

Many talented professionals at McGraw-Hill Higher Education have also contributed to the development of *Personal Finance,* 13th edition. We are especially grateful to Michele Janicek, Chuck Synovec, Jennifer Upton, Trina Maurer, Fran Simon, Jamie Koch, Jessica Cuevas, Abbey Jones, and Karen Jozefowicz.

In addition, Jack Kapoor expresses special appreciation to Theresa and Dave Kapoor, Kathryn Thumme, and Karen and Joshua Tucker for their typing, proofreading, and research assistance. Les Dlabay expresses his thanks to Joe Chmura, Kyle Dlabay, Linda Dlabay, Anne Jaspers, Jennifer Lazarus, Ben Rohde, and George Seyk for their help reviewing the manuscript. Finally, we thank our spouses and families for their patience, understanding, encouragement, and love throughout the years.

Personal Finance Offers You Everything You Have Always Expected . . . and More!

The primary purpose of this book is to help you apply the personal finance practices you learn from the book and from your instructor to your own life. The following *new* features of the 13th edition expand on this principle. You can use them to assess your current personal financial literacy, identify your personal finance goals, and develop and apply a personal finance strategy to help you achieve those goals. (*For a complete list of all of the features in* Personal Finance, *13th edition, refer to the Guided Tour on pages xxii–xxvii.*)

FINANCIAL LITERACY IN MY LIFE

This edition has moved with a laser-like focus toward the concept of financial literacy. In our many years of teaching and evaluating what knowledge and skills are most important to the lifelong success of our students, financial literacy—the ability to understand and interpret knowledge relating to the financial decisions we make—looms largest. We hope that students will remember all of the details we have put so much time and care into writing, and that you put into teaching. If nothing else, though, we feel we have been successful if students come out of this course with the skills required to interpret financial information and to make wise decisions about their own money, and the confidence that comes with knowing they are able to solve the problems they encounter.

Throughout the text, we spend more time talking about financial literacy. The new chapter opening vignettes ask questions about "Financial Literacy in My Life." The Financial Planning features are focused to emphasize "my life"—the life and decisions that you, the student, will make. Features on financial calculations and decision-making have been altered to focus on students achieving financial literacy.

Another new feature for this edition is the addition of updates related to the 2017 Tax Cuts and Jobs Act, which made drastic changes to much of our tax system. This is, of course, highlighted in the chapter about taxes (Chapter 4) but is touched on throughout the rest of the book, too—taxes impact budgeting, mortgages, estate planning, and many other topics. This expanded and updated coverage should help students to make sense of these new laws as they are implemented.

Additionally, you may notice that some contents covering important topics such as education funding, career development, and additional sources of information have been moved around in the book to integrate more tightly with the main contents. We know how important these topics are for students and wanted to find ways to make our discussion more accessible.

Chapter	*Selected Topics*	Benefits for the Teaching–Learning Environment
Chapter 1	*Revised exhibit:* Financial planning information sources (*Exhibit 1-3*)	Provides an updated overview of personal financial planning information sources.
	New Smart Money Minute *feature*	Offers an overview of technology influences on banking and financial activities, such as artificial intelligence, robotics, the Internet of Things, blockchain, and wearable technology.
	New Smart Money Minute *feature*	Provides suggestions for becoming financially disciplined, and emphasizes the importance of the "why" of financial goals.
	Updated apps and websites	Presents additional online and mobile sources to consult for expanded information and assistance.
	New Smart Money Minute *feature*	Offers guidance on how to avoid mistakes when studying personal finance.
	New Smart Money Minute *feature*	Suggests sources for funding education costs along with a reference to the Chapter 7 Appendix.
	Added content: Financial Literacy for My Life	Discusses common financial planning mistakes as identified by financial advisors.
	Repositioned Daily Spending Diary *sheet*	Presents an explanation of the *Daily Spending Diary* sheet at the end of the chapter, rather than at the end of the book.
Chapter 2	*Revised exhibit:* Education and income (*Exhibit 2-1*)	Updates median weekly earnings for various levels of education, based on data from the Bureau of Labor Statistics.
	New Smart Money Minute *feature*	Suggests factors to emphasize for enhanced job search success.
	New Smart Money Minute *feature*	Reports the main sources of newly created jobs with innovative and young companies.
	Revised exhibit: Career information sources (*Exhibit 2-4*)	Presents an updated format, organization, and content for locating useful career planning information.
	Expanded content: Career Development office	Expands discussion of services offered by campus career offices.
	Updated content: Industry trends	Lists job opportunities with the greatest potential for career success in various industries.
	Revised Financial Literacy for My Life *feature*	Discusses career options related to social entrepreneurship, gig economy, shared economy, and circular economy, along with the availability of microloans for business funding.
	New Smart Money Minute *feature*	Emphasizes actions to avoid spelling and grammar errors in résumés and cover letters.
	New Smart Money Minute *feature*	Points out actions to take for a condensed cover letter.
	Revised Financial Literacy for My Life *feature*	Provides an overview of common employee benefits along with innovative benefits offered by various companies.
	New Smart Money Minute *feature*	Discusses the use of artificial intelligence (AI) for identifying and hiring employees.
	New example: Social media résumé	Suggests methods for the use of social media to communicate career competencies to hiring managers.
	New content: F-O-C-U-S for a résumé and cover letter	Communicates key elements of a résumé and cover letter to enhance job search success.

Chapter	*Selected Topics*	Benefits for the Teaching–Learning Environment
Chapter 2 (Cont.)	*New content:* Preparing a cover letter	Highlights key items when preparing a cover letter.
	Revised exhibit: Interview questions you should expect (*Exhibit 2-D*)	Presents additional commonly encountered interview questions.
	New example: Checklist for interview success	Provides a list of factors to consider for enhanced interview success.
	Revised Smart Money Minute *feature*	Presents information on the use of simulations and job auditions as part of the interview process.
	Revised How To: Prepare for a Case Interview	Updates information to prepare for a case interview as part of the job application process.
Chapter 3	*Revised exhibit format:* Creating a personal balance sheet	Provides an updated format to enhance visual appeal and learning of balance sheet components.
	New Smart Money Minute *feature*	Suggests sources of grants and scholarships that go unused along with a reference to the Chapter 7 Appendix.
	Revised exhibit format: Creating a cash flow statement of income and outflows	Presents a revised format for improved understanding of cash inflows and outflows.
	New Smart Money Minute *feature*	Offers actions to take for keeping accurate financial records and to reduce financial stress.
	New Smart Money Minute *feature*	Suggests sources for additional income to enhance a person's financial situation.
	New Smart Money Minute *feature*	Presents financial rules of thumb for wise money management and for achieving saving and financial goals.
	New Smart Money Minute *feature*	Presents innovative apps and websites related to savings, borrowing, and other financial decisions.
	New Smart Money Minute *feature*	Reports on the financial attitudes and behaviors of young adults based on *Better Money Habits Millennial Report* conducted by Bank of America.
	Repositioned Appendix: Money Management Information Sources and Advisors	Presents updated money management and financial planning sources at the end of the chapter instead of at the end of the book.
	New Smart Money Minute *feature*	Points out the availability of robo-advisors to guide financial planning activities.
Chapter 4	*Updated content:* Tax Cuts and Jobs Act (TCJA)	Provides an updated, detailed incorporation of the new tax legislation.
	Updated content: Gift taxes	Covers new gift tax limits for 2018.
	Revised exhibit: Computing taxable income and tax liability (*Exhibit 4-1*)	Incorporates changes for the computation due to the TCJA.
	Revised content: Standard deductions	Updated annual limit for standard deduction for 2018.
	Revised content: Medical expense deduction	Incorporates changes for the computation due to the TCJA.
	Revised content: Itemized deductions	Incorporates changes for what is eligible due to the TCJA.
	Revised content: Tax rates	Demonstrates how to calculate total tax due using a tax bracket schedule, with most current tax rate information.
	Expanded content: Health care and taxes	Updates students on key changes related to the Affordable Care Act.

Chapter	*Selected Topics*	Benefits for the Teaching–Learning Environment
Chapter 4 (Cont.)	*Revised content:* Tax credits	Covers revised tax credits for 2018.
	Revised content: Tax forms	Updated for basic tax form to be used starting with 2018. Eliminating 1040A and 1040EZ.
	Revised content: Filing taxes online	Updates students on the most recent process for filing taxes online.
	Revised content: Tax scams	Describes the latest and most popular tax scams.
	Revised exhibit: How to avoid common filing errors (*Exhibit 4-8*)	Provides an updated, detailed list of steps one might take to reduce the likelihood of a filing error.
	Revised Smart Money Minute *feature*	Updates statistics on the likelihood of a tax audit in recent years.
	Revised content: Capital gains	Incorporates changes for new tax rates due to the TCJA for capital gains.
	Revised content: Kiddie tax	Incorporates changes for new tax rates due to the TCJA for children's investment income.
Chapter 5	*New* Smart Money Minute *feature*	Explains an app program from Instant Financial that allows employees to access 50 percent of their pay each day they work.
	Updated data: Understanding interest rates	Provides data for various interest rates that affect spending, saving, borrowing, and investing decisions
	New Smart Money Minute *feature*	Offers suggestions to avoid or minimize unnecessary banking fees.
	New content: Other financial service providers	Provides an overview of nonbank organizations offering financial services, such as retailers, internet banks, and P2P (peer-to-peer) lending networks.
	Revised exhibit: Choosing a financial institution (*Exhibit 5-5*)	Presents a focused process for assessing and selecting a financial institution.
	New Smart Money Minute *feature*	Discusses savings plans available for financing college education along with a reference to the Chapter 7 Appendix.
	Revised content: Savings bonds	Updates current information related to buying and redeeming savings bonds.
	Expanded content: Financial Literacy for My Life *feature*	Adds discussion of informal remittance networks to other alternative financial services used around the world.
	Revised content: Deposit insurance	Updates information on credit union deposit insurance coverage.
	New Smart Money Minute *feature*	Provides information on the benefits and concerns associated with Bitcoin and other crypto-currencies.
	Revised How To: Avoid Identity Theft	Expands suggestions to prevent identity theft with an update of sources for assistance.
	New Smart Money Minute *feature*	Presents technology examples for emerging financial services, such as video tellers, facial recognition payments, and banking virtual assistants.
	New content: Money transfers	Provides an overview of methods to send funds across the country or around the world.

Chapter	*Selected Topics*	Benefits for the Teaching–Learning Environment
Chapter 6	*Updated exhibit:* Volume of consumer credit (*Exhibit 6-1*)	Illustrates that the volume of consumer credit has been increasing steadily.
	New Smart Money Minute *feature*	Cautions what to watch for when activating a new credit card.
	New content: Use of smartphones	Describes the popularity and the use of smartphones worldwide.
	New content: Home equity loans	Explains how the Tax Cuts and Jobs Act of 2017 affects the deduction for home equity loans.
	Revised content: Debit and credit card fraud	Updated statistics and explanation for protecting yourself against credit card fraud.
	New content: Building and maintaining your credit rating	Describes a 2015 legal settlement that requires the Credit Reporting Agencies to reduce credit report errors.
	New content: What is in your credit files?	Summarizes the information contained in your credit report.
	New content: Time limits on adverse data	Explains that tax liens can be reported for 15 years on your credit report.
	New Financial Literacy for My Life *feature*	Describes what to do if you were affected by the Equifax data breach.
	New Smart Money Minute *feature*	Provides information on how to obtain your free credit reports from the three major credit reporting agencies.
	New Smart Money Minute *feature*	Explains that consumers are becoming more credit conscious and checking their credit scores more often.
	Revised content: FICO and VantageScore	Updates information about new FICO and VantageScore products.
	New and revised content: Financial Planning Problems	
Chapter 7	*New content:* Inexpensive loans	Refers readers to Chapter 7 Appendix: Education Financing, Loans, and Scholarships.
	Revised content: Medium-priced loans	Notes that 109 million members of the nation's 5,900 credit unions hold over $1.4 trillion in assets.
	New Smart Money Minute *feature*	Explains that debt collection is a $10.9 billion industry and employs nearly 120,000 workers.
	New content: Debt collection practices	Describes that in March 2018, the FTC and CFPB received 84,500 debt collection complaints.
	New Smart Money Minute *feature*	Explains what to do if you make a mistake of getting behind in paying your bills.
	New Smart Money Minute *feature*	Cautions readers about credit repair clinics.
	Updated exhibit: Consumer bankruptcy filings (*Exhibit 7-4*)	Provides up-to-date statistics on U.S. consumer bankruptcy filings from 1980–2017.
	Revised content: Chapter 7 bankruptcy	Updates fees on Chapter 7 bankruptcy in the United States for 2018.
Chapter 8	*New* Financial Literacy for My Life *feature*	Provides suggestions for obtaining the best buys for products and services during each month of the year.
	New Smart Money Minute *feature*	Encourages actions to avoid financial difficulties when people do not clearly distinguish needs from wants.

Chapter	*Selected Topics*	Benefits for the Teaching–Learning Environment
Chapter 8 (Cont.)	*New* Smart Money Minute *feature*	Presents information on current retailing technology trends designed to enhance the shopping experience.
	New Smart Money Minute *feature*	Describes the features of car subscription services.
	Updated Financial Literacy for My Life *feature*	Includes updated coverage of romance scams, the "yes" scam, and other fraudulent activities.
	New content: Scholarship and financial aid scams	Warns students of fraudulent college financing programs along with a reference to the Chapter 7 Appendix.
	New Smart Money Minute *feature*	Warns consumers of the safety and financial dangers of buying fake and counterfeit products.
	New Smart Money Minute *feature*	Suggests a method for increasing amounts saved by putting the "You Saved" amount from a receipt in a savings account.
	Repositioned Appendix: Consumer Protection Agencies and Organizations	Presents contact information for federal, state, local agencies, and other organizations at the end of the chapter instead of at the end of the book.
Chapter 9	*Revised exhibit:* The home-buying process (*Exhibit 9-5*)	Presents clarified information for the steps in the home-buying process.
	Revised content: Assess types of housing	Enhances coverage of multiunit dwellings, duplexes, town houses, and planned unit developments (PUDs).
	New content: Housing construction	Expands discussion of factory-built houses, prefabricated homes, modular homes, mobile homes, and manufactured homes.
	New Smart Money Minute *feature*	Discusses the benefits and limitations of tiny houses (400 square feet or less).
	New Smart Money Minute *feature*	Suggests actions to plan for overlooked costs when buying a home.
	New Smart Money Minute *feature*	Recommends the best times of the year to buy and sell a house.
	New content: United States Department of Agriculture (USDA) loan program	Reports on a government home loan program to finance housing and community facilities in rural areas.
	New Smart Money Minute *feature*	Discusses current home buying attitudes and behaviors among young people based on a Harris poll, conducted on behalf of Trulia.
	Revised Financial Literacy for My Life *feature*	Presents actions to take when deciding whether to pay off a mortgage early.
	Revised exhibit: The main elements of buying a home (*Exhibit 9-12*)	Provides an updated, condensed overview of the major elements of home buying.
	New content: Lifestyle inflation	Cautions about overspending on housing and other items when receiving a salary increase.
	New content: Down payment wire fraud	Warns about the growing threat of identity fraud and monetary loss when processing personal and financial information for a home purchase.
	New Smart Money Minute *feature*	Reports upgrades with the largest payoffs when selling a home along with desirable paint shades for various rooms.

Chapter	*Selected Topics*	Benefits for the Teaching–Learning Environment
Chapter 10	*New* Financial Literacy for My Life *feature*	Cautions readers that insurance companies may exclude coverage for certain losses.
	New Financial Literacy for My Life *feature*	Explains the importance of purchasing flood insurance.
	New Financial Literacy for My Life *feature*	Describes what steps to take if you are in an accident caused by another driver.
	Revised Smart Money Minute *feature*	Cautions that distracted driving can be dangerous, and offers tips to avoid it.
	New Financial Planning Problems	
Chapter 11	*New* Smart Money Minute *feature*	Describes how you can save time and money by receiving health care from a primary care physician.
	Revised content: High medical costs	Provides revised and updated information on runaway health care costs.
	Revised content: Rapid increase in medical expenditures	Updates data on medical expenditures.
	Revised exhibit: U.S. national health expenditures (*Exhibit 11-1*)	Provides projected health care costs to year 2026.
	New content: High costs of health care	Describes President Trump's executive order.
	New content: Reducing health care costs	Offers additional suggestions for staying healthy and well.
	New content: Group health insurance	Explains new Association Health Plans for small businesses, their employees, and proprietors.
	New Smart Money Minute *feature*	Discusses medical care benefit plans provided by employers to their employees in 2017.
	New Financial Literacy for My Life *feature*	Summarizes the specific qualifying events and qualified beneficiaries to elect continuation coverage under COBRA.
	New Smart Money Minute *feature*	Provides phone numbers and websites for COBRA, ACA, HIPAA, and ERISA.
	New Smart Money Minute *feature*	Provides the latest data on disability and long-term care services.
	Revised content: Long-term care insurance	Updates nursing home costs in the United States.
	New exhibit: Coverage limits of long-term care (*Exhibit 11-4*)	Summarizes the very limited long-term care coverage that Medicare, Medigap, and private health insurance provide.
	Revised Financial Literacy for My Life *feature*	Explains how HSAs work in 2019.
	New content: HSAs	Cautions that if you continue contributing to your HSA, you should not apply for Medicare or Social Security.
	New content: Medicare	Provides new contact information for Medicare websites.
	New content: Medicare and the Affordable Care Act	Explains that if you have Medicare Part A, you meet the requirement for having health coverage under the Affordable Care Act.
	New content: Medigap	Expands discussion about Medigap policies, and services they do and do not cover.
	New Smart Money Minute *feature*	Explains how Medicaid costs are rising rapidly.

Chapter	*Selected Topics*	Benefits for the Teaching–Learning Environment
Chapter 11 (Cont.)	*New content:* The American Health Care Act of 2017	Describes the attempt to repeal and replace the Affordable Care Act.
	New content: Shared responsibility	Explains that starting in 2019, the Tax Cuts and Jobs Act repeals the Affordable Care Act mandate to have health insurance or pay a penalty.
	Expanded content: Health insurance marketplace	Explains that if you have Medicare, you don't need to worry about the marketplace.
	New Financial Literacy for My Life *feature*	Describes five questions to ask yourself when choosing a plan.
	New content: College students and the marketplace	Explains what college students need to know about the marketplace.
	New Financial Planning Problem	
Chapter 12	*Revised content:* Life insurance	Provides updated information on life insurance policies and their face value for most recent years.
	New content: The reality of life	Shows statistics regarding the need for life insurance to provide for family members.
	Revised exhibit: Life expectancy (*Exhibit 12-2*)	Provides updated information on life expectancy for most recent years.
	Revised examples: Multiple Method, DINK Method, Non-Working Spouse Method	Provides revised examples to demonstrate the use of the methods for students.
	Revised Smart Money Minute *feature*	Provides information on the amount of hours and equivalent wage of a stay-at-home mom.
	New content: Reentry term	Provides information about an additional type of term insurance policy.
	New content: Modified life	Provides information about an additional type of whole life insurance policy.
	Revised Smart Money Minute *feature*	Provides updated statistics about the average face amount of life insurance policies.
	Revised exhibit: Growth of individual, group, and credit life insurance (*Exhibit 12-7*)	Shows updated data for the growth of different classes of life insurance.
	New content: Joint life insurance	Includes additional variations of life insurance policies that are available.
	Revised content: The cost of insurance	Shows an updated example of the cost of life insurance, including the time value of money.
	New content: Installment payments	Includes additional variations of installment payments for life insurance benefits.
Chapter 13	*Expanded content:* Budgeting	Describes how software and mobile apps can improve budgeting skills.
	Updated statistics: Credit cards	Reports current statistics on credit cards, credit card debt, and student debt.
	New Smart Money Minute *feature*	Describes how one investor avoided making a costly mistake by researching an investment that turned out to be a pyramid scheme.
	New example: Risk-return trade-off	A new example describes a recent price decline for Johnson & Johnson's stock.

