4-1 Resources and Choices

OBJECTIVES

- ***Explain how basic needs, other needs, and wants differ.***
- ***Describe how limited resources affect consumer choices.***
- ***Prepare a personal income and expense statement.***
- ***Prepare a personal balance sheet.***
- ***Apply a decision-making process to personal financial choices.***

Money Management focuses on planning for your financial future. It includes assessing where you are now and looking forward. You will learn how to prepare a personal income and expense statement, balance sheet, budget, and financial plan. You will study banking services and their costs. You will learn how to use a checking account. Keeping good records is an important step in preparing for the future. Risk management will help you to learn to protect your financial resources, including income and property.

Chapter 4 focuses on the starting point of good money management—assessing your needs and wants. In this chapter, you will learn how your financial resources impact your choices. You will look at where you are now (financially) and prepare a personal balance sheet. You will study strategies you can use to make better financial choices. You will then explore budgeting and create a simple budget. You will learn about budget variances and how to keep good financial records. Finally, you will examine a five-step financial planning process, which begins with setting your personal and financial goals.

MEETING NEEDS AND WANTS

Basic needs include food, clothing, shelter, and medical care. People need these items to survive. People who do not have their basic needs met are not able to provide for other needs or wants. Other needs include things such as more than one pair of shoes, clothing for different purposes, education, or furniture to make life more comfortable. Items to fill some of these needs can be rented instead of purchased. For example, a person can go to a library to borrow books rather than buy them. Other items, such as a washer and dryer, save the owner both time and money as compared to renting their use. While these items are not basic to survival, they are needed to have a comfortable lifestyle.

The term wants refers to things people desire for reasons beyond survival and basic comfort. These items allow people to enjoy life more. Examples of wants are new cars, vacation trips, a large wardrobe, dozens of pairs of shoes, and so on. Luxury items, which are very costly, often fill emotional wants rather than physical needs.

RESOURCES LIMIT CHOICES

The term financial resources refers to money or other items of value that people can use to acquire goods and services. Although their financial resources are limited, wants and needs for many people are unlimited and growing. Every day, new products and services appear to tempt consumers. Because most people do not have enough resources to meet all their needs and wants, people must make choices. For a person who has few resources, the choices available will also be few. This person may need to spend all resources to cover basic and other needs. For a person with more resources, more choices will be available. The amount of money a person has to spend after needs are met is called discretionary income. A person who has high discretionary income can consider buying a larger number or higher quality of goods.

INCOME STATEMENT

Income is the inflow of money you receive from working, investments, or other sources. You can spend this amount of money without using savings or other assets. Expenses are items for which you must spend money. An income and expense statement lists income received and money spent for expenses for a certain period of time, such as a month or a year. If you have more income than expenses, you have a net income for the period. If you have more expenses than income, you have a net loss for the period. Comparing monthly income and expense statements can help you see whether you are meeting your financial goals.

ANDREA MCCALL
PERSONAL INCOME AND EXPENSE STATEMENT
April 1-30, 20--

Income		
Work (part-time)	$150.00	
Allowance for doing household chores	40.00	
Lunch money allowance	60.00	
Total Income		$250.00
Expenses		
Gifts	$20.00	
Clothes and shoes	60.00	
Spending money (miscellaneous)	20.00	
Lunches	60.00	
Entertainment	40.00	
Total Expenses		200.00
Net Income		$50.00

BALANCE SHEET

Assets are money and items of value that you own. A personal balance sheet lists your assets and their current value on a certain date. Their value is the price you could get if you sold them (for goods, such as a car) or the monetary value (for cash or savings). The balance sheet also lists debts you owe, called liabilities. A liability is any debt that you must repay. The difference between your assets (what you own) and your liabilities (what you owe) is called net worth. Assets that are growing in value are said to be appreciating. Savings bonds and other types of savings will grow over time and will increase in value. The value of land or a house may also increase over time. Other assets, such as cars and electronic items, may be depreciating, or going down in value. These items have temporary value that will be used up over time.

