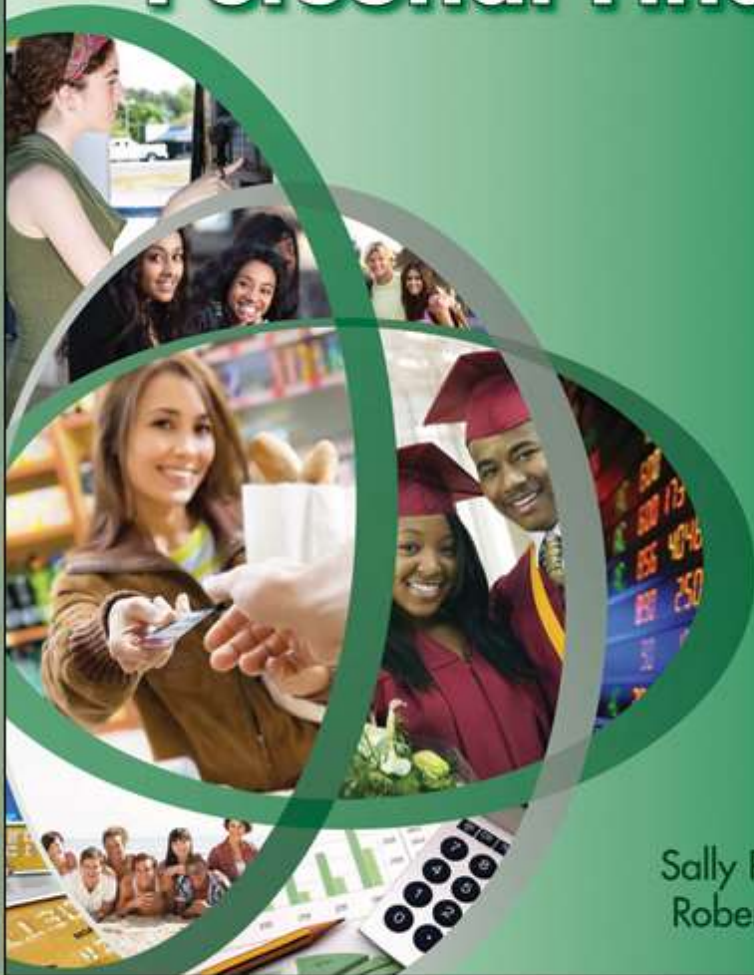


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Foundations of Personal Finance

Ninth Edition



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PowerPoint Presentations for

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Chapter 2

Making Smart Decisions

Section 2.1

YOUR PERSONAL FINANCIAL LANDSCAPE

Objectives

- List and describe the steps in managing your money through the planning and creation of a budget.
- Explain how to create a cash flow statement.
- Explain how to create a net worth statement.

Terms

- budget
- income
- expense
- fixed expense
- variable expense
- discretionary expense
- philanthropy
- cash flow statement
- net worth statement
- net worth
- asset
- liability
- wealth

Budgets

- A **budget** is a plan for the use of money over time, based on goals, expenses, and expected income to help you meet your needs and achieve goals

Creating a Budget

- | | |
|--------|--------------------------------------|
| Step 1 | Establish financial goals. |
| Step 2 | Estimate and total your income. |
| Step 3 | Estimate and total your expenses. |
| Step 4 | Analyze current income and spending. |
| Step 5 | Prepare a budget. |
| Step 6 | Evaluate your budget. |

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Establish Financial Goals

- Make a list of your important financial goals
 - Short-term (money for a movie this weekend)
 - Medium-term (saving for a 10-day camping trip next year)
 - Long-term (new car or college education)

Estimate and Total Your Income

- **Income** is any form of money received (allowance, paycheck, gifts, etc.)
- Determine your budget period (weekly, biweekly, or monthly)
- It makes sense to make your budget period align with your frequency of income
- Estimate your income for each budget period

Estimate and Total Your Expenses

- After calculating your income, estimate your typical expenses per budget period
- An **expense** is the cost of goods and services you buy
- **Fixed expenses** are set amounts that must be paid each budget period (rent, mortgage, insurance, etc.)

Estimate and Total Your Expenses (Continued)

- **Variable expenses** are costs that change both in amount, and time they must be paid (food, clothing, gas, cell phone bill, etc.)
- **Discretionary expenses** are amounts spent for items that a person could do without, or buy for less (restaurant meals, movie theater, etc.)