Chapter	*Selected Topics*	Benefits for the Teaching–Learning Environment
Chapter 13 (Cont.)	*New example:* Return on investment	Illustrates how to calculate return on investment for a stock investment in the Lowes Home Improvement chain.
	New example: Effect of changing interest rates on bond prices	Illustrates how bond prices can change for a John Deere corporate bond when interest rates in the economy change.
	New example: Business failure risk	Describes what happened to investors when Toys R Us filed for bankruptcy and eventually closed all its stores.
	New content: Growth investments	Explains why Facebook, Amazon, and Netflix are examples of growth stocks.
	New content: Dow Jones Average	Describes the largest one-day point decline in the history of the Dow Jones Average.
	Revised Smart Money Minute *feature*	Includes new statistics for income for American families.
	Revised exhibit: Asset allocation (*Exhibit 13-2*)	Illustrates the concept of asset allocation for an investor who is 28 years old.
	New example: Interest calculations	Illustrates interest calculations for a Ford Motor Credit Company bond.
	New content: Mutual fund fees	Provides more information on typical fees associated with mutual fund investments.
	New content: Real estate returns	Updates the statistics for average real estate returns.
	Updated content: Investment taxation	Describes how the Tax Cuts and Jobs Act of 2017 affects how investment gains are taxed.
	New examples: Information available on the Internet	Provides information for an additional search engine (Bing) and a new investor link for Exxon Mobil.
	Revised exhibit: Useful sites for financial planning (*Exhibit 13-6*)	Provides additional information on individual websites.
	Updated Financial Planning Activities	Includes a link to *The Occupational Outlook Handbook.*
	New Financial Planning Case	Provides details about the financial situation of John and Nina Hartwick, a couple in their mid-30s who earn over $100,000 a year, but after monthly expenses never have enough money to establish an emergency fund or save.
Chapter 14	*Revised example:* McDonald's	Reports the increased value of an investment in McDonald's stock at the end of 10 years.
	New content: Taxation of investments	Provides new information about taxation of long-term and short-term investments.
	New example: Stocks can lose money	Describes how the Dow Jones Industrial Average suffered the largest one-day decline in history.
	New example: Starbucks's dividend payments	Includes information about how to determine the record date for a corporate stock.
	New exhibit: Stock investment in Apple (*Exhibit 14-2*)	Illustrates how an investor can earn a profit from an investment in Apple.
	Revised exhibit: Stock classifications (*Exhibit 14-4*)	Provides a revised definition for a penny stock.
	New exhibit: Stock price information on the internet (*Exhibit 14-5*)	Reports current information for The Gap, as reported on Yahoo! Finance.

Chapter	*Selected Topics*	Benefits for the Teaching–Learning Environment
Chapter 14 (Cont.)	*Revised* Smart Money Minute *feature*	Includes statistics for the Dow Jones Industrial Average for 2016 and 2017.
	New exhibit: Value Line report for Home Depot (*Exhibit 14-7*)	Provides detailed financial information from Value Line about Home Depot.
	New content: Projected earnings	Describes the importance of projected earnings for Visa.
	Revised Financial Literacy Calculations *feature*	Calculates and then describes the importance of a price/earnings to growth ratio for Visa.
	New examples: Current ratios	Uses current information for 3M Company and American Airlines to calculate dividend payout, dividend yield, total return, annualized holding period yield, and beta.
	Revised content: Buying and selling stocks	Describes the recent IPO for Snap along with an update for the value of its stock, one year later.
	Revised How To: Open an Account with a Brokerage Firm	Provides new information about the amount required to open an account, commissions charged for online trades, and other information about specific brokerage firms.
	New Smart Money Minute *feature*	Explains the types of services provided by a robo-advisor.
	Revised exhibit: Dollar cost averaging (*Exhibit 14-9*)	Includes current share prices for 2017 and 2018 for Johnson & Johnson.
	New example: Margin transaction	Provides a new example for a margin transaction for Pepsico.
Chapter 15	*Revised example:* Asset Allocation	Includes additional information about asset allocation in the example in the chapter introduction.
	New example: Convertible bonds	Provides new information about a convertible bond issued by Intercept Pharmaceuticals.
	Revised example: Current interest rates	Reduced interest rate from 8 percent to 6 percent to reflect current interest rates for corporate bonds.
	Revised Financial Literacy for My Life *feature*	Explains why one couple chose two bond funds to earn investment returns with minimal risk.
	New example: Interest income	Illustrates how to calculate interest for a bond issued by Microsoft.
	New example: Bond price fluctuations	Provides an example of how the price for a corporate bond issued by Apple can increase or decrease until maturity.
	New example: Bonds in bankruptcy	Illustrates what happened to Toys R Us bondholders.
	New exhibit: Bond transaction (*Exhibit 15-3*)	Describes a typical bond transaction for a corporate bond issued by Apple.
	Revised Financial Literacy Calculations *feature*	Includes a new tryout problem that illustrates the time value of reinvested interest for a bond issued by Visa.
	New content: Treasury bills	Provides more information about current rates for T-bills.
	New weblinks: Investor websites	Includes new links to bond websites for investors.
	New exhibit: FINRA bond coverage (*Exhibit 15-6*)	Adds new information available from the Financial Industry Regulatory Authority (FINRA) for a Tesla bond.
	Revised How To: Evaluate Corporate, Government, and Municipal Bonds	Includes new material about the bond screeners available on the Fidelity and Charles Schwab websites.

Chapter	*Selected Topics*	Benefits for the Teaching–Learning Environment
Chapter 15 (Cont.)	*Revised exhibit:* Bond ratings (*Exhibit 15-7*)	Contains new information for the BBB− and BB+ bond ratings.
	New example: Boeing	Calculates current yield and yield to maturity calculations for Boeing.
	Revised Financial Literacy Calculations *feature*	Calculates the times interest earned ratio for Home Depot.
Chapter 16	*New* Chapter Opener *example*	Explains why one investor chose the T. Rowe Price Dividend Income fund for his investment portfolio.
	Revised content: Statistics for funds	Provides the latest available statistics for mutual funds.
	Revised content: Fund fees	Reports that the average load charge is now 3 to 5 percent.
	Revised content: Fund fees	Reports that the average management fee is now 0.5 to 2 percent.
	Revised exhibit: Fund fees (*Exhibit 16-2*)	Provides updated information from the fee table for the Davis New York Venture fund.
	Revised exhibit: Fund fees (*Exhibit 16-3*)	Summarizes the changes made throughout the chapter.
	Revised content: Type of funds	Includes revised amounts for large-cap funds (now $10 billion), mid-cap funds (now $2 to $10 billion), small-cap funds (now less than $2 billion).
	Revised Smart Money Minute *feature*	Describes why people invest in mutual funds.
	Revised How To: Open an Investment Account and Begin Investing in Funds	Adds more material on different types of investment accounts.
	New content: Economic factors	Provides new information about the relationship between the nations economy and a fund's performance and a fund's financial returns.
	Revised exhibit: Large fund families (*Exhibit 16-4*)	Describes the three large mutual fund companies: Vanguard, Fidelity, and American Funds.
	New exhibit: Fund research (*Exhibit 16-5*)	Illustrates detailed research information about the Fidelity Contrafund available from Morningstar.
	New exhibit: Kiplinger's Favorite Funds (*Exhibit 16-6*)	Shows a portion of the information available in the Kiplinger's 25 Favorite No Load Mutual Funds article.
	New example: Return on investment	Illustrates how an investor can earn a capital gain on an investment in the T. Rowe Price Communications and Technology fund.
	New content: Taxes and funds	Provides more information about how the 2017 Tax Cuts and Jobs Act affects fund investments.
	New and revised Financial Planning Problems	
Chapter 17	*New content:* How the Tax Cuts and Jobs Act affects home ownership	Explains how the new tax law reduces the tax benefit of owning a home.
	New exhibit: Annual home ownership rates for the United States by age groups (*Exhibit 17-2)*	Provides an insight into home ownership in the United States by age groups: 1982–2017.
	New Financial Literacy for My Life *feature*	Describes steps to take if you have been scammed and provides additional resources for help.

Chapter	*Selected Topics*	Benefits for the Teaching–Learning Environment
Chapter 17 (Cont.)	*Revised content:* REITs	Provides the latest available data on REITs.
	Revised Financial Literacy for My Life *feature*	Includes when Ginnie Mae, Sonny Mae, and Nellie Mae were established.
	New content: The Tax Cuts and Jobs Act	Explains how the new tax law limits the mortgage interest deduction and capital gains exclusions.
	Revised exhibit: Gold prices (*Exhibit 17-3*)	Illustrates how the price of gold has fluctuated from 1976 to 2018.
	Revised Smart Money Minute *feature*	Shows the biggest producers of gold in the world as of 2016.
	Revised content: Prices of precious metals	Includes the latest prices of silver, platinum, palladium, and rhodium.
	New Smart Money Minute *feature*	Describes how color, cut, clarity, and carat determine the value of diamonds.
	New Smart Money Minute *feature*	Cautions that many sellers of collectibles and coins promise false "buy back" options.
	New Smart Money Minute *feature*	Emphasizes comparing quality, price, and service before buying jewelry, precious stones, or collectibles.
Chapter 18	*Revised content:* Centenarians	Explains that the number of centenarians in the United States is increasing.
	New exhibit: Older household expenditures (*Exhibit 18-4*)	Illustrates how an "average" older household spends its money.
	New content: Inflation rate	Includes the annual inflation rate in 2018.
	Revised content: Social Security	Explains that today 66 million people collect over $1 trillion in Social Security benefits.
	Revised Smart Money Minute *feature*	Shows what groups are collecting Social Security as of 2017.
	New Smart Money Minute *feature*	Explains the importance of delaying Social Security benefits at least until the full retirement age.
	New Smart Money Minute *feature*	Offers suggestions on when one should begin receiving retirement benefits from Social Security.
	New How To: Choose a Social Security Benefit Calculator	Explains how to choose a Social Security calculator.
	Revised exhibit: Number of workers per beneficiary (*Exhibit 18-8*)	Illustrates how the number of workers per beneficiary has plummeted over the decades.
	Revised content: 401(k) plans	Updates the contribution limits for 2018.
	Revised Smart Money Minute *feature*	Shows that there are nearly 24,000 private-sector defined benefit plans protected by PBGC.
	Revised content: IRAs	Updates the Roth IRA contribution limits for 2018.
	Revised content: SEP-IRAs	Updates the SEP-IRA contribution limits for 2018.
	New content: Dipping into your nest egg	Explains the tax consequences of early withdrawals from retirement accounts.
	New Financial Planning Problems	

Chapter	*Selected Topics*	Benefits for the Teaching–Learning Environment
Chapter 19	*Revised content:* New lifestyles	Points out that the new tax law allows $11,800,000 exemption for estate taxes.
	Revised content: Stated Dollar Amount Will	Explains that the new tax law allows you to pass on the stated amount of $11,800,000 in 2018.
	Revised content: Aging with dignity	Explains that "Five Wishes" is now valid in 42 states and in the District of Columbia.
	New content: Credit shelter trust	Provides updated and new information about the Tax Cuts and Jobs Act and the new exemption amounts for 2018.
	Revised content: Testamentary trust	Describes that testamentary trusts do not protect assets from the probate process.
	Revised content: Federal and state estate taxes	Provides the latest available information about gift and estate taxes under the Tax Cuts and Jobs Act of 2017.
	New Smart Money Minute *feature*	Emphasizes the importance of lifetime gifting to reduce estate taxes.
	Updated exhibit: Estate tax law changes (*Exhibit 19-6)*	Includes the new exemption amounts for 2017, 2018, and beyond (until 2025).
	Revised content: Self-test problems	Covers new tax law exemptions for gifting.
	Revised content: Financial Planning Problems	

ASSURANCE OF LEARNING

Many educational institutions today are focused on the notion of assurance of learning, an important element of some accreditation standards. *Personal Finance,* 13th edition, is designed specifically to support your assurance of learning initiatives with a simple, yet powerful, solution.

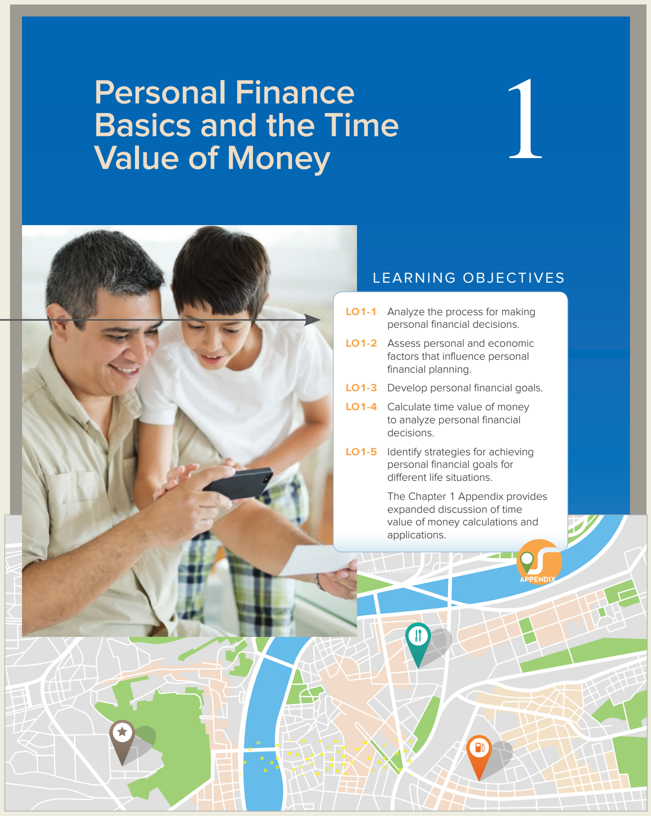
Each test bank question for *Personal Finance,* 13th edition, maps to a specific chapter learning outcome/objective listed in the text. You can use the test bank software to easily query for learning outcomes/objectives that directly relate to the learning objectives for your course. You can then use the reporting features of the software to aggregate student results in similar fashion, making the collection and presentation of assurance of learning data simple and easy.

GUIDED TOUR

Chapter Opener: The chapter opener contains new features that serve as the chapter road map at a glance!

Learning Objectives

A summary of learning objectives is presented at the start of each chapter. These objectives are highlighted at the start of each major section in the chapter and appear again in the end-of-chapter summary. The learning objectives are also used to organize the end-of-chapter problems and activities, as well as materials in the *Instructor's Manual* and *Test Bank*. Problems in *Connect* can also be organized using the objectives.



Personal Finance Basics and the Time Value of Money

1

LEARNING OBJECTIVES

LO1-1 Analyze the process for making personal financial decisions.

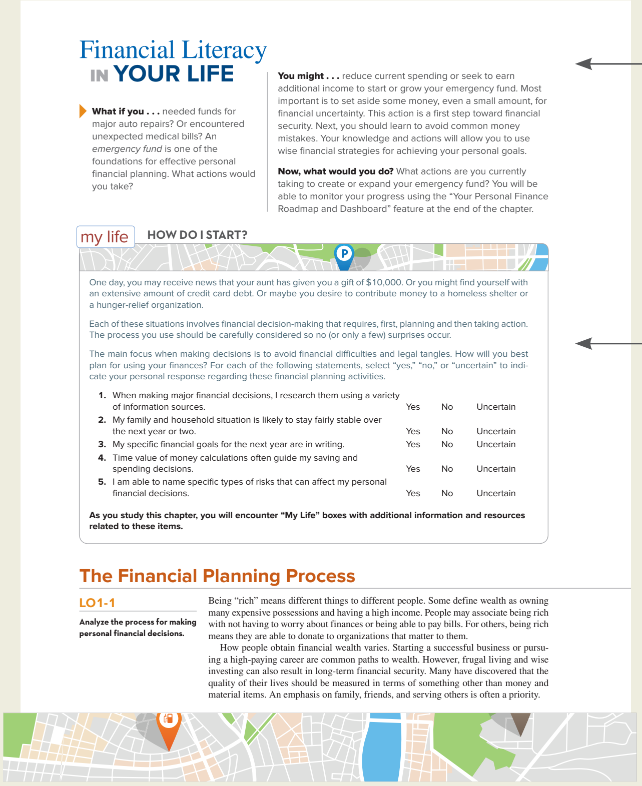
LO1-2 Assess personal and economic factors that influence personal financial planning.

LO1-3 Develop personal financial goals.

LO1-4 Calculate time value of money to analyze personal financial decisions.

LO1-5 Identify strategies for achieving personal financial goals for different life situations.

The Chapter 1 Appendix provides expanded discussion of time value of money calculations and applications.



Financial Literacy IN YOUR LIFE

What if you . . . needed funds for major auto repairs? Or encountered unexpected medical bills? An *emergency fund* is one of the foundations for effective personal financial planning. What actions would you take?

You might . . . reduce current spending or seek to earn additional income to start or grow your emergency fund. Most important is to set aside some money, even a small amount, for financial uncertainty. This action is a first step toward financial security. Next, you should learn to avoid common money mistakes. Your knowledge and actions will allow you to use wise financial strategies for achieving your personal goals.

Now, what would you do? What actions are you currently taking to create or expand your emergency fund? You will be able to monitor your progress using the "Your Personal Finance Roadmap and Dashboard" feature at the end of the chapter.

my life HOW DO I START?

One day, you may receive news that your aunt has given you a gift of $10,000. Or you might find yourself with an extensive amount of credit card debt. Or maybe you desire to contribute money to a homeless shelter or a hunger-relief organization.

Each of these situations involves financial decision-making that requires, first, planning and then taking action. The process you use should be carefully considered so no (or only a few) surprises occur.

The main focus when making decisions is to avoid financial difficulties and legal tangles. How will you best plan for using your finances? For each of the following statements, select "yes," "no," or "uncertain" to indicate your personal response regarding these financial planning activities.

1. When making major financial decisions, I research them using a variety of information sources.	Yes	No	Uncertain
2. My family and household situation is likely to stay fairly stable over the next year or two.	Yes	No	Uncertain
3. My specific financial goals for the next year are in writing.	Yes	No	Uncertain
4. Time value of money calculations often guide my saving and spending decisions.	Yes	No	Uncertain
5. I am able to name specific types of risks that can affect my personal financial decisions.	Yes	No	Uncertain

As you study this chapter, you will encounter "My Life" boxes with additional information and resources related to these items.