JERRY PEREZ
PERSONAL BALANCE SHEET
May 1, 20--

Assets		**Liabilities**	
Cash and checking account	$452.56	Car loan	$1,100.00
Savings account	500.00	Credit card debt	200.98
Savings bonds	300.00	**Total Liabilities**	$1,300.98
Movie collection	100.00		
Computer, iPod, games	300.00	**Net Worth**	
Car, current book value	3,000.00	Assets minus Liabilities	3,351.58
Total Assets	$4,652.56	**Total Liabilities and Net Worth**	$4,652.56

Net Worth

MAKING GOOD FINANCIAL CHOICES

Buying decisions play an important part in managing your money. When you give up a particular benefit or item to get another that you think is more desirable, you are making a trade-off. For example, you may choose to buy a music player such as an iPod. To have enough money to buy the iPod, you must not buy something else that you want. The benefit or item you give up (do not buy) is called the opportunity cost. For example, instead of the iPod, you might have bought a bicycle. In this situation, the bicycle is the opportunity cost. To help you make good financial decisions, use a step-by-step decision-making process.

1. Define the need or problem to be resolved by buying the item or service. For example, you might need access to a computer to use in doing homework and surfing the Internet. Think about all the ways in which the item or service could be used and features it should have to meet your needs.
2. List options for filling the need or solving the problem. For example, you could buy a new computer. You could rent a computer. You could use a computer at a local library. List the cost of each option. Research the features of any items you consider buying.
3. Compare the options you have identified. List the advantages and disadvantages of each one. For example, renting a computer may be more costly in the long term than buying one. Using a computer at the library will be less costly than buying a computer. However, you will have to travel to the library each time you want to use the computer. You can only use the computer during hours the library is open. Think about the opportunity cost of each option.
4. Make a decision based on your research and evaluation of the information you have gathered.
5. Take action based on your decision. For example, buy a computer or plan times to use one at the library.
6. Reevaluate your choices. After some time has passed, think about your decision again. Did the option you chose resolve the problem, or is it filling the need for which it was selected? If the answer is no, or if your needs have changed, follow the process again to make a new decision.

Financial choices you make today will affect your finances tomorrow. If you plan ahead, you will be better prepared to use your resources to fill your needs and wants. Making good financial choices will help prevent worry over financial matters. Follow these strategies to help you make good financial choices:

- Financial choices should be forward-looking. Ask yourself how a choice will affect your future.
- Consider the opportunity cost of each item or service you purchase.
- Doing so will help you decide whether the item or service selected is the best choice for you.
- When in doubt about whether to buy a particular item or service, do not make the purchase. If you are not sure of a choice, keep asking questions or doing research until you know enough to make a good decision.
- Do not make snap decisions about financial matters. Buyer’s remorse occurs when you make a purchase and then later regret it.
- Spend less than your income each month. Set aside money for unexpected expenses.
- Be realistic when deciding which wants you can fill. Learn to enjoy items you have rather than always wanting more items.

- Take enough time to read all financial agreements. Ask lots of questions; be sure you understand what you are agreeing to before you sign a financial document.
- Learn from mistakes that others have made. Listen to the experiences of others to learn about possible financial problems. This will help you avoid the same situations.

4-2 Budgeting

OBJECTIVES

- ***Identify the purpose of a budget.***
- ***Prepare a personal budget using the "pay-yourself-first" philosophy.***
- ***Describe recordkeeping methods used in the budgeting process.***

THE PURPOSE OF BUDGETING

Budgeting is a critical part of managing your money. The purpose of a budget is to plan how you will spend or save money. A budget is a spending and saving plan based on expected income and expenses. It lists expenses and the source of income to pay those expenses. Using a budget allows you to compare your financial resources with your financial needs. You may need to adjust amounts in a budget several times. Your goal is to create a plan that meets your spending and saving needs with your expected income. Using spreadsheet software, such as Microsoft Excel, makes adjusting amounts and recalculating totals easy. Using Excel, you can record your financial goals and then prepare the budgets that will help you achieve them.