Savings and Your Budget

- To save for a \$360 camping trip in five months:
 - Divide \$360 by five months
 - $\$360 \div 5 = \72 per month
- Five months is roughly 20 weeks. To save \$360 in 20 weeks:
 - Divide \$360 by 20 weeks
 - $\$360 \div 20 = \18 per week
- An emergency fund provides an important cushion for unexpected expenses and emergencies (loss of job, hospitalization expenses, car repair, etc.)

Charitable Giving as an Expense

- A **charity** usually refers to an organization that aids those in need (homeless, disaster victims, etc.)
- **Philanthropy** is the act of giving money, goods or services to meet the needs of others and to support organizations and causes that are important to you
- Check out charities on www.charitynavigator.com

Discussion

- What are some common charities you know of?
- How can teenagers contribute to charities when they do not have full-time jobs?

Analyze Current Income and Spending

- A record of spending usually turns up some unnecessary spending
- If you spend more than you earn, try to increase your income
 - Can you earn money by doing jobs for your family or neighbors?
 - Can you get a part-time job?
 - Can you get a raise, or work more hours?

Analyze Current Income and Spending (Continued)

- To reduce spending, study your expenses
 - Can you reduce discretionary expenses?
 - Can you eliminate discretionary expenses?
- Look at your fixed and variable expenses
 - Can you reduce variable expenses?
 - Can you eliminate variable expenses?
- Can you cut spending that does not bring you closer to your priorities and goals?

Prepare a Budget

- A budget brings together your goals, income and expenses and allows you to:
 - Compare your actual versus planned income
 - Compare your actual versus planned expenses
- When your expense is greater than planned, identify the cause and adjust your budget to show your actual income and spending
- Money management software can help you with budgeting

Prepare a Budget (Continued)

Quick Tips for Better Budgeting

- Keep it simple.
- Write it down.
- Be specific.
- Be flexible.
- Be disciplined.
- Keep it all together.
- Be prepared for the unexpected.

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Evaluate Your Budget

- Is your financial plan working?
- Is your money doing what you want it to do to reach important goals?
- Do you set new goals as you achieve others?
- Are you controlling your spending?
- Has your income or spending changed?
- Do you need to adjust your budget for changes in your life?

Cash Flow Statement

- A **cash flow statement** is a summary of money taken in and paid out during a specific time
 - Income is called *cash inflow*
 - Expenses are called *cash outflow*
 - The statement shows actual income and spending, not what was planned
 - Use an expense log or spending diary to keep track

Net Worth Statement

- A **net worth statement** is a written record of an individual's current financial situation
- **Net worth** is the difference between what you own and what you owe

Net Worth Statement (Continued)

- **Assets** are items of value, such as cash, cars, real estate, personal possessions
 - *Current assets, or liquid assets*, are cash and savings that quickly convert to cash
 - *Fixed assets* are investments such as stocks, bonds, invested funds, home, car, personal possessions, durable goods

Net Worth Statement (Continued)

- A **liability** is a current or future financial obligation
 - *Current liabilities* are due usually within a year (taxes, credit card bills, medical bills, etc.)
 - *Long-term liabilities* are paid over a long period of time (auto loan, home mortgage, etc.)

Net Worth

- Your **net worth** is the difference between assets and liabilities
- If you own more than you owe, you have a positive net worth
- If you owe more than you own, you have a negative net worth
- **Wealth** is an abundance of money and assets

Review 2.1

- What is an asset?
 - Something you own that has monetary value
- What is a liability?
 - Something for which you owe money now or in the future

Section 2.2

DOCUMENTATION

Objectives

- Discuss the importance of good recordkeeping to help you manage your finances.
- Explain how money management software can assist in financial planning.

Terms

- recordkeeping
- legal document
- money management software

Recordkeeping

- **Recordkeeping** is the process of setting up an organized system for financial and legal documents
- A **legal document** is a paper that can be filed with a court officer or used to uphold an agreement in a court of law
- It is essential to be able to find important documents when you need them
- If you lose track of your bills, you risk paying late or not at all

Financial Documents

- Income records:
 - paycheck stubs
 - interest statements
 - dividend records
 - cash gifts, tips, bonuses
- Spending records:
 - bank statements
 - checkbook register
 - bill and purchase receipts
 - credit account statements

Other Documents and Information

- Birth certificate
- Social Security card
- Bank account information
- Credit card information
- Investment records
- Will and trust information
- Loan documents

Safety

- Should you carry your Social Security card in your wallet in case you need your social security number for something?
- Should you write your PIN on the back of your credit or debit card?