The Financial Planning Process

LO1-1

Analyze the process for making personal financial decisions.

Being "rich" means different things to different people. Some define wealth as owning many expensive possessions and having a high income. People may associate being rich with not having to worry about finances or being able to pay bills. For others, being rich means they are able to donate to organizations that matter to them.

How people obtain financial wealth varies. Starting a successful business or pursuing a high-paying career are common paths to wealth. However, frugal living and wise investing can also result in long-term financial security. Many have discovered that the quality of their lives should be measured in terms of something other than money and material items. An emphasis on family, friends, and serving others is often a priority.

Financial Literacy in Your Life

Covers why and how the issues presented in the chapter are important, and presents some alternatives that one might consider when facing related decisions. There is a strong emphasis here on action.

My Life

The *My Life* concept begins with the chapter opener. It presents students with an engaging scenario that relates what they're about to learn to their own lives. The follow-up questions are designed to get students thinking about how involved they currently are in their personal finances and to motivate them to try new beneficial practices in their own personal finance life. The *My Life* boxes throughout the chapters and the Learning Objectives in the chapter summary expand on this concept.

Boxed features are used in each chapter to build student interest and highlight important topics. Three different types of boxed features are used.

How To . . .

The *How To . . .* boxes fit in with the application-driven themes of *Personal Finance*. Each box highlights a personal finance issue and walks students through how to navigate the situation.

HOW TO . . . Choose a Credit Counselor

Credit counseling organizations provide valuable assistance to financially distressed consumers. However, some firms may be misleading you about who they are, what they do, or how much they charge. Experts advise that you ask the following questions to find the best credit counselor.

- *What services do you offer?* Look for an organization that offers budget counseling and money management classes as well as a debt-management plan.
- *Do you offer free information?* Avoid organizations that charge for information or demand details about your problem first.
- *What are your fees?* Are there set-up and/or monthly fees? A typical set-up fee is $10. If you're paying a lot more, you may be the one who's being set up.
- *How will the debt-management plan work?* What debts can be included in the plan, and will you get regular reports on your accounts?
- *Can you get my creditors to lower or eliminate my interest and fees?* If the answer is yes, contact your creditors to verify this.
- *What if I can't afford to pay you?* If an organization won't help you because you can't afford to pay, go somewhere else for help.
- *Will you help me avoid future problems?* Getting a plan for avoiding future debt is as important as solving the immediate debt problem.
- *Will we have a contract?* All verbal promises should be in writing before you pay any money.
- *Are your counselors accredited or certified?* Legitimate credit counseling firms are affiliated with the National Foundation for Credit Counseling or the Association of Independent Consumer Credit Counseling Agencies.

Check with your local consumer protection agency and the Better Business Bureau to see if any complaints have been filed about the company.

Financial Literacy for My Life

This box offers information that can assist students when faced with special situations and unique financial planning decisions. Many emphasize the use of online sources.

Financial Literacy for My Life

IS IT TAXABLE INCOME? IS IT DEDUCTIBLE?

Certain financial benefits individuals receive are not subject to federal income tax. Indicate whether each of the following items would or would not be included in taxable income when you compute your federal income tax.

Is it taxable income?	Yes	No
1. Lottery/Jackpot winnings	_____	_____
2. Child support received	_____	_____
3. Worker's compensation benefits	_____	_____
4. Life insurance death benefits	_____	_____
5. Cash rebate for laptop	_____	_____
6. Unemployment income	_____	_____

Indicate whether each of the following items would or would not be deductible when you compute your federal income tax.

Is it deductible?	Yes	No
7. Life insurance premiums	_____	_____
8. Baggage fees for self-employed	_____	_____
9. Fees for traffic violations	_____	_____
10. Mileage for driving to volunteer work	_____	_____
11. An attorney's fee for preparing a will	_____	_____
12. Income tax preparation fee	_____	_____

Note: These taxable income items and deductions are based on the 2018 tax year and may change due to changes in the tax code.

Answers: 1, 6, 8, 10—yes; 2, 3, 4, 5, 7, 9, 11, 12—no.

Financial Literacy Calculations

This feature presents more than 90 mathematical applications relevant to personal financial situations.

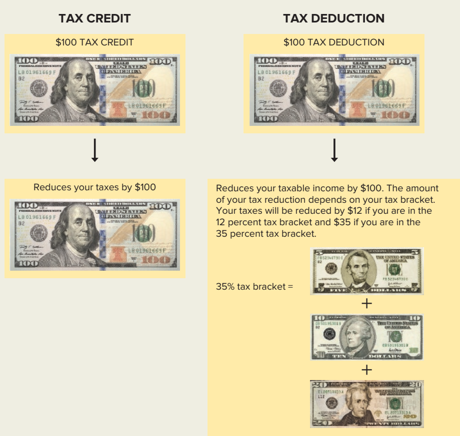
Financial Literacy Calculations

TAX CREDITS VERSUS TAX DEDUCTIONS

Many people confuse *tax credits* with *tax deductions*. Is one better than the other? A *tax credit,* such as eligible child care or dependent care expenses, results in a dollar-for-dollar reduction in the amount of taxes owed. A *tax deduction,* such as an itemized deduction in the form of medical expenses, mortgage interest, or charitable contributions, reduces the taxable income on which your taxes are based.

Shown at right is how a $100 tax credit compares with a $100 tax deduction:

As you might expect, tax credits are less readily available than tax deductions. To qualify for a $100 child care tax credit, you may have to spend $500 in child care expenses. In some situations, spending on deductible items may be more beneficial than qualifying for a tax credit. A knowledge of tax law and careful financial planning will help you use both tax credits and tax deductions to maximum advantage.



©Andriy Nekrasov/123RF, ©Ruslan Nassyrov/Alamy

Key Terms

Key terms appear in bold type and in the margin definition boxes. The terms and their page references are also listed at the end of each chapter.

My Life Boxes

My Life boxes appear next to material that relates back to the opening My Life scenario and the Learning Objectives. These boxes offer useful tips and possible solutions to help students better manage their finances.

Smart Money Minute

Each chapter contains several *Smart Money Minute* features with fun facts, information, and financial planning assistance. Many in this new edition focus on the ways that technology is changing personal finance.


Chapter 3 Money Management Strategy: Financial Statements and Budgeting **95**

Her take-home pay is $3,196. This amount, plus earnings from savings and investments, is the income she has available for use during the current month.

Take-home pay may also be referred to as *disposable income,* the amount a person or household has available to spend. **Discretionary income** is money left over after paying for housing, food, and other necessities. Studies report that discretionary income ranges from less than 5 percent for people under age 25 to more than 40 percent for older people.

Daily purchasing decisions influence cash outflows and long-term financial goals.
©Lew Robertson/Corbis/Getty Images

STEP 2: RECORD CASH OUTFLOWS Cash payments for living expenses and other items make up the second component of a cash flow statement. Lin Ye divides her cash outflows into two major categories: *fixed expenses* and *variable expenses.* While every individual and household has different cash outflows, these main categories, along with the subcategories Lin uses, can be adapted to most situations.

1. *Fixed expenses* are payments that do not vary from month to month. Rent or mortgage payments, installment loan payments, wifi service fees, and a monthly train ticket for commuting to work are examples of constant or fixed cash outflows.
   For Lin, another type of fixed expense is the amount she sets aside each month for payments due once or twice a year. For example, Lin pays $384 every March for life insurance. Each month, she records a fixed outflow of $32 for deposit in a special savings account so that the money will be available when her insurance payment is due.
2. *Variable expenses* are flexible payments that change from month to month. Common examples of variable cash outflows are food, clothing, utilities (such as electricity, cell phone, gas), recreation, medical expenses, gifts, and donations. The use of an app or some other record-keeping system is necessary for an accurate total of cash outflows.

discretionary income Money left over after paying for housing, food, and other necessities.

STEP 3: DETERMINE NET CASH FLOW The difference between income and outflows can be either a positive (*surplus*) or a negative (*deficit*) cash flow. A deficit exists if more cash goes out than comes in during a given month. This amount must be made up by withdrawals from savings or by borrowing.

When you have a cash surplus, as Lin did (Exhibit 3-4), this amount is available for saving, investing, or paying off debts. Each month, Lin sets aside money for her *emergency fund* in a savings account that she would use for unexpected expenses or to pay living costs if she did not receive her salary. She deposits the rest of the surplus in savings and investment plans that have two purposes. The first is the achievement of short-term and intermediate financial goals, such as a new car, a vacation, or reenrollment in school; the second is long-term financial security—her retirement.

A cash flow statement provides the foundation for preparing and implementing a spending, saving, and investment plan. The cash flow statement reports the *actual* spending of a household. In contrast, a budget, which has a similar format, considers both *projected* income and spending.

The nearby *Financial Literacy Calculations* feature offers tools that may be used to determine improvements in your balance sheet and cash flow statement.

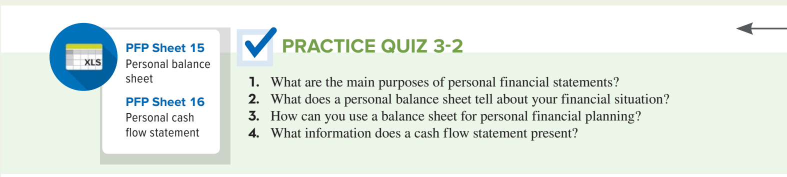
my life 2

I know the details of my cash flow statement.

In what ways might the *Daily Spending Diary* (at the end of Chapter 1) be of value when preparing a personal cash flow statement?

smart money minute

Many people make the ***mistake*** of not maintaining an accurate record of their spending, resulting in high levels of debt and low amounts in savings. An ***action*** might be to make use of an app or keep a written record of your spending. This can result in ***success*** of having funds for financial goals and emergencies. Other actions to consider for reduced financial stress include: (1) Have a low debt-to-income ratio. (2) Delay, reduce, or eliminate unnecessary expenses. (3) Build up emergency savings. (4) Seek additional income from a part-time job or selling possessions. (5) Build a higher amount of assets.


PFP Sheet 15 Personal balance sheet

PFP Sheet 16 Personal cash flow statement

PRACTICE QUIZ 3-2

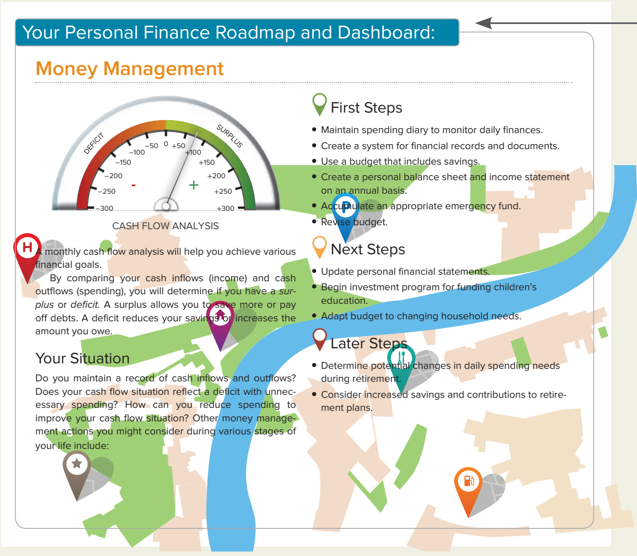
1. What are the main purposes of personal financial statements?
2. What does a personal balance sheet tell about your financial situation?
3. How can you use a balance sheet for personal financial planning?
4. What information does a cash flow statement present?

Practice Quiz

The *Practice Quiz* at the end of each major section provides questions to help students assess their knowledge of the main ideas covered in that section. As shown here, many of these quizzes include references to related *Personal Financial Planning* sheets, offered both in Excel and in hard copy at the back of the book.

Final PDF to printer

A variety of end-of-chapter features are offered to support the concepts presented throughout each chapter.

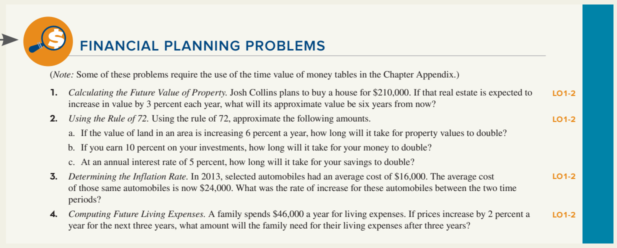


Personal Finance Roadmap and Dashboard

There are increasing numbers of nontraditional students taking personal finance. The Dashboard feature provides students of all ages with a high-level snapshot outlining how to evaluate progress for key financial planning activities. The Roadmap at the end of each chapter provides personal finance action items for students of all ages.

Financial Planning Problems

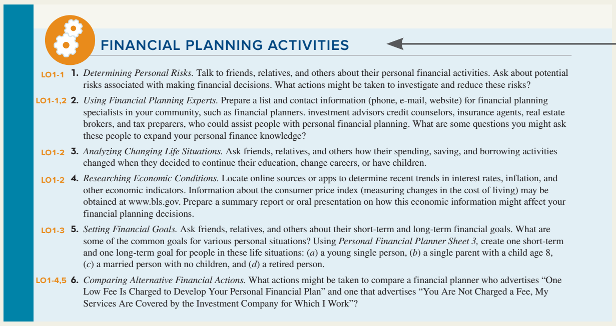
With more added to this edition, these problems allow students to apply their quantitative analysis of personal financial decisions.



FINANCIAL PLANNING PROBLEMS

(*Note:* Some of these problems require the use of the time value of money tables in the Chapter Appendix.)

1. *Calculating the Future Value of Property.* Josh Collins plans to buy a house for $210,000. If that real estate is expected to increase in value by 3 percent each year, what will its approximate value be six years from now? LO1-2
2. *Using the Rule of 72.* Using the rule of 72, approximate the following amounts. LO1-2
   a. If the value of land in an area is increasing 6 percent a year, how long will it take for property values to double?
   b. If you earn 10 percent on your investments, how long will it take for your money to double?
   c. At an annual interest rate of 5 percent, how long will it take for your savings to double?
3. *Determining the Inflation Rate.* In 2013, selected automobiles had an average cost of $16,000. The average cost of those same automobiles is now $24,000. What was the rate of increase for these automobiles between the two time periods? LO1-2
4. *Computing Future Living Expenses.* A family spends $46,000 a year for living expenses. If prices increase by 2 percent a year for the next three years, what amount will the family need for their living expenses after three years? LO1-2



FINANCIAL PLANNING ACTIVITIES

LO1-1 1. *Determining Personal Risks.* Talk to friends, relatives, and others about their personal financial activities. Ask about potential risks associated with making financial decisions. What actions might be taken to investigate and reduce these risks?

LO1-1,2 2. *Using Financial Planning Experts.* Prepare a list and contact information (phone, e-mail, website) for financial planning specialists in your community, such as financial planners. investment advisors credit counselors, insurance agents, real estate brokers, and tax preparers, who could assist people with personal financial planning. What are some questions you might ask these people to expand your personal finance knowledge?

LO1-2 3. *Analyzing Changing Life Situations.* Ask friends, relatives, and others how their spending, saving, and borrowing activities changed when they decided to continue their education, change careers, or have children.

LO1-2 4. *Researching Economic Conditions.* Locate online sources or apps to determine recent trends in interest rates, inflation, and other economic indicators. Information about the consumer price index (measuring changes in the cost of living) may be obtained at www.bls.gov. Prepare a summary report or oral presentation on how this economic information might affect your financial planning decisions.

LO1-3 5. *Setting Financial Goals.* Ask friends, relatives, and others about their short-term and long-term financial goals. What are some of the common goals for various personal situations? Using *Personal Financial Planner Sheet 3,* create one short-term and one long-term goal for people in these life situations: (*a*) a young single person, (*b*) a single parent with a child age 8, (*c*) a married person with no children, and (*d*) a retired person.

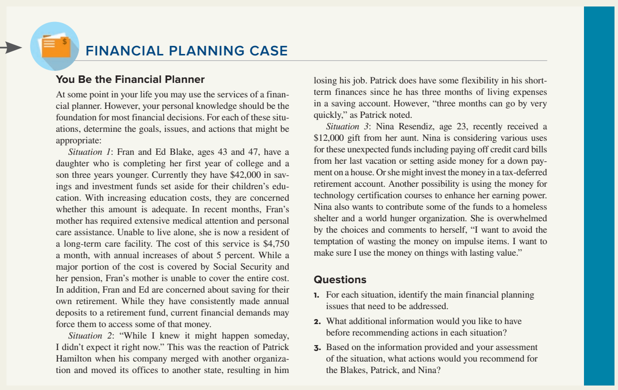
LO1-4,5 6. *Comparing Alternative Financial Actions.* What actions might be taken to compare a financial planner who advertises "One Low Fee Is Charged to Develop Your Personal Financial Plan" and one that advertises "You Are Not Charged a Fee, My Services Are Covered by the Investment Company for Which I Work"?

Financial Planning Activities

The *Financial Planning Activities* provide methods of researching and applying financial planning topics.

Financial Planning Case

Students are given a hypothetical personal finance dilemma and data to work through to practice concepts they have learned from the chapter. A series of questions helps students to use analytic and critical thinking skills while reinforcing their mastery of chapter topics.



FINANCIAL PLANNING CASE

You Be the Financial Planner

At some point in your life you may use the services of a financial planner. However, your personal knowledge should be the foundation for most financial decisions. For each of these situations, determine the goals, issues, and actions that might be appropriate:

Situation 1: Fran and Ed Blake, ages 43 and 47, have a daughter who is completing her first year of college and a son three years younger. Currently they have $42,000 in savings and investment funds set aside for their children's education. With increasing education costs, they are concerned whether this amount is adequate. In recent months, Fran's mother has required extensive medical attention and personal care assistance. Unable to live alone, she is now a resident of a long-term care facility. The cost of this service is $4,750 a month, with annual increases of about 5 percent. While a major portion of the cost is covered by Social Security and her pension, Fran's mother is unable to cover the entire cost. In addition, Fran and Ed are concerned about saving for their own retirement. While they have consistently made annual deposits to a retirement fund, current financial demands may force them to access some of that money.

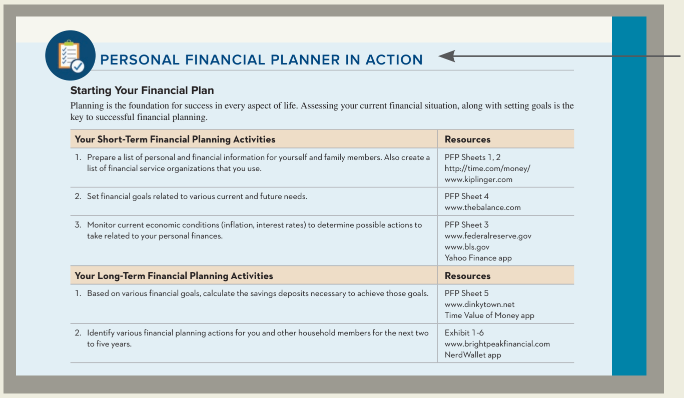
Situation 2: "While I knew it might happen someday, I didn't expect it right now." This was the reaction of Patrick Hamilton when his company merged with another organization and moved its offices to another state, resulting in him losing his job. Patrick does have some flexibility in his short-term finances since he has three months of living expenses in a saving account. However, "three months can go by very quickly," as Patrick noted.