ANDREA MCCALL
BUDGET FOR 20--

	Weekly	Monthly	Yearly
Income			
Work (part-time)	$30.00	$120.00	$1,440.00
Allowance for doing household chores	10.00	40.00	480.00
Lunch money allowance	15.00	60.00	720.00
Total Income	$55.00	$220.00	$2,640.00
Savings			
Deposit to savings account	$5.00	$20.00	$240.00
Expenses			
Gifts	$5.00	$20.00	$240.00
Clothes and shoes	15.00	60.00	720.00
Spending money (miscellaneous)	5.00	20.00	240.00
Lunches	15.00	60.00	720.00
Entertainment	10.00	40.00	480.00
Total Expenses	$50.00	$200.00	$2,400.00
Total Expenses and Savings	$55.00	$220.00	$2,640.00

Spreadsheets allow you to insert numbers and then change them later. You can use formulas to compute the amounts of budget variances and the percentage of variances. Excel also makes changing a budget or a financial plan easy. For example, what if your expenses go up by 8 percent? How will the budget be affected? What if the price of a car you are saving to buy goes up by 10 percent during the time you are saving for it? How much money will you need for the car? Allowing you to answer "what if" questions easily is one of the strengths of a spreadsheet program. When you change a number in Excel that is part of a calculation, the result is automatically updated. When you enter a new expense amount, for example, the total expense amount will be updated. Because amounts are calculated using formulas, math errors are eliminated.

BUILDING A BUDGET

A budget should be designed to help meet financial goals such as paying for current expenses and saving for the future. To create a budget, begin by looking at the amount you have available to spend or save. Then decide how much of that amount you will save and how much you will spend. You must also choose the items or services for which you plan to spend. Remember that a budget is a plan. Your actual income, saving, and spending may not be exactly as planned. You can compare your actual spending and saving to the budget to see how well you planned. This process will help you create better budgets in the future.

STEP 1: ESTIMATE INCOME

You may have many different sources of income. Whether the money is earned or unearned, you should keep track of where it comes from and how often it is received. Because most budgets are prepared once a year, you should calculate income for an entire year. Money you will receive during the year is estimated in a budget. You may receive the money weekly, monthly, yearly, or on some other schedule. No matter when the money is received, it can be accounted for in terms of a monthly budget. If you receive money weekly, multiply the weekly amount by 4 to see how much that is per month. For example, $10 received per week would be $40 a month. (Rounding is okay as long as your total yearly amount is accurate.) If you get money once a month, you can multiply by 12 to get yearly income. When you look at the big picture—how much money comes in and goes out during an entire year—it may change the way you think about money.

STEP 2: PLAN SAVINGS

Pay yourself first—put money into savings before you consider other expenses. If you plan what you want to spend first, you may have no money left for savings. Enter an amount that you would like to save. After entering expenses, you may need to adjust this amount. You might not be able to save as much as you want and still pay for all expenses. Plan to save some money, however, if at all possible. Savings allow you to plan for the future. You can identify items you would like to purchase at a future time with savings. Savings can also be used to pay for unexpected expenses that you may have in the future.

STEP 3: ESTIMATE EXPENSES

Expenses are items for which you spend money. Clothes, lunches at school, and bus fares are examples of expenses. You may make payments on an asset you purchase, such as a car. Other expenses are related to living costs and entertainment. Keeping track of what you spend will help you estimate expenses for the future. If you are trying to control expenses, seeing exactly how much you spend for each expense can be helpful.

Variable Expenses

Expenses that can go up and down each month are called variable expenses. Examples of variable expenses are food, entertainment, and clothing. These expenses go up or down as you need more or fewer items. For example, when the weather is cold, the heating expense may go up. Expenses can also vary due to changing prices. For example, as the price of gasoline rises, the transportation expense will also rise. Some variable expenses can be decreased when you have less income or higher expenses than expected. For example, you could spend less than planned on entertainment. You can spend more on variable expenses, such as clothes, if you have more income or fewer expenses than expected. For example, if you receive a gift of cash for your birthday, you can use the money to make an unplanned purchase.

Fixed Expenses

Expenses that do not change each month are called fixed expenses. Examples of fixed costs are rent, insurance, and car payments. Renters typically have a contract that states a monthly rent amount. The rent does not change each month. Although rent and insurance expenses do go up periodically, these increases typically occur on a yearly basis. Monthly car payments are usually fixed for the term of the car loan. Fixed expenses remain constant each month and must be paid even when income is less than expected. If income continues to be less than planned, a fixed expense may have to be eliminated. For example, suppose Terry's income goes down because he loses his job. Terry may have to sell his car and pay off his car loan to eliminate this fixed expense that he can no longer afford.