Money Management Software

- **Money management software** is used to organize day-to-day finances and keep track of finances
- Software may be purchased to load on your computer
- Software may be available as a web-based service and your information will be stored on a server, instead of on your own computer

Security Online

- Firewalls, antivirus software, malware protection, and back-up systems are important to keep your information secure
- Create passwords that contain upper- and lower-case letters and numbers
- Do not use public computers or Wi-Fi connections for your financial transactions
- Use secure payment methods

Discussion

What is the difference between a website starting with *http*, and website that begins with *https*?

Review 2.2

- What type of software can be used to organize day-to-day finances and keep track of income, spending, saving, debts, investments, and financial future?
 - Money management software
- How can you eliminate the need for stamps and envelopes when you are paying bills?
 - Pay bills online

Section 2.3

YOUNG ADULT AND FAMILY FINANCES

Objectives

- Describe the financial tasks attached to adult life.
- Analyze how the family life cycle influences financial decisions.
- Discuss variations in the family life cycle.
- Outline ways to avoid financial problems.

Terms

- written roommate agreement
- family life cycle
- stages in the life cycle
- variations in the life cycle
- family financial crisis

On Your Own

- Having a roommate can reduce your overall expenses by sharing them with another person
- Issues to discuss in your **written roommate agreement** include:
 - Lease, rent, and security deposit
 - Cleaning, cooking, and food
 - Shared space
 - Cable and utilities
 - Guests, privacy, and noise

Discussion

What are five things that should be included in a roommate agreement?

Family Life Cycle

- **Family life cycle** are the stages a family passes through over its lifetime
- **Stages in the life cycle** are the typical patterns of social and financial behavior families follow at different periods in the life cycle
- Goals, needs, earning and spending patterns will change with each stage

Beginning Stage

- Getting married is the beginning stage of the family life cycle
- Expenses are likely to include college loans, home furnishings, insurance, rent or mortgage, auto, savings, and contributions to retirement funds

Expanding Stage

- Birth or adoption of the first child brings families into the expanding stage
- New expenses may include childcare, clothing, supplies, medical expenses, new home, additional insurance protection, educational fund
- A will should be drawn up for each parent

Developing Stage

- Children are school age or adolescent in this stage
- Family life tends to revolve around children and their school life
- Additional expenses may include larger clothing budget, sports and hobbies, lessons, allowances, savings, additional car and higher insurance rates for teen drivers

Launching Stage

- This stage begins as children leave home for college, jobs, or homes of their own
- Parents' earnings may peak during this time
- Additional expenses include college expenses, more life insurance, and retirement savings
- “Sandwich generation” refers to parents sandwiched financially and emotionally between their own aging parents and their college-bound teens

Aging Stage

- From late 50s to retirement, people often need to adjust to new events:
 - “Empty nest” created by children leaving home
 - Many become grandparents
 - Travel, or become more active in community
 - Retirement planning, may move to smaller homes
 - Focus on health and long-term care insurance
 - Revise wills and estate plans

Variations in the Life Cycle

- **Variations in the life cycle** are patterns that differ from typical families:
 - Number and spacing of children, or no children
 - Skip, overlap, or repeat stages
 - Second marriages
 - Caring for grandchildren

Variations in the Life Cycle (Continued)

- *Singles and childless couples* may spend more on travel, leisure, charities; often feel greater responsibility to help aging parents
- *Single-parent families* are most often led by females; typically have less income than single families led by males
- *Separated and divorced individuals* may encounter settlement and legal fees, alimony, child support, moving and new housing fees

Working Through Financial Problems

- Live within your means and keep debt under control
- Start an emergency fund to prepare for the unexpected
- Get insurance against financial risks
- A **family financial crisis** is a major problem that changes the future of the family and its lifestyle (job loss, divorce, death, disability, serious illness, natural disaster)

Discussion

Which of these is better for retirement planning?

- Begin in your 20s by putting away a small amount of money each month toward retirement and regularly increase that amount when you are able to contribute more
- Wait until you are about 40 when you can afford to put away a large amount of money each month and keep doing it until you retire

Review 2.3

- What is it called when parents are sandwiched financially and emotionally between their own aging parents and their college-bound teens?
 - Sandwich generation
- Which family members will be affected by a family financial crisis?
 - All family members