Situation 3: Nina Resendiz, age 23, recently received a $12,000 gift from her aunt. Nina is considering various uses for these unexpected funds including paying off credit card bills from her last vacation or setting aside money for a down payment on a house. Or she might invest the money in a tax-deferred retirement account. Another possibility is using the money for technology certification courses to enhance her earning power. Nina also wants to contribute some of the funds to a homeless shelter and a world hunger organization. She is overwhelmed by the choices and comments to herself, "I want to avoid the temptation of wasting the money on impulse items. I want to make sure I use the money on things with lasting value."

Questions

1. For each situation, identify the main financial planning issues that need to be addressed.
2. What additional information would you like to have before recommending actions in each situation?
3. Based on the information provided and your assessment of the situation, what actions would you recommend for the Blakes, Patrick, and Nina?

kap13995_fm_i-xxxviii.indd xxvii 01/08/19 07:39 PM



PERSONAL FINANCIAL PLANNER IN ACTION

Starting Your Financial Plan

Planning is the foundation for success in every aspect of life. Assessing your current financial situation, along with setting goals is the key to successful financial planning.

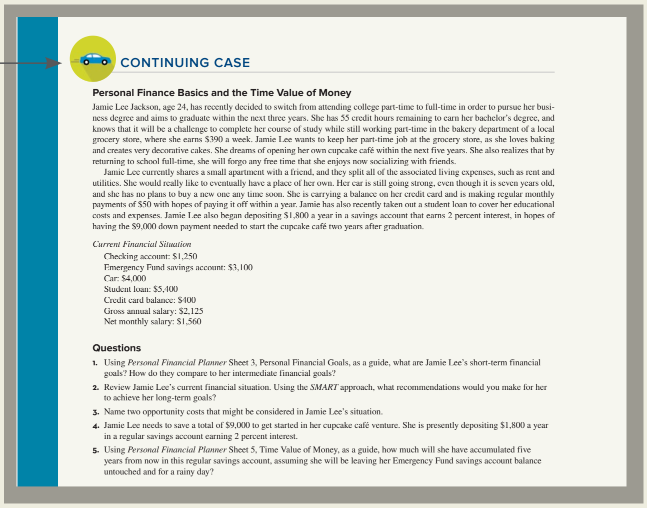
Your Short-Term Financial Planning Activities	Resources
1. Prepare a list of personal and financial information for yourself and family members. Also create a list of financial service organizations that you use.	PFP Sheets 1, 2 http://time.com/money/ www.kiplinger.com
2. Set financial goals related to various current and future needs.	PFP Sheet 4 www.thebalance.com
3. Monitor current economic conditions (inflation, interest rates) to determine possible actions to take related to your personal finances.	PFP Sheet 3 www.federalreserve.gov www.bls.gov Yahoo Finance app
Your Long-Term Financial Planning Activities	**Resources**
1. Based on various financial goals, calculate the savings deposits necessary to achieve those goals.	PFP Sheet 5 www.dinkytown.net Time Value of Money app
2. Identify various financial planning actions for you and other household members for the next two to five years.	Exhibit 1-6 www.brightpeakfinancial.com NerdWallet app

Personal Financial Planner in Action

This feature provides long- and short-term financial planning activities per the concepts learned within the chapter, and links each to relevant *Personal Financial Planner* sheets (located at the end of the book) along with websites and apps for further guidance.

Continuing Case

The continuing case gives students the opportunity to apply course concepts in a life situation. This feature encourages students to evaluate the changes that affect real life and then respond to the resulting shift in needs, resources, and priorities through the questions at the end of each case.



CONTINUING CASE

Personal Finance Basics and the Time Value of Money

Jamie Lee Jackson, age 24, has recently decided to switch from attending college part-time to full-time in order to pursue her business degree and aims to graduate within the next three years. She has 55 credit hours remaining to earn her bachelor's degree, and knows that it will be a challenge to complete her course of study while still working part-time in the bakery department of a local grocery store, where she earns $390 a week. Jamie Lee wants to keep her part-time job at the grocery store, as she loves baking and creates very decorative cakes. She dreams of opening her own cupcake café within the next five years. She also realizes that by returning to school full-time, she will forgo any free time that she enjoys now socializing with friends.

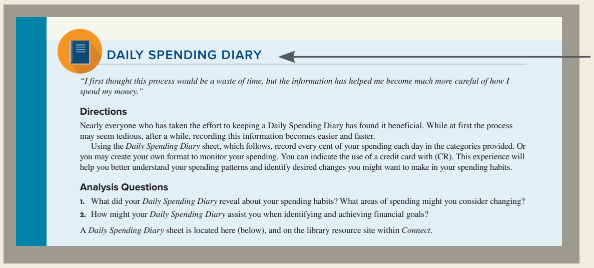
Jamie Lee currently shares a small apartment with a friend, and they split all of the associated living expenses, such as rent and utilities. She would really like to eventually have a place of her own. Her car is still going strong, even though it is seven years old, and she has no plans to buy a new one any time soon. She is carrying a balance on her credit card and is making regular monthly payments of $50 with hopes of paying it off within a year. Jamie has also recently taken out a student loan to cover her educational costs and expenses. Jamie Lee also began depositing $1,800 a year in a savings account that earns 2 percent interest, in hopes of having the $9,000 down payment needed to start the cupcake café two years after graduation.

Current Financial Situation

Checking account: $1,250
Emergency Fund savings account: $3,100
Car: $4,000
Student loan: $5,400
Credit card balance: $400
Gross annual salary: $2,125
Net monthly salary: $1,560

Questions

1. Using *Personal Financial Planner* Sheet 3, Personal Financial Goals, as a guide, what are Jamie Lee's short-term financial goals? How do they compare to her intermediate financial goals?
2. Review Jamie Lee's current financial situation. Using the *SMART* approach, what recommendations would you make for her to achieve her long-term goals?
3. Name two opportunity costs that might be considered in Jamie Lee's situation.
4. Jamie Lee needs to save a total of $9,000 to get started in her cupcake café venture. She is presently depositing $1,800 a year in a regular savings account earning 2 percent interest.
5. Using *Personal Financial Planner* Sheet 5, Time Value of Money, as a guide, how much will she have accumulated five years from now in this regular savings account, assuming she will be leaving her Emergency Fund savings account balance untouched and for a rainy day?



DAILY SPENDING DIARY

"I first thought this process would be a waste of time, but the information has helped me become much more careful of how I spend my money."

Directions

Nearly everyone who has taken the effort to keeping a Daily Spending Diary has found it beneficial. While at first the process may seem tedious, after a while, recording this information becomes easier and faster.

Using the *Daily Spending Diary* sheet, which follows, record every cent of your spending each day in the categories provided. Or you may create your own format to monitor your spending. You can indicate the use of a credit card with (CR). This experience will help you better understand your spending patterns and identify desired changes you might want to make in your spending habits.

Analysis Questions

1. What did your *Daily Spending Diary* reveal about your spending habits? What areas of spending might you consider changing?
2. How might your *Daily Spending Diary* assist you when identifying and achieving financial goals?

A *Daily Spending Diary* sheet is located here (below), and on the library resource site within *Connect*.

Daily Spending Diary

Do you buy a latte or a soft drink every day before class? Do you and your friends meet for a movie once a week? How much do you spend on gas for your car each month? Do you try to donate to your favorite local charity every year?

These everyday spending activities might go largely unnoticed, yet they have a significant effect on the overall health of an individual's finances. The *Daily Spending Diary* sheet (following Chapter 1 and online) and end-of-chapter activities offer students a place to keep track of *every cent they spend* in any category. Careful monitoring and assessing of these daily spending habits can lead to better control and understanding of students' personal finances.

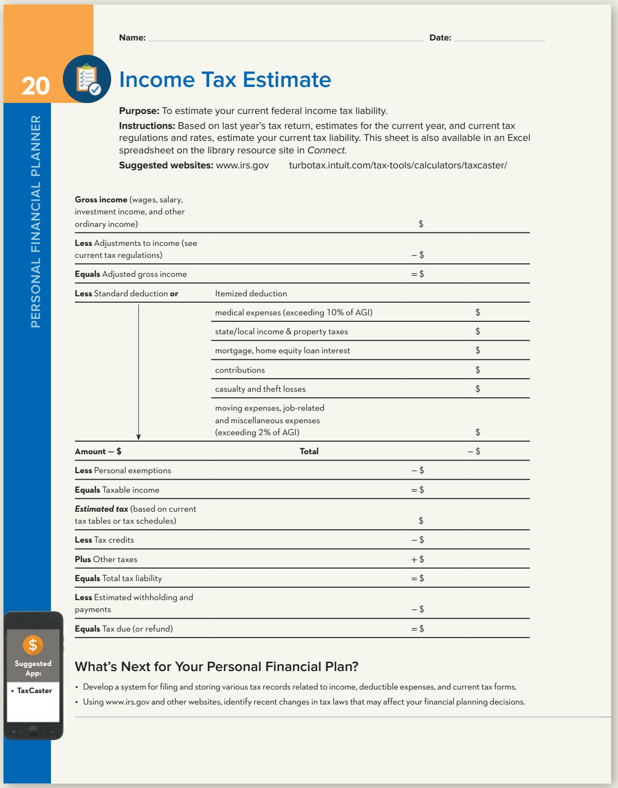
Personal Finance continues to provide instructors and students with features and materials to create a learning environment that can be adapted to any educational setting.

Personal Financial Planner Sheets

The PFP sheets that correlate with sections of the text are conveniently located at the end of the text. Each worksheet asks students to work through the application and record their own personal financial plan answers. These sheets apply concepts learned to students' personal situation and serve as a roadmap to their personal financial future. Students can fill them out, submit them for homework, and keep them filed in a safe spot for future reference!

Key websites are provided to help students research and devise their personal financial plan, and the "What's Next for Your Personal Financial Plan?" section at the end of each sheet challenges students to use their responses to plan the next level, as well as foreshadow future decisions. The authors also recommend favorite apps to help students master the relevant contents.

Look for one or more PFP icons next to many Practice Quizzes. The icons direct students to the *Personal Financial Planner* sheet that corresponds with the preceding section.



Name: Date:

20 Income Tax Estimate

PERSONAL FINANCIAL PLANNER

Purpose: To estimate your current federal income tax liability.

Instructions: Based on last year's tax return, estimates for the current year, and current tax regulations and rates, estimate your current tax liability. This sheet is also available in an Excel spreadsheet on the library resource site in *Connect*.

Suggested websites: www.irs.gov turbotax.intuit.com/tax-tools/calculators/taxcaster/

Gross income (wages, salary, investment income, and other ordinary income)		$	
Less Adjustments to income (see current tax regulations)		– $	
Equals Adjusted gross income		= $	
Less Standard deduction **or**	Itemized deduction		
	medical expenses (exceeding 10% of AGI)		$
	state/local income & property taxes		$
	mortgage, home equity loan interest		$
	contributions		$
	casualty and theft losses		$
	moving expenses, job-related and miscellaneous expenses (exceeding 2% of AGI)		$
Amount – $	**Total**		– $
Less Personal exemptions		– $	
Equals Taxable income		= $	
Estimated tax (based on current tax tables or tax schedules)		$	
Less Tax credits		– $	
Plus Other taxes		+ $	
Equals Total tax liability		= $	
Less Estimated withholding and payments		– $	
Equals Tax due (or refund)		= $	

Suggested App:
- TaxCaster

What's Next for Your Personal Financial Plan?

- Develop a system for filing and storing various tax records related to income, deductible expenses, and current tax forms.
- Using www.irs.gov and other websites, identify recent changes in tax laws that may affect your financial planning decisions.

kap13995_fm_i-xxxviii.indd xxix 01/08/19 07:39 PM

Students—study more efficiently, retain more and achieve better outcomes. Instructors—focus on what you love—teaching.

SUCCESSFUL SEMESTERS INCLUDE CONNECT

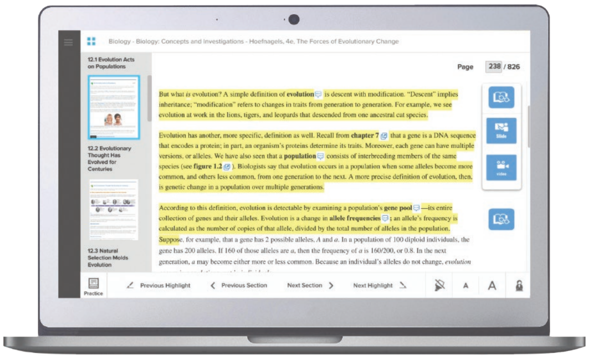
For Instructors

You're in the driver's seat.

Want to build your own course? No problem. Prefer to use our turnkey, prebuilt course? Easy. Want to make changes throughout the semester? Sure. And you'll save time with Connect's auto-grading too.

65%

Less Time Grading



They'll thank you for it.

Adaptive study resources like SmartBook® help your students be better prepared in less time. You can transform your class time from dull definitions to dynamic debates. Hear from your peers about the benefits of Connect at **www.mheducation.com/highered/connect**

Make it simple, make it affordable.

Connect makes it easy with seamless integration using any of the major Learning Management Systems—Blackboard®, Canvas, and D2L, among others—to let you organize your course in one convenient location. Give your students access to digital materials at a discount with our inclusive access program. Ask your McGraw-Hill representative for more information.

©Hill Street Studios/Tobin Rogers/Blend Images LLC

Solutions for your challenges.

A product isn't a solution. Real solutions are affordable, reliable, and come with training and ongoing support when you need it and how you want it. Our Customer Experience Group can also help you troubleshoot tech problems—although Connect's 99% uptime means you might not need to call them. See for yourself at **status.mheducation.com**

For Students

Effective, efficient studying.

Connect helps you be more productive with your study time and get better grades using tools like SmartBook, which highlights key concepts and creates a personalized study plan. Connect sets you up for success, so you walk into class with confidence and walk out with better grades.

©Shutterstock/wavebreakmedia

"I really liked this app—it made it easy to study when you don't have your text-book in front of you."

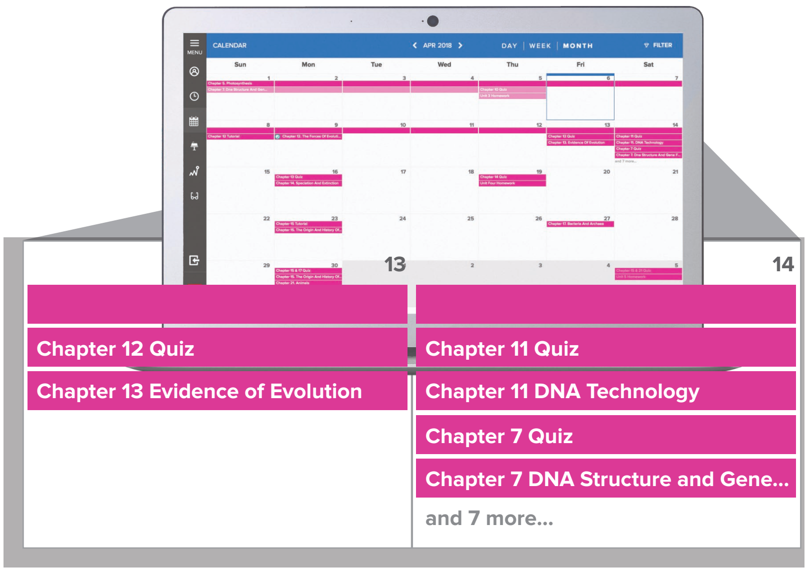
- Jordan Cunningham,
Eastern Washington University

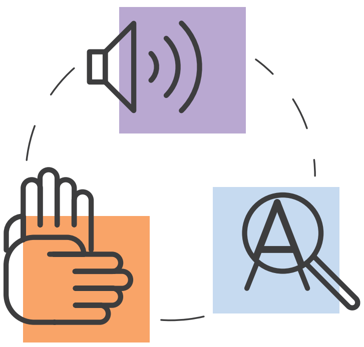
Study anytime, anywhere.

Download the free ReadAnywhere app and access your online eBook when it's convenient, even if you're offline. And since the app automatically syncs with your eBook in Connect, all of your notes are available every time you open it. Find out more at **www.mheducation.com/readanywhere**

No surprises.

The Connect Calendar and Reports tools keep you on track with the work you need to get done and your assignment scores. Life gets busy; Connect tools help you keep learning through it all.





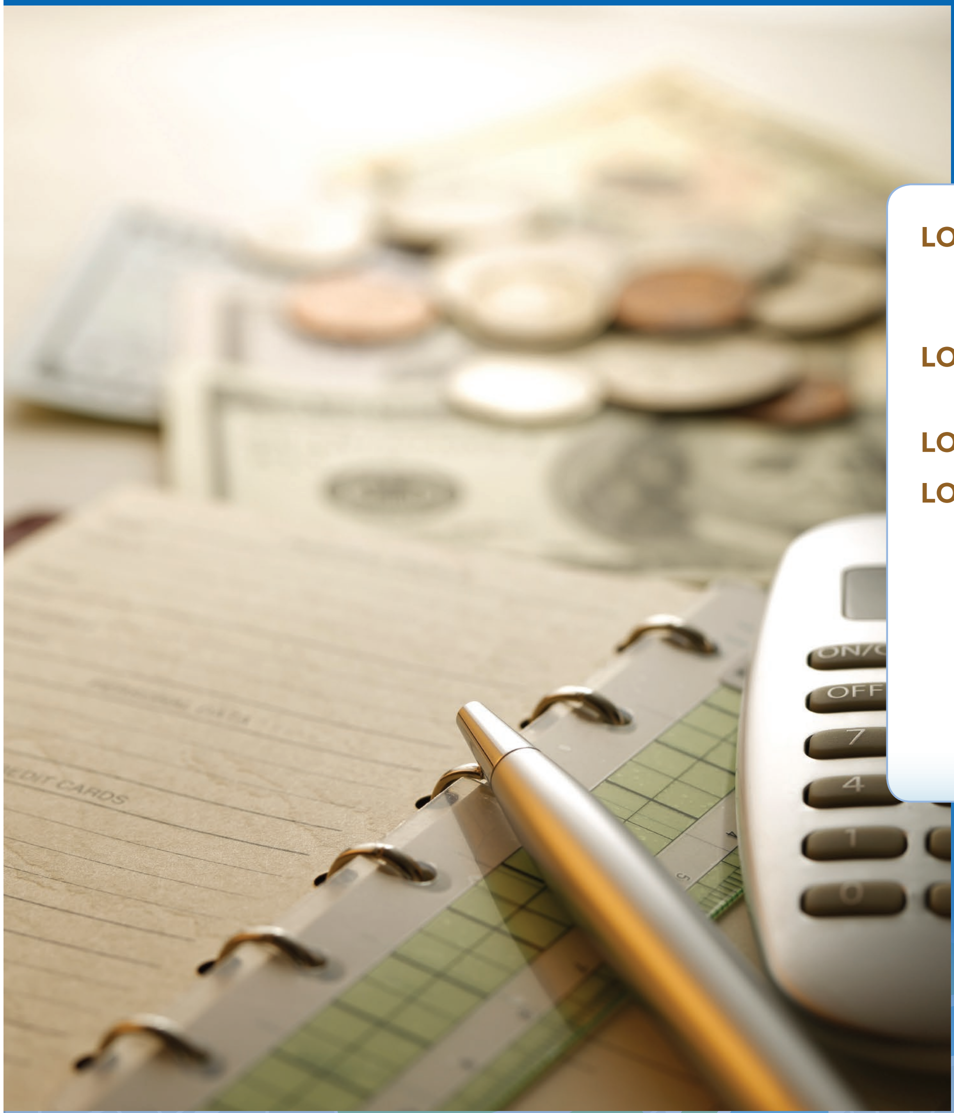
Learning for everyone.