STEP 4: BALANCE THE BUDGET

Find the total of each category in the budget—income, savings, and expenses. Find the total of savings and expenses. This amount should be the same as the total income amount. When these amounts are the same, the budget is in balance.

PREPARING A BUDGET ANALYSIS

A budget is a plan for saving and spending. You should not expect income, savings, and expenses to be exactly as you planned in a budget. Looking at differences between planned income or spending and actual income or spending, called variances, can help you plan better when creating budgets in the future. Sometimes you will earn or save more than you estimated. This is a favorable variance. If you earn or save less than you estimated, it's an unfavorable variance. The same is true with expenses. If you spend less money than you planned to spend, this is a favorable variance, but if you spend more than you planned to spend, it is an unfavorable variance.

The budget on the next page shows budget variances—both in dollar amounts and in percents. To compute the percents for income and savings, subtract the budgeted amount from the actual amount; then divide the difference by the budgeted amount. To compute the percents for expenses, subtract the actual amount from the budgeted amount; then divide the difference by the budgeted amount. By looking carefully at variances, you can see where you spent more or less than the estimated amounts. Any variance that is more or less than 10 percent of what you had planned should be looked at carefully. For example, Andrea had planned to spend $60 on clothes and shoes for the month, but she actually spent $70. That is $10 more than budgeted, or a 17 percent difference. Andrea should think about why this happened. She may decide that she needs to revise the budget or change her spending habits. Analyzing variances will help you understand and better estimate your income and expenses.

RECORDKEEPING METHODS

Keeping good records will help you prepare a better budget. Good information will also help you do a better job analyzing your budget. There are several methods you can use as you keep track of what you are earning, spending, saving, and investing.

ANDREA MCCALL
BUDGET VARIANCES FOR AUGUST

	Budgeted Amount	Actual Amount	Dollar Variance	Percent Variance
Income				
Work (part-time)	$120.00	$110.00	-$10.00	-8% U
Allowance for doing household chores	40.00	50.00	10.00	25% F
Lunch money allowance	60.00	60.00	0.00	0%
Total Income	$220.00	$220.00	$0.00	0%
Savings				
Deposit to savings account	$20.00	$20.00	$0.00	0%
Expenses				
Gifts	$20.00	$18.00	$2.00	10% F
Clothes and shoes	60.00	70.00	-10.00	-17% U
Spending money (miscellaneous)	20.00	22.00	-2.00	-10% U
Lunches	60.00	55.00	5.00	8% F
Entertainment	40.00	35.00	5.00	13% F
Total Expenses	$200.00	$200.00	$0.00	0%
Total Expenses and Savings	$220.00	$220.00	$0.00	0%

Percents are rounded to the nearest whole number.

MANUAL RECORDS

You can keep logs or journals on paper that list types and amounts of income, savings, and expenses. You can manually compute your variances and make notations about what to change. You will want to keep these journals over time so you can compare them. For example, you can look at the previous year's budget and see how your income has grown. You can also see how your spending habits have changed.

COMPUTERIZED RECORDS

Software packages such as Quicken or Microsoft Money allow you to keep financial records using a computer. The software will retain the data and will allow you to print reports, such as a personal balance sheet. It will also allow you to quickly reference expense information. You can also use spreadsheet programs, such as Microsoft Excel, for data entry and budget analysis. The program will allow you to compute variances in dollar amounts as well as percentages. You can set up worksheets and link them together. This will allow you to make estimates and change amounts easily.

4-3 Personal Financial Planning

OBJECTIVES

- ***Explain the purpose of a financial plan.***
- ***List the steps of the financial planning process.***
- ***Describe how financial goals help make achieving personal goals possible.***
- ***Prepare a personal financial plan.***

FINANCIAL PLANNING

A financial plan contains personal goals you want to accomplish. It also contains a timeline for reaching these goals and methods you will use to finance them. Getting a college education, owning a car, and owning a home are examples of personal goals. For each personal goal, you will have a related financial goal. Paying for living expenses, tuition, books, and other related expenses while in college is a financial goal. Saving for a down payment and having a job that provides enough income to make monthly car payments are financial goals. Saving for a down payment and having a job that provides enough income to make monthly house payments are financial goals. A financial plan is more than a budget. Its purpose is to plan for earning, spending, saving, and investing that will allow you to achieve your personal goals in the present and the future.