McGraw-Hill works directly with Accessibility Services Departments and faculty to meet the learning needs of all students. Please contact your Accessibility Services office and ask them to email accessibility@mheducation.com, or visit **www.mheducation.com/about/accessibility.html** for more information.

Contents

Money Management Strategy: Financial Statements and Budgeting

3



LEARNING OBJECTIVES

LO3-1 Recognize relationships among financial documents and money management activities.

LO3-2 Develop a personal balance sheet and cash flow statement.

LO3-3 Create and implement a budget.

LO3-4 Relate money management and savings activities to achieving financial goals.

The Chapter 3 Appendix provides additional information on money management advisors and information sources.

APPENDIX

©bernie_photo/Getty Images

Financial Literacy IN YOUR LIFE

What if you . . . continually spend more each month than your income? If you regularly take money out of savings or overuse a credit card for living expenses, what actions would you take?

You might . . . maintain a daily spending diary to evaluate areas where you might reduce current spending. This would allow you to determine unnecessary expenses that might be reduced or cut back. Or you might consider actions to increase your income. Your ability to monitor and control spending provides a foundation for wise money management and long-term financial security.

Now, what would you do? What actions are you currently taking to create and improve your cash flow surplus? You will be able to examine your progress using the "Your Personal Finance Roadmap and Dashboard" feature at the end of the chapter.

my life SAVING IS THE ONLY PATH FOR FINANCIAL SUCCESS

"Money not going out is like money coming in!" Reducing your spending will result in lower credit card debt, more money for emergencies, and funds for long-term investing.

From a budgeting perspective, "if you only spend money on things you *really need,* you always have money for things you really want." Very often, people use the word *need* when they really mean *want.* As a result, overspending, increased debt, and lower saving and investing occur.

What are your money management habits? You can now start to assess your money management knowledge and skills. For each of the following statements, circle the choice that best describes your current situation.

1. My money management activities are most valuable to help me
   - **a.** avoid credit problems.
   - **b.** achieve financial goals.
   - **c.** enjoy spending for daily needs.
2. My system for organizing personal financial records could be described as
   - **a.** nonexistent . . . I have documents that are missing in action!
   - **b.** basic . . . I can find most stuff when I need to!
   - **c.** very efficient . . . better than Google!
3. The details of my cash flow statement are
   - **a.** simple . . . "money coming in" and "money going out."
   - **b.** appropriate for my needs . . . enough information for me.
   - **c.** very informative . . . I know where my money goes.
4. My budgeting activities could be described as
   - **a.** "I don't have enough money to worry about where it goes."
   - **b.** "I keep track of my spending on my phone."
   - **c.** "I have a written plan for spending and paying my bills on time."
5. The status of my savings goals could be described as
   - **a.** "Good progress is being made."
   - **b.** "If I save $100 more, I'll have $100!"
   - **c.** "What's a savings goal?"

As you study this chapter, you will encounter "My Life" boxes with additional information and resources related to these items.

Successful Money Management

LO3-1

Recognize relationships among financial documents and money management activities.

"Each month, I have too many days and not enough money. If the month were only 20 days long, budgeting would be easy." Most of us have heard a comment like this when it comes to budgeting and money management.

Your daily spending and saving decisions are the main element of financial planning. You must coordinate these decisions with your needs, goals, and personal situation. When people watch a sporting event, they usually know the score. In financial planning, knowing the score is also important.

Maintaining financial records and planning your spending are essential to successful personal financial management. The time and effort you devote to these record-keeping activities will yield benefits. **Money management** refers to the day-to-day financial activities necessary to manage current personal economic resources while working toward long-term financial security.

money management
Day-to-day financial activities necessary to manage current personal economic resources while working toward long-term financial security.

OPPORTUNITY COST AND MONEY MANAGEMENT

Daily decision-making is a fact of life, and trade-offs are associated with each choice made. Selecting an alternative means you give up something else. In terms of money management decisions, examples of trade-off situations, or *opportunity costs,* include the following:

- Spending for current living expenses reduces the amount you have for saving and investing for long-term financial security.
- Saving and investing for the future reduces the amount you can spend now.
- Buying on credit results in payments later and reduces the amount of future income available for spending.
- Using savings for purchases results in lost interest earnings and an inability to use savings for other purposes.
- Comparison shopping can save you money and improve the quality of your purchases but uses up something of value you cannot replace: your time.

As you plan and implement various money management activities, you need to assess financial and personal costs and benefits associated with financial decisions.

COMPONENTS OF MONEY MANAGEMENT

As Exhibit 3-1 shows, three major money management activities are interrelated. First, personal financial records and documents are the foundation of systematic resource use. These provide written evidence of business transactions, ownership of property, and legal matters. Next, personal financial statements enable you to measure and assess your financial position and progress. Finally, your spending plan, or *budget,* is the basis for effective money management.

A PERSONAL FINANCIAL RECORDS SYSTEM

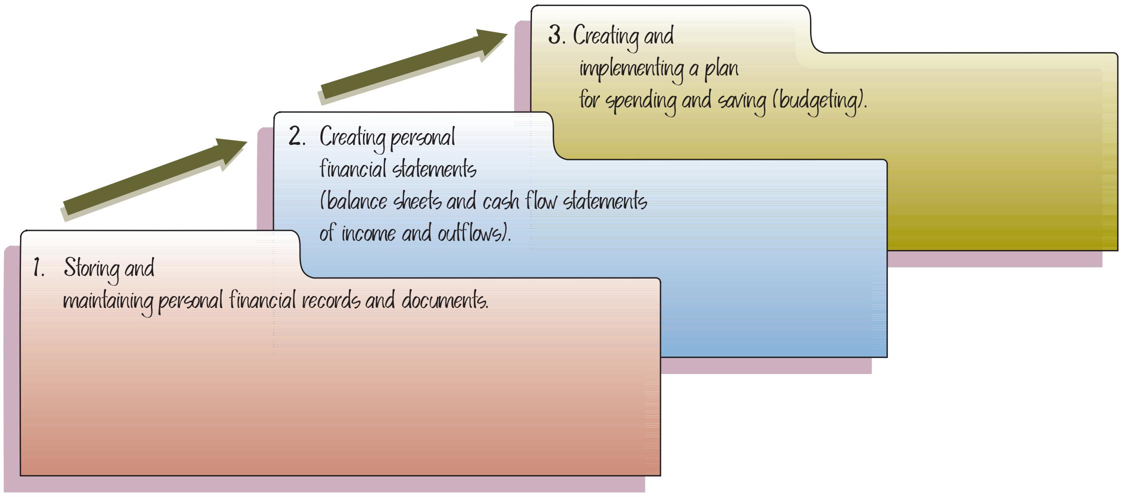
Receipts, credit card statements, insurance policies, and tax forms document various personal financial activities. An organized system of financial records provides a basis for (1) handling daily business activities, such as bill paying; (2) planning and measuring financial progress; (3) completing required tax reports; (4) making effective investment decisions; and (5) determining available resources for current and future spending.

my life 1

I understand the value of money management activities.

Many online sources are available to provide money management information. Locate a blog that you consider reliable for obtaining money management guidance.

EXHIBIT 3-1 Money management activities



smart money minute

A poorly organized financial record system can result in lost valuables and hidden assets such as U.S. savings bonds, old life insurance policies with a cash value, dormant savings accounts, old investments, and unused gift cards.

Most financial records are kept in one of three places: a home file, a safe deposit box, or online. A home file should be used to keep records for current needs and documents with limited value. Your home file may be a series of folders, a file cabinet, or even a box. Whatever method you use, your home file should be organized to allow quick access to needed documents and information, which can easily be organized into 10 categories (see Exhibit 3-2). These groups correspond to the major topics covered in this book. You may not need to use all of these records and documents at present. As your financial situation changes, you will add others.

safe deposit box A private storage area at a financial institution with maximum security for valuables.

Important financial records and valuable articles should be kept in a location that provides better security than a home file. A **safe deposit box** is a private storage area at a financial institution with maximum security for valuables and difficult-to-replace documents. Access to the contents of a safe deposit box requires two keys. One key is issued to you; the other is kept by the financial institution where the safe deposit box is located. Items commonly kept in a safe deposit box include birth certificate, car title, passport, list of credit card numbers and insurance policies, a USB drive with vital financial documents, and valuables such as rare coins. These documents may also be kept in a fireproof home safe.

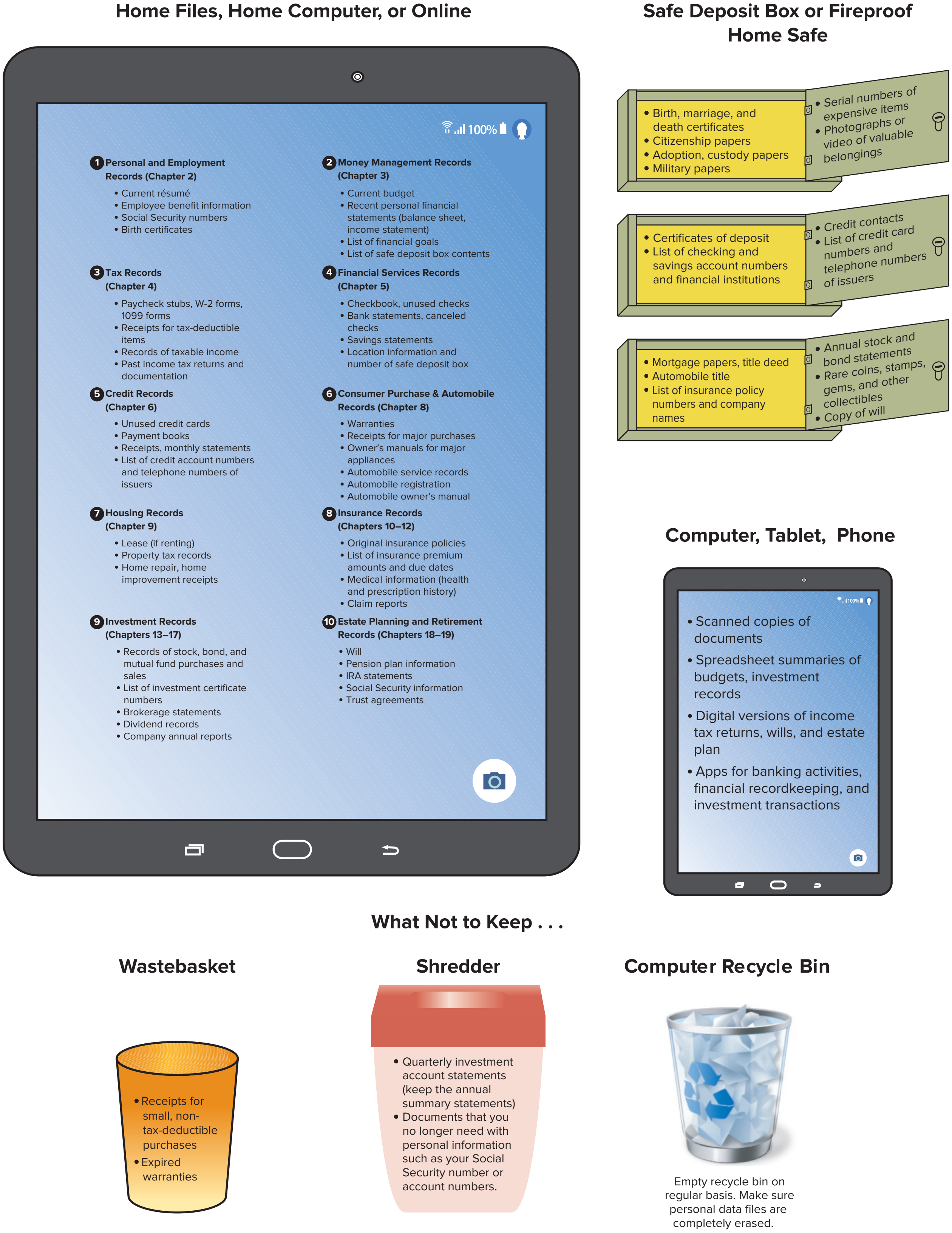
As more documents are provided in a digital format, and people are using cloud storage, consider the following actions.

- Download copies of all statements and forms to your local storage area using a logical system of files and folders.
- Back up files on external media or use an online backup service.
- Secure data with complex passwords and encryption.
- Scan copies of documents so you no longer need to keep paper versions.
- Take appropriate action to completely erase files when discarding items no longer needed.

Hard copies may still be required, such as car titles, birth certificates, property deeds, and life insurance policies. Original receipts may be needed for returns or warranty service.

How long should you keep personal finance records? Records such as birth certificates, wills, and Social Security data should be kept permanently. Records of property

EXHIBIT 3-2 Where to keep your financial records



Source: © Microsoft 2013.

and investments should be kept as long as you own these items. Federal tax laws dictate the length of time you should keep tax-related information. Copies of tax returns and supporting data should be saved for seven years. Normally, an audit will go back only three years; however, under certain circumstances, the Internal Revenue Service may request information from further back. Financial experts recommend keeping documents related to the purchase and sale of real estate indefinitely.

XLS **PFP Sheet 14** Financial documents and records

PRACTICE QUIZ 3-1

1. What opportunity costs are associated with money management activities?
2. What are the three major money management activities?
3. What are the benefits of an organized system of financial records and documents?
4. What suggestions would you give for creating a system for organizing and storing financial records and documents?

Personal Financial Statements

LO3-2

Develop a personal balance sheet and cash flow statement.

Every journey starts somewhere. You need to know where you are before you can go somewhere else. Personal financial statements tell you the starting point of your financial journey.

Most of the financial documents discussed in the previous section come from financial institutions, businesses, or government. Two documents that you create, the personal balance sheet and the cash flow statement, are called *personal financial statements.* These reports provide information about your current financial position and present a summary of your income and spending. The main purposes of personal financial statements are to

- Report your current financial position in relation to the value of items you own and amounts you owe.
- Measure your progress toward financial goals.
- Maintain information about your financial activities.
- Provide data you can use when preparing tax forms or applying for credit.

THE PERSONAL BALANCE SHEET: WHERE ARE YOU NOW?

balance sheet A financial statement that reports what an individual or a family owns and owes; also called a *net worth statement.*

The current financial position of an individual or a family is a common starting point for financial planning. A **balance sheet,** also called a *net worth statement* or *statement of financial position,* reports what you own and what you owe. You prepare a personal balance sheet to determine your current financial position using the following process:

Items of value (what you own) − Amounts owed (what you owe)
= Net worth (your wealth)

For example, if your possessions are worth $4,500 and you owe $800 to others, your net worth is $3,700.

assets Cash and other property with a monetary value.

STEP 1: LIST ITEMS OF VALUE Money in bank accounts combined with other items of value are the foundation of your current financial position. **Assets** are cash and other tangible property with a monetary value. The balance sheet for Rose and Edgar Gomez (Exhibit 3-3) lists their assets under four categories.

EXHIBIT 3-3 Creating a personal balance sheet

Rose and Edgar Gomez
Personal Balance Sheet as of October 31, 2019

Assets		
Liquid Assets		
Checking account balance (Chap. 5)	$ 1,450	
Savings/money market accounts (Chap. 5)	5,235	
Cash value of life insurance (Chap. 12)	3,685	
Total liquid assets		$ 10,370
Real Estate		
Current market value of home (Chap. 9)		$ 189,900
Personal Possessions		
Market value of automobile	8,000	
Furniture and appliances	5,900	
Stereo and video equipment	2,600	
Home computer	1,400	
Jewelry	2,200	
Total household assets		$ 20,100
Investment Assets (Chaps. 13–17)		
Retirement accounts (Chap. 18)	26,780	
Mutual funds (Chap. 16)	11,890	
Total investment assets		38,670
Total assets		$ 259,040
Liabilities		
Current Liabilities		
Medical bills (Chap. 11)	$ 150	
Charge account and credit card balances (Chaps. 6, 7)	3,340	
Balance due on auto loan	1,750	
Total current liabilities		$ 5,240
Long-Term Liabilities		
Mortgage (Chap. 9)	91,600	
Home improvement loan (Chaps. 6, 7)	1,760	
Student loan	1,200	
Total long-term liabilities		94,560
Total liabilities		$ 99,800
Net worth (assets minus liabilities)		$ 159,240

Step 1
Prepare a total of all items of value (assets). Include amounts in bank accounts, investments, and the cost (or estimated current value) of your possessions.

Step 2
List and total the amounts owed to others (liabilities). This list will include current debts, charge account/credit card balances, and amounts due on loans and mortgages.

Step 3
Subtract total liabilities from total assets to determine net worth. This amount indicates the current financial position of an individual or a household.

Note: Various asset and liability items are discussed in the chapters listed next to them.

1. **Liquid assets** are cash and items of value that can easily be converted to cash. Money in checking and savings accounts is *liquid* and available to the Gomez family for current spending. The cash value of their life insurance may be borrowed if needed. While assets other than liquid assets can also be converted into cash, the process is not quite as easy.
2. *Real estate* includes a home, a condominium, vacation property, or other land that a person or family owns.
3. *Personal possessions* are a major portion of assets for most people. Included in this category are automobiles and other personal belongings. While these items have value, they may be difficult to convert to cash. You may decide to list your possessions on the balance sheet at their original cost. However, these

liquid assets Cash and items of value that can easily be converted to cash.

smart money minute

An estimated $3 billion of grants and scholarships go unused each year. One of the simplest ways to take advantage of these funds is to complete the Free Application for Federal Student Aid (FAFSA) at https://fafsa.ed.gov. In addition, www.finaid.org, www.fastweb.com, and www.cappex.com are some of the online sources for locating scholarships for which you may qualify. For additional guidance on financing your education, see the Chapter 7 Appendix.

values probably need to be revised over time, since a three-year-old television set, for example, is worth less now than when it was new. Thus, you may wish to list your possessions at their current value (also referred to as *market value*). This method takes into account the fact that such things as a home or rare jewelry may increase in value over time. You can estimate current value by looking at ads for the selling price of comparable automobiles, homes, or other possessions. Or you may use the services of an appraiser.

4. *Investment assets* are funds set aside for long-term financial needs. The Gomez family will use their investments for such things as financing their children's education, purchasing a vacation home, and planning for retirement.

Since investment assets usually fluctuate in value, the amounts listed should reflect their value at the time the balance sheet is prepared.

liabilities Amounts owed to others.

current liabilities Debts that must be paid within a short time, usually less than a year.

long-term liabilities Debts that are not required to be paid in full until more than a year from now.

STEP 2: DETERMINE AMOUNTS OWED Looking at the total assets of the Gomez family, you might conclude that they have a strong financial position. However, their debts must also be considered. **Liabilities** are amounts owed to others but do not include items not yet due, such as next month's rent. A liability is a debt you owe now, not something you may owe in the future. Liabilities fall into two categories:

1. **Current liabilities** are debts you must pay within a short time, usually less than a year. These liabilities include such things as medical bills, tax payments, insurance premiums, cash loans, and charge accounts.
2. **Long-term liabilities** are debts you do not have to pay in full until more than a year from now. Common long-term liabilities include auto loans, educational loans, and mortgages. A *mortgage* is an amount borrowed to buy a house or other real estate that will be repaid over a period of usually 15 years or more. Similarly, a home improvement loan may be repaid over the next 5 to 10 years.

The debts listed in the liability section of a balance sheet represent the amount owed at the moment; they do not include future interest payments or monthly expenses due at a later time. However, each debt payment is likely to include a portion of interest. Chapters 6 and 7 discuss the cost of borrowing.

net worth The difference between total assets and total liabilities.

STEP 3: COMPUTE NET WORTH Your **net worth** is the difference between your total assets and your total liabilities. This relationship can be stated as

$$\text{Assets} - \text{Liabilities} = \text{Net worth}$$

Net worth is the amount you would have if all assets were sold for the listed values and all debts were paid in full. Also, total assets equal total liabilities plus net worth. The balance sheet of a business is commonly expressed as

$$\text{Assets} = \text{Liabilities} + \text{Net worth}$$

As Exhibit 3-3 shows, Rose and Edgar Gomez have a net worth of $159,240. Since very few people, if any, liquidate all assets, the amount of net worth has a more practical purpose: It provides a measurement of your current financial position.

EXAMPLE: Net Worth

If a household has $193,000 of assets and liabilities of $88,000, the net worth would be $105,000 ($193,000 minus $88,000).

A person may have a high net worth but still have financial difficulties. Having many assets with low liquidity means not having the cash available to pay current expenses.

Insolvency is the inability to pay debts when they are due; it occurs when a person's liabilities far exceed available assets. Bankruptcy, discussed in Chapter 7, may be an alternative for a person in this position.

insolvency The inability to pay debts when they are due because liabilities far exceed the value of assets.

The main ways to increase your net worth are by

- Increasing your savings.
- Reducing spending.
- Increasing the value of investments and other possessions.
- Reducing the amounts you owe.

Remember, your net worth is *not* money available for use but an indication of your financial position on a given date.

EVALUATING YOUR FINANCIAL POSITION

A personal balance sheet helps you measure progress toward financial goals. Your financial situation improves if your net worth increases each time you prepare a balance sheet. It will improve more rapidly if you are able to set aside money each month for savings and investments. As with net worth, the relationship among various balance sheet items can give an indication of your financial position.

THE CASH FLOW STATEMENT: WHERE DID YOUR MONEY GO?

Each day, financial events can affect your net worth. When you receive a paycheck or pay living expenses, your total assets and liabilities change. **Cash flow** is the actual inflow and outflow of cash during a given time period. Income from employment will probably represent your most important *cash inflow;* however, other income, such as interest earned on a savings account, should also be considered. In contrast, payments for items such as rent, food, and loans are *cash outflows.*

cash flow The actual inflow and outflow of cash during a given time period.

A **cash flow statement,** also called a *personal income and expenditure statement* (Exhibit 3-4), is a summary of cash receipts and payments for a given period, such as a month or a year. This report provides data on your income and spending patterns, which will be helpful when preparing a budget. Your bank account can provide information for a cash flow statement. Deposits to the account are your *inflows;* checks written, online payments, and debit card purchases are your *outflows.* Of course, in using this system, when you make cash payments or purchases, you must also note these amounts for your cash flow statement.

cash flow statement A financial statement that summarizes cash receipts and payments for a given period.

The process for preparing a cash flow statement is

Total cash received during the time period − Cash outflows during the time period = Cash surplus or deficit

STEP 1: RECORD INCOME Creating a cash flow statement starts with identifying the cash received during the time period involved. **Income** is the inflows of cash for an individual or a household. For most people, the main source of income is money received from their work. Other common income sources include:

income Inflows of cash to an individual or a household.

- Wages, salaries, and commissions.
- Self-employment business income.
- Savings and investment income (interest, dividends, rent).
- Gifts, grants, and scholarships.

EXHIBIT 3-4 Creating a cash flow statement of income and outflows

Step 1

For a set time period (such as a month), record your income from various sources, such as wages, salary, interest, or payments from the government.

Step 2

Develop categories and record cash payments for the time period covered by the cash flow statement.

Step 3

Subtract the total outflows from the total inflows. A positive number (surplus) represents the amount available for saving and investing. A negative number (deficit) represents the amount that must be taken out of savings or borrowed.

Lin Ye

Cash Flow Statement for the Month Ended September 30, 2019

Income (cash inflows)				
Salary (gross income)		$4,350		
Less deductions				
Federal income tax	$810			
State income tax	108			
Social Security	332			
Total deductions		$1,250		$3,100
Interest earned on savings				34
Earnings from investments				62
Total income				$3,196
Cash Outflows				
Fixed Expenses				
Rent		$1,150		
Loan payment		216		
Cable television		52		
Monthly train ticket		196		
Life insurance		32		
Apartment insurance		23		
Total fixed outflows			$1,669	
Variable Expenses				
Food at home		260		
Food away from home		168		
Clothing		150		
Telephone		52		
Electricity		48		
Personal care (dry cleaning, laundry, cosmetics)		66		
Medical expenses		85		
Recreation/entertainment		100		
Gifts		70		
Donations		80		
Total variable outflows			1,079	
Total outflows				$2,748
Cash surplus + (or deficit –)				+$448
Allocation of Surplus				
Emergency fund savings				168
Savings for short-term/intermediate financial goals				80
Savings/investing for long-term financial security				200
Total surplus				$448

- Government payments, such as Social Security, public assistance, and unemployment benefits.
- Amounts received from pension and retirement programs.
- Alimony and child support payments.

take-home pay Earnings after deductions for taxes and other items; also called *net pay.*

In Exhibit 3-4, notice that Lin Ye's monthly salary (or *gross income*) of $4,350 is her main source of income. However, she does not have use of the entire amount. **Take-home pay,** also called *net pay,* is a person's earnings after deductions for taxes and other items. Lin's deductions for federal, state, and Social Security taxes are $1,250.

Her take-home pay is $3,196. This amount, plus earnings from savings and investments, is the income she has available for use during the current month.

Take-home pay may also be referred to as *disposable income,* the amount a person or household has available to spend. **Discretionary income** is money left over after paying for housing, food, and other necessities. Studies report that discretionary income ranges from less than 5 percent for people under age 25 to more than 40 percent for older people.

Daily purchasing decisions influence cash outflows and long-term financial goals.
©Lew Robertson/Corbis/Getty Images

discretionary income Money left over after paying for housing, food, and other necessities.

STEP 2: RECORD CASH OUTFLOWS Cash payments for living expenses and other items make up the second component of a cash flow statement. Lin Ye divides her cash outflows into two major categories: *fixed expenses* and *variable expenses.* While every individual and household has different cash outflows, these main categories, along with the subcategories Lin uses, can be adapted to most situations.

1. *Fixed expenses* are payments that do not vary from month to month. Rent or mortgage payments, installment loan payments, wifi service fees, and a monthly train ticket for commuting to work are examples of constant or fixed cash outflows.

   For Lin, another type of fixed expense is the amount she sets aside each month for payments due once or twice a year. For example, Lin pays $384 every March for life insurance. Each month, she records a fixed outflow of $32 for deposit in a special savings account so that the money will be available when her insurance payment is due.

2. *Variable expenses* are flexible payments that change from month to month. Common examples of variable cash outflows are food, clothing, utilities (such as electricity, cell phone, gas), recreation, medical expenses, gifts, and donations. The use of an app or some other record-keeping system is necessary for an accurate total of cash outflows.

STEP 3: DETERMINE NET CASH FLOW The difference between income and outflows can be either a positive (*surplus*) or a negative (*deficit*) cash flow. A deficit exists if more cash goes out than comes in during a given month. This amount must be made up by withdrawals from savings or by borrowing.

When you have a cash surplus, as Lin did (Exhibit 3-4), this amount is available for saving, investing, or paying off debts. Each month, Lin sets aside money for her *emergency fund* in a savings account that she would use for unexpected expenses or to pay living costs if she did not receive her salary. She deposits the rest of the surplus in savings and investment plans that have two purposes. The first is the achievement of short-term and intermediate financial goals, such as a new car, a vacation, or reenrollment in school; the second is long-term financial security—her retirement.

A cash flow statement provides the foundation for preparing and implementing a spending, saving, and investment plan. The cash flow statement reports the *actual* spending of a household. In contrast, a budget, which has a similar format, considers both *projected* income and spending.

The nearby *Financial Literacy Calculations* feature offers tools that may be used to determine improvements in your balance sheet and cash flow statement.

my life 2

I know the details of my cash flow statement.

In what ways might the *Daily Spending Diary* (at the end of Chapter 1) be of value when preparing a personal cash flow statement?

smart money minute

Many people make the ***mistake*** of not maintaining an accurate record of their spending, resulting in high levels of debt and low amounts in savings. An ***action*** might be to make use of an app or keep a written record of your spending. This can result in ***success*** of having funds for financial goals and emergencies. Other actions to consider for reduced financial stress include: (1) Have a low debt-to-income ratio. (2) Delay, reduce, or eliminate unnecessary expenses. (3) Build up emergency savings. (4) Seek additional income from a part-time job or selling possessions. (5) Build a higher amount of assets.

Financial Literacy Calculations

RATIOS FOR EVALUATING FINANCIAL PROGRESS

Financial ratios provide guidelines for measuring the changes in your financial situation. These relationships can indicate progress toward an improved financial position.

Ratio	Calculation	Example	Interpretation
Debt ratio	Liabilities divided by assets	$25,000/$50,000 = 0.5	Shows relationship between debt and assets; a low debt ratio is best.
Current ratio	Liquid assets divided by current liabilities	$4,000/$2,000 = 2	Indicates $2 in liquid assets for every $1 of current liabilities; a high current ratio is desirable to have cash available to pay bills.
Liquidity ratio	Liquid assets divided by monthly expenses	$10,000/$4,000 = 2.5	Indicates the number of months in which living expenses can be paid if an emergency arises; a high liquidity ratio is desirable.
Debt-payments ratio	Monthly credit payments divided by take-home pay	$540/$3,600 = 0.15	Indicates how much of a person's earnings goes for debt payments (excluding a home mortgage); financial advisors recommend a debt/payments ratio of less than 20 percent.
Savings ratio	Amount saved each month divided by gross income	$648/$5,400 = 0.12	Financial experts recommend monthly savings of 5–10 percent.

Based on the following information, calculate the ratios requested:

Liabilities $12,000
Liquid assets $2,200
Monthly credit payments $150
Monthly savings $130

Total assets $36,000
Current liabilities $550
Take-home pay $900
Gross income $1,500

1. Debt ratio ____________________
2. Current ratio ____________________
3. Debt-payments ratio ____________________
4. Savings ratio ____________________

Analysis: How do these ratios compare with the guidelines mentioned in the "Interpretation" column above?

Answers: (1) $12,000/$36,000 = 0.33; (2) $150/$900 = 0.167; (3) $2,200/$550 = 4.0; (4) $130/$1,500 = 0.087, 8.7 percent

PFP Sheet 15
Personal balance sheet

PFP Sheet 16
Personal cash flow statement

PRACTICE QUIZ 3-2

1. What are the main purposes of personal financial statements?
2. What does a personal balance sheet tell about your financial situation?
3. How can you use a balance sheet for personal financial planning?
4. What information does a cash flow statement present?

Budgeting for Skilled Money Management

LO3-3

Create and implement a budget.

budget A specific plan for spending income.

Varied segments of the population encounter different money management challenges and budgeting activities. An *achiever,* with a strong financial resource base, would usually encounter money issues different from those of an *explorer,* someone seeking to get to the next level of financial success. A *striver,* with minimal financial resources, would need to carefully plan the use of available funds.

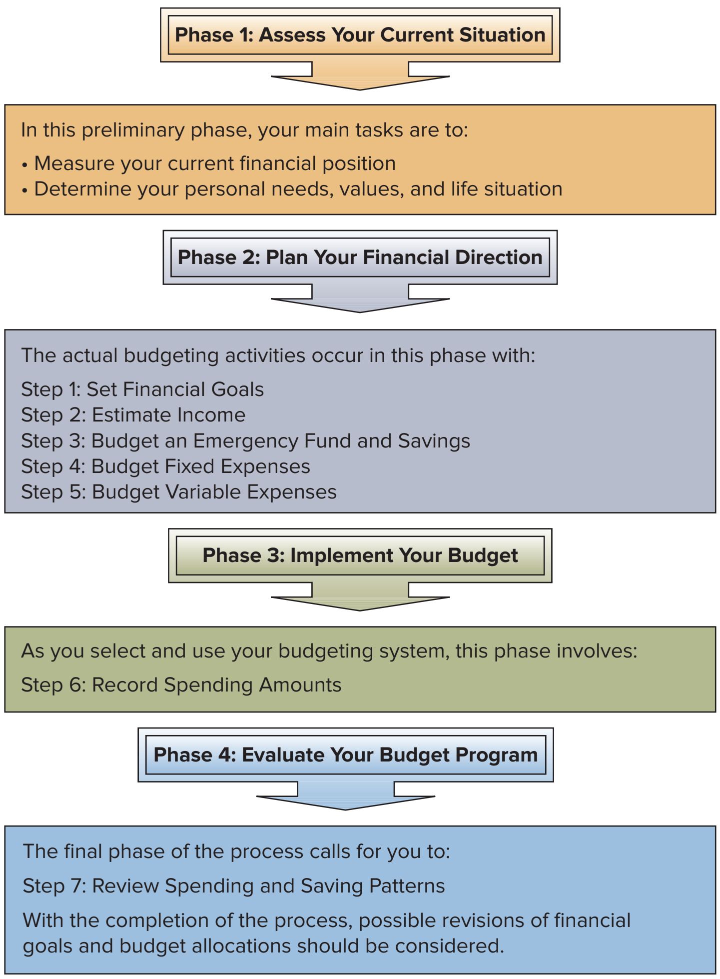
A **budget,** or *spending plan,* is necessary for successful financial planning. The common financial problems of overusing credit, lacking a regular savings program, and failing to ensure future financial security can be minimized through budgeting. The main purposes of a budget are to help you: (1) live within your income; (2) spend your money wisely; (3) reach your financial goals; (4) prepare for financial emergencies; and (5) develop wise financial management habits.

With a budget, you will be in control of your life. Without a budget, others will be in control, such as those to whom you owe money. Use a budget to tell your money where to go, rather than having overspending and debt control your life. Budgeting may be viewed in four major phases, as shown in Exhibit 3-5.

In Phase 1 (Assess Your Current Situation), the emphasis will be on recording and reviewing your past spending, saving, and income amounts. This information is the basis for your budget. Phase 2 (Plan Your Financial Direction) involves the steps necessary for planning the budget components. Phase 3 (Implement Your Budget) requires that you maintain a record of your spending to compare actual amounts to budgeted

EXHIBIT 3-5

Creating and implementing a budget



amounts. Finally, in Phase 4 (Evaluate Your Budget Program), you review and adjust budget amounts for the future based on changes in household situation, finances, and goals.

THE BUDGETING PROCESS

The financial statements and documents discussed earlier in this chapter are the starting point for money management activities. A personal balance sheet is an effective scorecard for measuring financial progress. An improved net worth, as a result of increased assets or decreased debt, is evidence of a better financial position. A regular assessment of your financial standing is one of the foundation elements of budgeting activities, which involves the following steps.

STEP 1: SET FINANCIAL GOALS Future plans are an important dimension of your financial direction. Financial goals are plans for future activities that require you to plan your spending, saving, and investing. Exhibit 3-6 gives examples of common financial goals based on life situation and time.

As discussed in Chapter 1, financial goals should take a S-M-A-R-T approach with goals that are **S**pecific, **M**easurable, **A**ction-oriented, **R**ealistic, and **T**ime-based. Your personal financial statements and budget allow you to achieve your financial goals, with

1. Your balance sheet reporting your current financial position—where you are now.
2. Your cash flow statement telling you what you received and spent over the past month.
3. Your budget setting a plan for spending and saving to achieve financial goals.

smart money minute

Instead of reducing spending, you may try to increase your income. Some sources of additional income include: working extra hours at your current job or extra part-time work; creating a home-based or online business; selling unneeded household items or clothes online or with a garage sale; turning a hobby into a business; or selling your advice or expertise as a consultant. Search online for additional ideas for added income.

STEP 2: ESTIMATE INCOME As Exhibit 3-7 shows, you should next estimate available money for a given time period. A common budgeting period is a month, since many payments, such as rent or mortgage, utilities, and credit cards, are due each month. In determining available income, include only money that you are sure you'll receive. Bonuses, gifts, or unexpected income should not be considered until the money is actually received.

If you get paid once a month, planning is easy since you will work with a single amount. But if you get paid weekly or twice a month, you will need to plan how much of each paycheck will go for various expenses. If you get paid every two weeks,

EXHIBIT 3-6 Common financial goals

Personal Situation	Short-Term Goals (less than 1 year)	Intermediate Goals (1–5 years)	Long-Term Goals (over 5 years)
Single person	• Complete college • Pay off auto loan	• Take a vacation to Europe • Pay off education loan • Attend graduate school	• Buy a vacation home in the mountains • Provide for retirement income
Married couple (no children)	• Take an annual vacation • Buy a new car	• Remodel home • Build a stock portfolio	• Buy a retirement home • Provide for retirement income
Single parent (young children)	• Increase life insurance • Increase savings	• Increase investments • Buy a new car	• Accumulate a college fund for children • Move to a larger home

EXHIBIT 3-7 The Fraziers develop and implement a monthly budget

Step 1
Set financial goals.

Step 2
Estimate expected income from all sources; this amount is to be allocated among various outflow categories.

Step 3
Budget amount for an emergency fund, periodic expenses, and financial goals.

Step 4
Budget set amounts that you are obligated to pay.

Step 5
Budget estimated amounts to be spent for various household and living expenses.

Step 6
Record actual amounts for inflows and outflows. Compare actual amounts with budgeted amounts to determine variances.

Step 7
Evaluate whether revisions are needed in your spending and savings plan.

Monthly Budget

Financial goals: increase emergency fund; avoid credit card debt.