A FIVE-STEP FINANCIAL PLANNING PROCESS

Financial planning is a formal process. It involves looking carefully at your current situation and thinking about your future. It also requires a long-term commitment. You must put your plan into action and monitor it periodically. At least once a year, you should review and update the plan. Your plan should contain details, but it should not be too complicated to review and follow. Some people create a plan by themselves. They may think they do not need help, or they may want to keep their financial information and goals private. Other people hire a financial planner. A financial planner is trained to help people with advice about how to invest earnings, plan for retirement, and manage other financial matters. Whether you do planning by yourself or with help from others, you will need to complete five steps.

STEP 1: GATHER INFORMATION

The first step in financial planning is gathering information. Everything related to your finances should be considered. The purpose of gathering information is to look at the state of your finances now—your starting point. The following list shows examples of items you may need to gather. You may not have all the items listed at this time in your life. However, you can gather or prepare the first three items. Other items may become part of your plan in later life.

- Personal income and expense statement
- Personal balance sheet
- Personal budget
- Checkbooks
- Current bank account statements
- Investment account statements
- Insurance policies
- Current paycheck stub
- Tax returns
- Will
- Trusts
- Financial contracts for items purchased on credit
- Other legal documents related to your finances

At some point when you review your plan, you will need to think about how to finance your retirement. You may want to gather data about your medical history and the medical history of family members. This data may help you estimate your life span, which affects the amount of income you will need over your lifetime. For example, many people may live until age 85 or 90 and should plan how to meet financial needs through that age.

STEP 2: ANALYZE INFORMATION

Take a careful look at the documents and information you have gathered. Find out if any data are missing, and take steps to get the data. Carefully look at each document, and make notes about what you see. Review your income and expense statement to see what your current sources of income are. Look at your expenses. Do you have enough income to pay for your expenses and save for the future? If not, try to find ways to increase income and decrease expenses. Review your personal balance sheet. What are your assets? What liabilities do you have? What is your net worth? Review a current monthly or yearly budget. Look at the items for which you spend money. Is there a way you can spend less and save more to meet long-term goals? As you review your financial plan each year, consider the following questions. Some of them may apply now. Others may not apply to you for a few years or for many years.

- Is your income steadily growing over time? If so, by what amount and percentage? For example, you may have $2,000 more in income this year than last year. This is a favorable trend that will help you reach your goals.
- Is your net worth growing over time? When you compare the current balance sheet to previous ones, do you see growth? If so, by what amount and percentage?
- How are your spending habits changing? What types of things are you buying (needs versus wants), and what are your purchasing plans over time?
- Who else depends on your income? Do you have a spouse or children that will be affected by your financial plan? What will they contribute?
- What new goals do you need to add and plan for? Do you need a plan to pay for a college education for your child? Is it time to plan for retirement? Does your will need to be updated to include a new grandchild?

STEP 3: SET GOALS

Two types of goals should be considered when creating a financial plan— personal goals and financial goals:

- Personal goals are the things you want to achieve. Living in your own apartment, owning a car, and taking a two-week vacation are personal goals. Personal goals should be set first because your financial goals will be based on them.
- Financial goals describe how you will pay for your personal goals. Financial goals may be short-term, intermediate, or long-term.

Short-term goals include what you will do this week, this month, and this year. A financial plan for the short term tells you on a week-to-week or month-to-month basis what you would like to achieve. Perhaps you would like to save $40 by the end of the month. Perhaps you want to add $200 to your savings account by the end of the year. Short-term financial goals are usually for between 1 week and 2 years. Using monthly and yearly budgets can help you achieve short-term goals and save for long-term goals.

Intermediate goals include what you want to achieve up to 3 or 4 years from now. You may wish to save money for college or for a future purchase or need. You may want to increase your yearly income by $100 a month within 3 years. Intermediate goals are usually for between 2 and 5 years.

Long-term goals typically include what you want to achieve more than 5 years from now. You may wish to save enough money to buy a car or go on an expensive vacation. You may want to repay loans for money you borrowed to complete college. When you begin working full-time, you may contribute to a 401(k) to save money for your retirement.

Achieving intermediate and long-term goals may require that you save money for a long time. Doing without an item you would like to buy now in order to save money for a long-term goal is an example of delayed gratification. For instance, you may have a goal of saving $30 per month to help pay for your college education. This month, you would like to buy a music CD. However, if you do so, you will not be able to make your savings goal. Doing without the CD now in order to be able to pay for college later is an example of delayed gratification.

STEP 4: DEVELOP A TIMELINE

Plan a time to put your goals into action. How soon do you need or want to achieve a certain goal? For each personal goal, there may be a financial goal you must first achieve. Financial goals can further be divided into parts or steps. For each step, consider how long it will take to complete. Then set a target date for completion. The record of what you intend to accomplish is your financial plan. Once you clearly understand your current finances and the goals you want to accomplish, you can then take steps to reach your goals. A sample timeline for one goal is shown to the right.

BILL WONG FINANCIAL PLAN
Updated April 1, 20--

Net Worth on April 1, 20-- $525.56

Personal Goal	Financial Goal	Steps to Take	Timeline
Live in my own house in the country	Own a house in the country	1. Save money for a down payment ($12,000)	5 years
		• Set aside $200 per month	Once per month
		• Open a separate account for money saved	April 8 (next week)
		• Talk to a mortgage broker to get prepared	Make an appointment for April 15
		2. Have a job that provides enough income to make monthly payments	5 years

STEP 5: IMPLEMENT AND EVALUATE THE PLAN

Once you have decided on your personal and financial goals, begin working toward achieving them. Check off the items on your timeline as they are completed. Set new steps as you learn about other or better ways of meeting your goals. Most importantly, take a look at your financial plan often. At least once each year, you should evaluate the financial plan and update or revise it as needed. Your financial plan represents your personal and financial goals at one point in time. Those goals are likely to change over time. For example, you may inherit money, or you may have children. You may have a job opportunity overseas, or you may wish to spend more time on a hobby or a side business. As your personal and family goals change, your financial plan should be updated to reflect new goals. The financial plan is a work in progress; it is never finished. As one goal is accomplished, another personal goal is defined. Keep your financial plan and all the related documents in a safe place where you can work on them regularly.

FOCUS ON: Phishing

When providers of financial products contact you directly by e-mail or using Web sites, you should be careful. There are many scams on the Internet. Web pages that appear to be genuine may not be posted by the company indicated. One common Internet scam is called phishing. In this scam, a person is sent an e-mail saying, for example, that there is a problem with his or her bank account. The individual is asked to confirm a Social Security number, account number, password, or other sensitive information. The From field of the e-mail may have the real name of your bank. The real company logo may be shown. However, the message is not from the real bank. Do not respond to such an attempt to get personal information. The message is most likely from a phisher. The phisher wants to use your information illegally. Identity theft occurs when someone uses your personal information without your permission to commit fraud or other crimes. If you think that a message regarding your bank account or other financial matters may be real, contact the bank or other business by phone. Ask if there is a problem with your account. Do not reply to the e-mail message or go to the link provided.

Chapter Summary

- ***Many people have unlimited wants and needs but limited resources to meet those wants and needs.***
- ***Because resources are limited, people must make choices. Every choice is a trade-off between the item or benefit you get and an opportunity cost (the item or benefit given up).***
- ***Income and assets are financial resources that can be called on to meet our wants and needs.***
- ***A personal income and expense statement lists income, expenses, and net income. A personal balance sheet lists assets, liabilities, and net worth.***
- ***Budgeting helps you manage your financial resources.***
- ***Building a budget requires you to estimate income, plan savings, and estimate expenses.***
- ***A budget analysis shows how planned spending (budget) compares to actual spending. Any differences are called variances.***
- ***Manual and computerized recordkeeping methods will help you keep organized and prepare better financial records.***
- ***A financial plan contains personal goals and financial goals that allow you to achieve personal goals.***
- ***Five steps in financial planning are gathering information, analyzing information, setting goals, setting steps with a timeline, and implementing and evaluating the plan.***