	Budgeted (dollars)	Amounts (percent)	Actual Amounts	Variance
Projected Inflows (income)				
Salary	2874	100	2874	—
Projected Outflows (disbursements)				
Emergency Fund and Savings:				
Emergency fund savings	115	4	115	—
Savings for auto insurance	29	1	29	—
Savings for vacation	57	2	57	—
Savings for investments	57	2	57	—
Total savings	258	9	258	—
Fixed Expenses				
Mortgage payment	518	18	518	—
Property taxes	115	4	115	—
Auto loan payment	144	5	144	—
Life insurance	29	1	29	—
Total fixed expenses	806	28	806	—
Variable Expenses				
Food	402	14	417	-15
Utilities (telephone, heat, electric, water)	172	6	164	-8
Clothing	116	4	93	+23
Transportation (automobile operation, repairs, public transportation)	460	16	471	-11
Personal and health care	172	6	163	+9
Entertainment	172	6	201	-29
Reading, education	86	3	78	+8
Gifts, donations	144	5	150	-6
Personal allowances, miscellaneous expenses	86	3	90	-4
Total variable expenses	1810	63	1827	-17
Total outflow	2874	100	2891	-17

plan your spending based on the two paychecks you will receive each month. Then, during the two months each year that have three paydays, you can put additional amounts into savings, pay off debts, or make a special purchase.

Budgeting income may be difficult if your earnings vary by season or your income is irregular, as with sales commissions. In these situations, attempt to estimate your income based on the past year and on your expectations for the current year. Estimating your income on the low side will help you avoid overspending and other financial difficulties.

Maintaining income and expense records makes the budgeting process easier.
©Chris Ryan/age fotostock

STEP 3: BUDGET AN EMERGENCY FUND AND SAVINGS To set aside money for unexpected expenses as well as future financial security, the Fraziers (see Exhibit 3-7) have budgeted several amounts for savings and investments. Financial advisors suggest that an *emergency fund* representing three to six months of living expenses be established for use in periods of unexpected financial difficulty. This amount will vary based on a person's life situation and employment stability. A three-month emergency fund is probably adequate for a person with a stable income or secure employment, while a person with erratic or seasonal income may need to set aside an emergency fund sufficient for six months or more of living expenses.

The Fraziers also set aside an amount each month for their automobile insurance payment, which is due every six months. Both this amount and the emergency fund are

smart money minute

Financial *rules of thumb* are money management guidelines. The 50/30/20 rule suggests that 50 percent of income be for necessities, 30 percent for wants, and 20 percent for saving and financial goals. These categories can provide a starting point for a budget. For car buying, the 20/4/10 rule recommends a 20 percent down payment with no more than a four-year loan, and spending no more than 10 percent of your gross income on transportation costs. Rules of thumb can be a good beginning for making wise financial decisions.

my life 3

I adapt my budgeting activities for changing situations.

Your buying habits will vary depending on the number of people in your household, their ages, and your geographic location. The spending patterns for various households, reported with consumer expenditure data and the latest consumer price index, are available at stats.bls.gov.

put into a savings account. The *time value of money,* discussed in Chapter 1, refers to increases in an amount of money as a result of interest earned. Savings methods for achieving financial goals are discussed later in this chapter.

A very common mistake is to save the amount left at the end of the month, if any. When you do that, you often have *nothing* left for savings. Since savings are vital to long-term financial security, advisors suggest that an amount be budgeted as a fixed expense.

STEP 4: BUDGET FIXED EXPENSES Definite obligations make up this portion of a budget. As Exhibit 3-7 shows, the Fraziers have fixed expenses for housing, taxes, and loan payments. They make a monthly payment of $29 for life insurance. The budgeted total for the Fraziers' fixed expenses is $806, or 28 percent of estimated available income.

You will notice that a budget has a similar format to the previously discussed cash flow statement. A budget, however, involves *projected* or planned income and expenses. The cash flow statement reports the *actual* income and expenses.

Assigning amounts to spending categories requires careful consideration. The amount you budget for various items will depend on your current needs and plans for the future. The following sources can help you plan your spending.

- Your cash flow statement.
- Consumer expenditure data from the Bureau of Labor Statistics.
- Articles in magazines such as *Kiplinger's Personal Finance Magazine* and *Money.*
- Estimates of future income and expenses and anticipated changes in inflation.

Exhibit 3-8 provides suggested budget allocations for different life situations. Although this information can be of value, maintaining a detailed record of your spending for several months is a better source for your personal situation. However, don't become discouraged. Use a simple system, such as a notebook or your bank account. This *Daily Spending Diary* (see end of Chapter 1) will help you know where your money is going. Remember, a budget is an *estimate* for spending and saving intended to help you make better use of your money, not to reduce your enjoyment of life.

smart money minute

Personal FinTech: Innovative apps and websites can help with money management activities.

- **Albert** (www.meetalbert.com) is an app to guide your financial decisions.
- **EARN** (www.earn.org) helps create a habit of saving.
- **Scratch** (www.scratch.fi) helps borrowers better understand, manage, and repay loans.
- **WiseBanyan** (www.wisebanyan.com) is a free financial advisor that suggests and manages investments for your financial goals.

STEP 5: BUDGET VARIABLE EXPENSES Planning for variable expenses is not as easy as budgeting for savings or fixed expenses. Variable expenses will fluctuate by household situation, time of year, health, economic conditions, and other factors. A major portion of the Fraziers' planned spending—over 60 percent of their budgeted income—is for variable living costs.

The Fraziers base their estimates on their needs and desires for the items listed and on expected changes in the cost of living. The *consumer price index (CPI)* is a measure of the general price level of consumer goods and services in the United States. This government statistic indicates changes in the buying power of a dollar. As consumer prices increase due to inflation,

EXHIBIT 3-8 Typical after-tax budget allocations for different life situations

Budget Category	Student	Working Single (no dependents)	Couple (children under 18)	Single Parent (young children)	Parents (children over 18 in college)	Couple (over 55, no dependent children)
Housing (rent or mortgage payment; utilities; furnishings and appliances)	0–25%	30–35%	25–35%	20–30%	25–30%	25–35%
Transportation	5–10	15–20	15–20	10–18	12–18	10–18
Food (at home and away from home)	15–20	15–25	15–25	13–20	15–20	18–25
Clothing	5–12	5–15	5–10	5–10	4–8	4–8
Personal and health care (including child care)	3–5	3–5	4–10	8–12	4–6	6–12
Entertainment and recreation	5–10	5–10	4–8	4–8	6–10	5–8
Reading and education	10–30	2–4	3–5	3–5	6–12	2–4
Personal insurance and pension payments	0–5	4–8	5–9	5–9	4–7	6–8
Gifts, donations, and contributions	4–6	5–8	3–5	3–5	4–8	3–5
Savings	0–10	4–15	5–10	5–8	2–4	3–5

Sources: Bureau of Labor Statistics (stats.bls.gov); *American Demographics; Money; The Wall Street Journal.*

people must spend more to buy the same amount. Changes in the cost of living will vary depending on where you live and what you buy.

As mentioned in Chapter 1, the *rule of 72* can help you budget for price rises. At a 2 percent inflation rate, prices will double in 36 years (72/2). However, at a 6 percent inflation rate, prices will double in 12 years (72/6).

STEP 6: RECORD SPENDING AMOUNTS After you have established your spending plan, you will need to keep records of your actual income and expenses similar to those when preparing a cash flow statement. In Exhibit 3-7, notice that the Fraziers estimated specific amounts for income and expenses. These are presented under "Budgeted Amounts."

The family's actual spending was not always the same as planned. A **budget variance** is the difference between the amount budgeted and the actual amount received or spent. The total variance for the Fraziers was a $17 **deficit,** since their actual spending exceeded their planned spending by this amount. The Fraziers would have had a **surplus** if their actual spending had been less than they had planned.

budget variance The difference between the amount budgeted and the actual amount received or spent.

deficit The amount by which actual spending exceeds planned spending.

surplus The amount by which actual spending is less than planned spending.

EXAMPLE: Budget Variance

If a family budgets $380 a month for food and spends $363, this would result in a $17 budget *surplus*. However, if the family spent $406 on food during the month, a $26 budget *deficit* would exist.

smart money minute

Households can save $500 or more each month by cutting insurance costs, shopping with coupons, using less energy, having a less expensive wifi or phone plan, or by avoiding debt. They can also choose not to receive a tax refund at the end of the year and, instead, have less taxes withheld every month. For additional ideas to cut your spending, go to www.clark.com, www.doughroller.net, www.wisebread.com, and www.thesimpledollar.com. By clearly identifying essentials (your needs) and luxury items (your wants), wise spending and increased savings are much more likely.

Variances for income should be viewed as the opposite of variances for expenses. Less income than expected would be a deficit, while more income than expected would be a surplus.

Spending more than planned for an item may be justified by reducing spending for another item or putting less into savings. However, it may be necessary to revise your budget and financial goals.

STEP 7: REVIEW SPENDING AND SAVING PATTERNS

Like most decision-making activities, budgeting is a circular, ongoing process. You will need to review and perhaps revise your spending plan on a regular basis.

Review Your Financial Progress There may be obviously positive outcomes from your budget, such as having extra cash in your bank account, or obviously negative outcomes, such as falling behind in your bill payments, that will require you to review and make changes to your initial plan. However, such obvious results may not always be present. Occasionally, you will have to evaluate (with other household members, as appropriate) and review areas where spending has been more or less than expected.

As Exhibit 3-9 shows, you can prepare an annual summary to compare actual spending with budgeted amounts. This type of summary may also be prepared every three or six

EXHIBIT 3-9 An annual budget summary

Actual Spending (Cash Outflows)														Annual Totals	
Item	Monthly Budget	Jan.	Feb.	Mar	Apr	May	June	July	Aug.	Sept.	Oct	Nov.	Dec.	Actual	Budgeted
Income	2,730	2,730	2,730	2,730	2,940	2,736	2,730	2,730	2,730	2,856	2,850	2,850	2,850	33,450	32,760
Savings	150	150	150	200	150	90	50	30	100	250	250	150	40	1,610	1,800
Mortgage/Rent	826	826	826	826	826	826	826	826	826	826	826	826	826	9,912	9,912
Housing Costs (insurance, utilities)	190	214	238	187	176	185	88	146	178	198	177	201	195	2,283	2,280
Telephone	50	43	45	67	56	54	52	65	45	43	52	49	47	618	600
Food (at home)	280	287	277	245	234	278	267	298	320	301	298	278	324	3,407	3,360
Food (away from home)	80	67	76	64	87	123	09	89	83	67	76	83	143	1,089	960
Clothing	100	98	78	123	156	86	76	111	124	87	95	123	111	1,268	1,200
Transportation (auto operation, public transportation)	340	302	312	333	345	297	287	390	373	299	301	267	301	3,807	4,000
Credit payments	249	249	249	249	249	249	249	249	249	249	249	249	249	2,988	2,908
Insurance (life, health, other)	45	–	–	135	–	–	35	–	–	135	–	–	135	540	540
Health care	140	176	145	187	122	111	56	186	166	134	189	193	147	1,912	1,680
Recreation	80	67	98	123	98	67	45	87	98	65	87	87	111	1,033	960
Heading, education	40	32	54	44	34	39	54	12	38	54	34	76	45	516	480
Gifts, donations	100	102	116	94	87	123	69	95	94	113	87	99	134	1,227	1,200
Personal miscellaneous expense	60	89	45	67	54	98	59	54	49	71	65	90	56	797	720
Total	2,730	2,702	2,705	2,984	2,674	2,626	2,642	2,638	2,743	2,892	2,786	2,771	2,864	33,007	32,760
Surplus (deficit)		26	25	(234)	266	104	86	92	(13)	(42)	64	79r	(14)	443	. . .

months. A spreadsheet program or app can be useful for this purpose. The summary will help you see areas where changes in your budget may be necessary. This review process is vital to both successful short-term money management and long-term financial security.

Revise Your Goals and Budget Allocations What should you cut first when a budget shortage occurs? This question doesn't have easy answers, and the answers will vary for different household situations. The most common overspending areas are entertainment and food, especially away-from-home meals. Purchasing less expensive brand items, buying quality used products, avoiding credit card purchases, and renting rather than buying are common budget adjustment techniques. When having to cut household budgets, reduced spending most often occurs for vacations, dining out, cleaning and lawn services, wifi service, and charitable donations.

At this point in the budgeting process, you may also revise your financial goals. Are you making progress toward achieving your objectives? Have changes in your personal situation or economic conditions affected the feasibility of certain goals? Have new goals surfaced that should be given a higher priority than those that have been your major emphasis? Addressing these issues while creating an effective saving method will help ensure accomplishment of your financial goals.

CHARACTERISTICS OF SUCCESSFUL BUDGETING

Having a spending plan will not eliminate financial worries. A budget will only be effective if you follow it. Changes in income, expenses, and goals will require changes in your spending plan. Money management experts advise that a successful budget should be:

- *Well planned.* A good budget takes time and effort to prepare. Planning a budget should involve everyone affected by it. Children can learn valuable money management lessons by helping to develop and implement the family budget.
- *Realistic.* If you have a moderate income, don't immediately expect to save enough money for an expensive car or vacation. A budget is not designed to prevent you from enjoying life but to help you obtain what you want most.
- *Flexible.* Unexpected expenses and changes in your cost of living will require a budget that you can easily revise. Special situations, such as two-income families or the arrival of a baby, may require an increase in certain expenses.
- *Clearly communicated.* Unless you and others involved are aware of the spending plan, it will not work. The budget should be in writing or online, and available to all household members.

TYPES OF BUDGETING SYSTEMS

Although your bank statement and online payments summary may give you a fairly complete picture of your expenses, these records do not serve the purpose of planning for spending. A *budget* requires that you outline how you will spend available income. The following are commonly used budgeting systems.

1. A *mental budget* exists only in a person's mind. This simple system may be appropriate if you have very limited resources and minimal financial responsibilities. However, an "in your head" budget can be dangerous when you forget the amounts you plan to spend.
2. A *physical budget* involves envelopes, folders, or containers to hold money or slips of paper representing amounts allocated for spending categories. This system allows you to actually see where your money goes. Envelopes would contain the amount of cash or a note listing the amount to be used for food, rent, clothing, auto payment, entertainment, and other expenses. Budget "envelope" apps and online templates to create envelopes are available to help you visualize where your money is going.

3. A *written budget* provides a detailed plan for spending. This type of budget can be in a notebook or on accounting paper or a budget record book available in office supply stores. A common written budget format is a spreadsheet that has several monthly columns for comparing budgeted and actual amounts for various expense items.
4. A *computerized budgeting system* may be developed using spreadsheet software. Excel budget templates may be obtained with an online search. Or you may use money management software such as *Quicken* (www.quicken.com). In addition to creating a budget, these programs handle other financial planning tasks.
5. An *online budget* may be used through a website such as www.mint.com. In addition, banks, credit unions, brokerage firms, and other financial institutions have various budgeting and personal financial management tools on their websites.
6. A *budgeting app* on your phone or tablet has various money management features. Costs for these apps range from free downloads to a few dollars.

Your decision for a budgeting system will depend on your personal situation and preference. The most important consideration is to find one that provides accurate and timely information for helping you achieve your financial goals.

HOW TO . . . Conduct a Money Management SWOT Analysis

SWOT (strengths, weaknesses, opportunities, threats) is a planning tool used by many organizations. This technique can also be used for your money management and budgeting activities. Listed below are examples of possible items for each SWOT category. Now, in the area provided, determine your strengths, weaknesses, opportunities, and threats related to budgeting and money management. Do online research and talk with others to get ideas for your personal SWOT items.

Internal (Personal) Factors	External (Economic, Social) Influences
Strengths	**Opportunities**
• Saving 5–10 percent of income • Informed on personal finance topics • No credit card debt • Flexible job skills *Your strengths:* ______	• Phone apps for monitoring finances • Part-time work to supplement income • Availability of no-fee bank account • Low-interest-rate education loan *Potential opportunities:* ______
Weaknesses	**Threats**
• High level of credit card debt • No emergency fund • Automobile in need of repairs • Low current cash inflow *Your weaknesses:* ______	• Lower market value of retirement fund • Possible reduced hours at part-time job • Reduced home market value • Increased living costs (inflation) *Potential threats:* ______

Creating a money management SWOT analysis is only a start. Next you need to select actions to build on your strengths, minimize your weaknesses, take advantage of opportunities, and avoid being a victim of threats. Through research and innovation, weaknesses and threats can become strengths and opportunities.

PRACTICE QUIZ 3-3

1. What are the main purposes of a budget?
2. How does a person's life situation affect goal setting and amounts allocated for various budget categories?
3. What are the main steps in creating a budget?
4. What are commonly recommended qualities of a successful budget?
5. What actions might you take when evaluating your budgeting program?

PFP Sheet 17 Cash budget

PFP Sheet 18 Annual budget summary

Money Management and Achieving Financial Goals

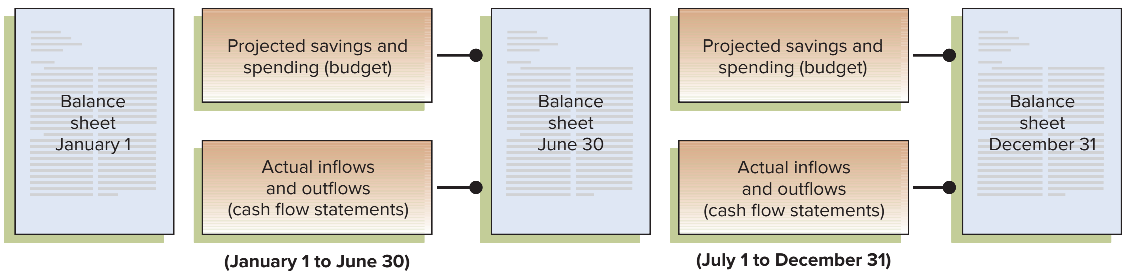
LO3-4

Relate money management and savings activities to achieving financial goals.

Your personal financial statements and budget allow you to achieve your financial goals with

1. Your balance sheet: reporting your current financial position—where you are now.
2. Your cash flow statement: telling you what you received and spent over the past month.
3. Your budget: planning spending and saving to achieve financial goals.

People commonly prepare a balance sheet on a periodic basis, such as every three or six months. Between those points in time, your budget and cash flow statement help you plan and measure spending and saving activities. For example, you might prepare a balance sheet on January 1 and July 1. Your budget would serve to plan your spending and saving between these points in time, and your cash flow statement of income and outflows would document your actual spending and saving. This relationship may be illustrated in this way:



Changes in your net worth result from cash inflows and outflows. In periods when your outflows exceed your inflows, you must draw on savings or borrow (buy on credit). When this happens, lower assets (savings) or higher liabilities (due to the use of credit) result in a lower net worth. When inflows exceed outflows, putting money into savings or paying off debts will result in a higher net worth.

Specific savings activities contribute to achieving long-term financial goals.
©LightFieldStudios/Getty Images

IDENTIFYING SAVING GOALS

Saving current income, as well as investing (discussed in Chapters 13, 14, 15, 16, 17), is the basis for an improved financial position and long-term financial security. Common reasons for saving include:

- To create an emergency fund for irregular and unexpected expenses.
- To pay for the replacement of expensive items, such as appliances or an automobile, or to have money for a down payment on a house.

smart money minute

Today's young adults (ages 23–37) are concerned about not having enough money saved. Over 70 percent of this group believe their generation overspends, and 64 percent believe that their generation is bad at managing money. According to the *Better Money Habits Millennial Report* conducted by Bank of America, over 60 percent of those in the study are saving, and 67 percent are consistent in working toward a savings goal. A reported 73 percent who have a budget stay within their budget every month or most months. Nearly half (47 percent) of those surveyed have $15,000 or more in savings.

Source: https://bettermoneyhabits.bankofamerica.com/content/dam/bmh/pdf/ar6vnln9-boa-bmh-millennial-report-winter-2018-final2.pdf, accessed June 22, 2018.

my life 4

I regularly review the status of my saving goals.

Reaching your financial goals will depend on the savings method used and the time value of money. How do the examples shown in Exhibit 3-10, Using Savings to Achieve Financial Goals, relate to your current or future life situation?

- To buy expensive items such as electronics or sports equipment or to pay for a vacation.
- To provide for long-term expenses such as the education of children or retirement.
- To earn income from the interest on savings for use in paying living expenses.

SELECTING A SAVING TECHNIQUE

Consistently, the United States ranks poorly among industrial nations in savings rate. Low savings affect personal financial situations. Studies reveal that most Americans do not have an adequate amount set aside for emergencies.

Since most people find saving difficult, financial advisors suggest these methods to make it easier.

1. Each payday, write a check or use an automatic payment or an app to transfer an amount to a separate savings account. This deposit can be a percentage of income, such as 5 or 10 percent, or a specific dollar amount. *Payroll deduction plans* are available through many places of employment.
2. Apps such as Qapital and Acorns can be used to automatically move small amounts into your savings account or investment program.
3. Saving coins or spending less on certain items can help you save. Each day, put your change in a container. You can also increase your savings by taking a sandwich to work instead of buying lunch or limiting impulse buying for snacks, coffee, or other small purchases. This action can result in savings of over $1,000 a year.

How you save is far less important than making regular periodic savings deposits that will help you achieve financial goals. Small amounts of savings can grow faster than most people realize.

CALCULATING SAVINGS AMOUNTS

To achieve your financial objectives, convert your savings goals into specific amounts. Your use of a savings or investment plan is vital to the growth of your money. As Exhibit 3-10 shows, using the time value of money calculations, introduced in Chapter 1, can help you calculate progress toward achieving your financial goals.

XLS

PFP Sheet 19
College education cost analysis, savings plan

PRACTICE QUIZ 3-4

1. What are some suggested methods to make saving easy?
2. What methods are available to calculate amounts needed to reach savings goals?

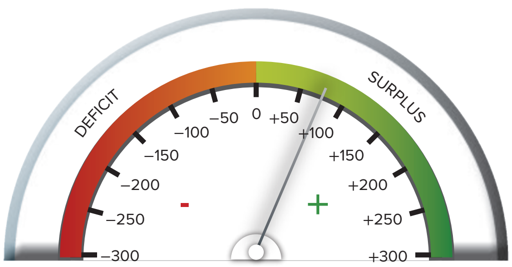
EXHIBIT 3-10

Using savings to achieve financial goals

Financial Goal	Saving Method	Annual Interest Rate	Savings Balance After:		
Set aside $6,000 for unexpected expenses and financial emergencies	A single deposit from past savings	3%	2 years: $6,365	5 years: $6,956	10 years: $8,064
Save for a down payment to purchase a home	Deposit $200 every three months	4%	2 years: $1,657	4 years: $3,452	6 years: $5,395
Save for retirement living expenses	Deposit $2,000 a year	8%	10 years: $28,973	20 years: $91,524	30 years: $226,566

Your Personal Finance Roadmap and Dashboard:

Money Management



CASH FLOW ANALYSIS

A monthly cash flow analysis will help you achieve various financial goals.

By comparing your cash inflows (income) and cash outflows (spending), you will determine if you have a *surplus* or *deficit*. A surplus allows you to save more or pay off debts. A deficit reduces your savings or increases the amount you owe.

Your Situation

Do you maintain a record of cash inflows and outflows? Does your cash flow situation reflect a deficit with unnecessary spending? How can you reduce spending to improve your cash flow situation? Other money management actions you might consider during various stages of your life include:

First Steps

- Maintain spending diary to monitor daily finances.
- Create a system for financial records and documents.
- Use a budget that includes savings.
- Create a personal balance sheet and income statement on an annual basis.
- Accumulate an appropriate emergency fund.
- Revise budget.

Next Steps

- Update personal financial statements.
- Begin investment program for funding children's education.
- Adapt budget to changing household needs.

Later Steps

- Determine potential changes in daily spending needs during retirement.
- Consider increased savings and contributions to retirement plans.

SUMMARY OF LEARNING OBJECTIVES

LO3-1

Recognize relationships among financial documents and money management activities. Successful money management requires effective coordination of personal financial records, personal financial statements, and budgeting activities. Your system for organizing personal financial records and documents is the foundation of effective money management. This structure should provide ease of access as well as security for financial documents that may be impossible to replace.

LO3-2

Develop a personal balance sheet and cash flow statement. A personal balance sheet, also known as a *net worth statement* or *statement of financial position,* is prepared by listing all items of value (assets) and all amounts owed to others (liabilities). The difference between your total assets and your total liabilities is your net worth. A cash flow statement, also called a *personal income and expenditure statement,* is a summary of cash receipts and payments for a given period, such as a month or a year. This report provides data on your income and spending patterns.

LO3-3

Create and implement a budget. Your budgeting activities should involve four phases: (1) assessing your current personal and financial situation, (2) planning your financial direction by setting financial goals and creating budget allowances, (3) implementing your budget, and (4) evaluating your budgeting program.

LO3-4

Relate money management and savings activities to achieving financial goals. Your saving goals should be based on the relationship among the personal balance sheet, cash flow statement, and budget. Saving current income provides the basis for achieving long-term financial security. Future value and present value calculations may be used to compute the increased value of savings for achieving financial goals.

KEY TERMS

KEY FORMULAS

Topic	Formula
Net worth	Net worth = Total assets − Total liabilities *Example*: = \$125,000 − \$53,000 = \$72,000
Cash surplus (or deficit)	Cash surplus(or deficit) = Total inflows − Total outflows *Example*: = \$5,600 − \$4,970 = \$630 (surplus)
Debt ratio	Debt ratio = Liabilities/Assets *Example*: = \$7,000/\$21,000 = 0.33

Topic	Formula
Current ratio	Current ratio = Liquid assets/Current liabilities *Example* : = \$8,500/\$4,500 = 1.88
Liquidity ratio	Liquidity ratio = Liquid assets/Monthly expenses *Example* : = \$8,500/\$3,500 = 2.4
Debt-payments ratio	Debt-payments ratio = Monthly credit payments/Take-home pay *Example* : = \$760/\$3,800 = 0.20
Savings ratio	Savings ratio = Amount saved per month/Gross monthly income *Example* : = \$460/\$3,800 = 0.12

SELF-TEST PROBLEMS

1. The Hamilton household has \$145,000 in assets and \$63,000 in liabilities. What is the family's net worth?
2. Harold Daley budgeted \$210 for food for the month of July. He spent \$227 on food during July. Does he have a budget surplus or deficit, and what amount?

Self-Test Solutions

1. Net worth is determined by assets (\$145,000) minus liabilities (\$63,000) resulting in \$82,000.
2. The budget *deficit* of \$17 is calculated by subtracting the actual spending (\$227) from the budgeted amount (\$210).

FINANCIAL PLANNING PROBLEMS

1. *Determining Liquid Assets and Current Liabilities.* Based on these items, what is the total of the (a) liquid assets and (b) current liabilities? **LO3-2**

   Checking account balance, \$860
   Retirement account balance, \$57,000
   Credit card balance, \$117
   Coin collection, \$450
   Savings account balance, \$2,675
   Current student loan payment due, \$220
   Investment account balance, \$8,000
   Mortgage, \$178,000

2. *Calculating Balance Sheet Amounts.* Based on the following data, compute the total assets, total liabilities, and net worth. **LO3-2**

   Liquid assets, \$4,670
   Investment assets, \$26,910
   Current liabilities, \$2,670
   Household assets, \$93,780
   Long-term liabilities, \$76,230

3. *Preparing a Personal Balance Sheet.* Use the following items to prepare a balance sheet and a cash flow statement. Determine the total assets, total liabilities, net worth, total cash inflows, and total cash outflows. **LO3-2**

   Rent for the month, \$650
   Monthly take-home salary, \$1,950
   Cash in checking account, \$450
   Savings account balance, \$1,890
   Spending for food, \$345
   Balance of educational loan, \$2,160
   Current value of automobile, \$7,800
   Telephone bill paid for month, \$65
   Credit card balance, \$235
   Loan payment, \$80
   Auto insurance, \$230
   Household possessions, \$3,400
   Stereo equipment, \$2,350
   Payment for electricity, \$90
   Lunches/parking at work, \$180
   Donations, \$70
   Home computer, \$1,500
   Value of stock investment, \$860
   Clothing purchase, \$110
   Restaurant spending, \$130

LO3-2 **4.** *Computing Balance Sheet Amounts.* For each of the following situations, compute the missing amount.

a. Assets $48,000; liabilities $12,800; net worth $_____.

b. Assets $78,780; liabilities $_____; net worth $13,700.

c. Assets $44,280; liabilities $12,265; net worth $_____.

d. Assets $_____; liabilities $38,374; net worth $53,795.

LO3-2 **5.** *Calculating Financial Ratios.* The Fram family has liabilities of $128,000 and assets of $340,000. What is their debt ratio? How would you assess this?

LO3-2 **6.** *Determining Financial Progress.* Carl Lester has liquid assets of $2,680 and current liabilities of $2,436. What is his current ratio? What comments do you have about this financial position?

LO3-3 **7.** *Determining Budget Variances.* Fran Bowen created the following budget:

Food, $350
Transportation, $320
Housing, $950
Clothing, $100
Personal expenses and recreation, $275

She actually spent $298 for food, $337 for transportation, $982 for housing, $134 for clothing, and $231 for personal expenses and recreation. Calculate the variance for each of these categories, and indicate whether it was a *deficit* or a *surplus.*

LO3-3 **8.** *Calculating the Effect of Inflation.* Bill and Sally Kaplan have an annual spending plan that amounts to $39,500. If inflation is 3 percent a year for the next three years, what amount will the Kaplans need for their living expenses three years from now?

LO3-4 **9.** *Computing the Time Value of Money for Savings.* Use future value and present value calculations (see Chapter 1 Appendix) to determine the following:

a. The future value of a $400 savings deposit after eight years at an annual interest rate of 3 percent.

b. The future value of saving $1,800 a year for five years at an annual interest rate of 4 percent.

c. The present value of a $6,000 savings account that will earn 3 percent interest for four years.

LO3-4 **10.** *Calculating Present Value of a Savings Fund.* Hal Thomas wants to establish a savings fund from which a community organization could draw $1,000 a year for 20 years. If the account earns 2 percent, what amount would he have to deposit now to achieve this goal?

LO3-4 **11.** *Future Value of Reduced Spending.* Brenda plans to reduce her spending by $80 a month. Calculate the future value of this increase in savings over the next 10 years. (Assume an annual deposit to her savings account, and an annual interest rate of 5 percent.)

LO3-4 **12.** *Future Value of Savings.* Kara Delaney received a $4,000 gift for graduation from her uncle. If she deposits the entire amount in an account paying 3 percent, what will be the value of this gift in 15 years?

FINANCIAL PLANNING ACTIVITIES

LO3-1 **1.** *Researching Money Management Information.* Talk to two or three people regarding wise and poor money management actions they have taken in their lives, and about the system they use to keep track of various financial documents and records. Based on this information, what actions might you take now or in the future?

LO3-2 **2.** *Creating Personal Financial Statements.* Using *Personal Financial Planner Sheets 15 and 16,* or some other format you find online, prepare a personal balance sheet and cash flow statement. What information from your personal financial statements might help you make wiser financial decisions?

LO3-1, LO3-3 **3.** *Researching Money Management Apps.* Locate several budgeting and money management apps. Evaluate the features, ease of operation, and information provided by these apps. Which app would you consider using for your budgeting and money management activities?

LO3-3 **4.** *Analyzing Budgeting Situations.* Discuss with several people how the budget in Exhibit 3-7 might be changed based on various budget variances. If the household faced a decline in income, what actions would you suggest?

LO3-4 **5.** *Analyzing Saving Habits.* Talk to a young single person, a young couple, and a middle-aged person about their financial goals and saving habits. What actions do they take to determine and achieve various financial goals?

LO3-2 **6.** *Creating a Career Portfolio.* Your ability to present and interpret data is a vital career skill. As part of your career portfolio, consider presenting a balance sheet, cash flow statement, or budget for a campus organization or other group with which you are involved. How would this item communicate your data analysis ability?

FINANCIAL PLANNING CASE

Adjusting the Budget

In a recent month, the Constantine family had a budget deficit, which is something they want to avoid so they do not have future financial difficulties. Jason and Karen Constantine and their children (ages 10 and 12) plan to discuss the situation after dinner this evening.

While at work, Jason was talking with his friend Ken Lopez. Ken had been a regular saver since he was very young, starting with a small savings account. Those funds were then invested in various stocks and mutual funds. While in college, Ken was able to pay for his education while continuing to save between $50 and $100 a month. He closely monitored his spending. Ken realized that the few dollars here and there for snacks and other minor purchases quickly add up.

Today, Ken works as a customer service manager for the online division of a retailing company. He lives with his wife and their two young children. The family's spending plan allows for all their needs and also includes regularly saving and investing for the children's education and for retirement.

Jason asked Ken, "How come you never seem to have financial stress in your household?"

Ken replied, "Do you know where your money is going each month?"

"Not really," was Jason's response.

"You'd be surprised by how much is spent on little things you might do without," Ken responded.

"I guess so. I just don't want to have to go around with a notebook writing down every amount I spend," Jason said in a troubled voice.

"Well, you have to take some action if you want your financial situation to change," Ken countered.

That evening, the Constantine family met to discuss their budget situation:

Current Spending		Suggested Budget	
Rent	$950	Rent	$ _____
Electricity, water	120	Electricity, water	_____
Telephone	55	Telephone	_____
Wifi service	125	Wifi service	_____
Food (at home)	385	Food (at home)	_____
Food (away)	230	Food (away)	_____
Auto payment	410	Auto payment	_____
Gas, oil changes	140	Gas, oil changes	_____
Insurance	125	Insurance	_____
Clothing	200	Clothing	_____
Personal, gifts	185	Personal, gifts	_____
Donations	50	Donations	_____
Savings	35	Savings	_____
Total spending	$3,010	Total budgeted	$ _____
Total monthly amount available	$2,800	Total monthly amount available	$2,800
Surplus (deficit)	($210)	Surplus (deficit)	$ _____

Questions

1. What situations might have created the budget deficit for the Constantine family?
2. What amounts would you suggest for the various categories for the family budget?
3. Describe additional actions for the Constantine family related to their budget or other money management activities.

PERSONAL FINANCIAL PLANNER IN ACTION

Personal Financial Statements and a Spending Plan

Money management activities are the foundation for other financial planning actions. Creation of a financial document filing system, a personal balance sheet, a cash flow statement, and a budget provide you with tools for setting, implementing, and achieving financial goals.

Your Short-Term Financial Planning Activities	Resources
1. Develop a filing system to organize your financial records and documents.	PFP Sheet 14 www.quicken.com www.kiplinger.com
2. Create a personal balance sheet and a personal cash flow statement.	PFP Sheets 15, 16 time.com/money/ www.thesimpledollar.com Wally app Personal Capital app
3. Based on your current financial situation, set short-term financial goals and develop a budget. Monitor your spending for various categories.	PFP Sheets 17, 18 www.betterbudgeting.org www.mymoney.gov thefinancialdiet.com Mint app
4. Accumulate an appropriate amount for an emergency fund.	www.americasaves.org www.choosetosave.org
Your Long-Term Financial Planning Activities	
1. Set long-term financial goals related to education, housing, or retirement.	PFP Sheet 19 www.brightpeakfinancial.com www.dinkytown.net
2. Develop a savings plan, such as automatic withdrawals, to achieve long-term financial goals.	Section 3-4 www.choosetosave.org Acorns app

CONTINUING CASE

Money Management Strategy: Financial Statements and Budgeting

Jamie Lee Jackson, age 25, now a busy full-time college student and part-time bakery clerk, has been trying to organize all of her priorities, including her budget. She has been wondering if she is allocating enough of her income toward savings, which includes accumulating enough money toward the $9,000 down payment she needs to achieve her dream and open a cupcake café.

Jamie Lee has been making regular deposits to her regular and emergency savings accounts. She would really like to sit down and get a clearer picture of how much she is spending on various expenses, including rent, utilities, and entertainment, and how her debt compares to her savings and assets. She realizes that she must stay on track and keep a detailed budget if she is to realize her dream of being self-employed after college graduation.

Current Financial Situation

***Assets*:**
Checking account: $1,250
Emergency fund savings account: $3,100
Car: $4,000

***Liabilities*:**
Student loan: $5,400
Credit card balance: $400

***Income*:**

Gross monthly salary: $2,125
Net monthly salary: $1,560

***Monthly Expenses*:**

Rent obligation: $275
Utilities obligation: $125
Food: $120
Gas/maintenance: $100
Credit card payment: $50

***Savings*:**

Regular savings: $150
Rainy day savings: $25

***Entertainment*:**

Cake decorating class: $35
Movies with friends: $50

Questions

1. According to the text, a *Personal Balance Sheet* is a statement of your net worth. It is an accounting of what you own as well as what you owe. Using the information provided, prepare a personal balance sheet for Jamie Lee.
2. Using the table found in *Ratios for Evaluating Financial Progress,* what is Jamie Lee's debt ratio? When comparing Jamie Lee's liabilities and her net worth, is the relationship a favorable one?
3. Using the table found in *Ratios for Evaluating Financial Progress,* what is Jamie Lee's savings ratio? Using the rule of thumb recommended by financial experts, is she saving enough?
4. Using Exhibit 3-8, *Typical After-Tax Budget Allocations for Different Life Situations,* calculate the budget allocations for Jamie Lee, using her net monthly salary (or after-tax salary) amount. Is she within the recommended parameters for a student?

DAILY SPENDING DIARY

"I am amazed how little things can add up. However, since I started keeping track of all my spending, I realized that I need to cut down on some items so I can put some money into savings."

Directions

Continue or start using the *Daily Spending Diary* sheets, or create your own format, to record *every cent* of your spending in the categories provided. This experience will help you better understand your spending patterns and help you plan for achieving financial goals.

Analysis Questions

1. What information from your *Daily Spending Diary* might encourage you to reconsider various money management actions?
2. How can your *Daily Spending Diary* assist you when planning and implementing a budget?

A *Daily Spending Diary* sheet is located at the end of Chapter 1 and on the library resource site within *Connect.*