CHAPTER 6

Personal Finance: An Overview

Reading for Meaning

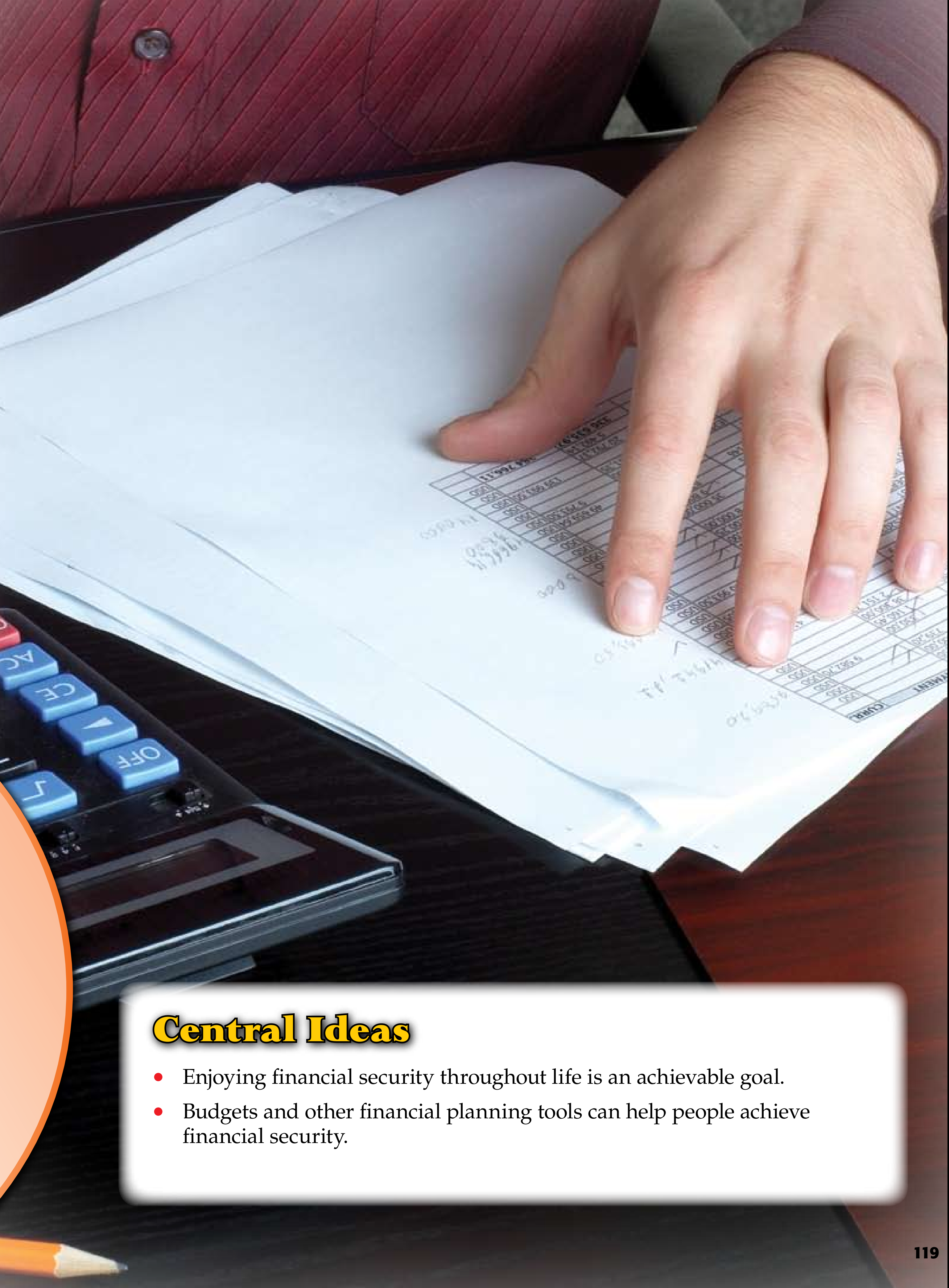
Skim the chapter by reading the first sentence of each paragraph. Use this information to create an outline of the chapter before you read it.

financial literacy
budget
income
expense
fixed expense
variable expense
philanthropy
cash flow statement
net worth statement
net worth
liability
wealth
family life cycle
demographics
family crisis
recordkeeping

CHAPTER OBJECTIVES

After studying this chapter, you will be able to

- **prepare** a budget tailored to income and needs.
- **prepare** cash flow and net worth statements.
- **plan** family finances for different stages in the life cycle.
- **give examples** of economic, demographic, cultural, and technological factors that can impact financial planning.
- **explain** ways to deal with a financial crisis.
- **identify** important financial and legal documents to keep on hand.



Central Ideas

- Enjoying financial security throughout life is an achievable goal.
- Budgets and other financial planning tools can help people achieve financial security.

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The average high school graduate can expect to earn just over one million dollars in a lifetime, according to statistics. College graduates will earn more than two million. However, no matter how much you earn, your needs may not be met if resources are not used wisely.

Financial planning is an ongoing process designed to take you from where you are to where you wish to be financially. It is a way to take control of your financial resources and future. The ultimate purpose of financial planning is to reach important goals and achieve a sense of financial security for life. *Financial security* is the ability to meet essential needs without taking on more debt than you can repay.

Preparing Financial Statements

Reaching financial security is the result of planning. Before you learn to plan, though, you must achieve financial literacy. **Financial literacy** is the understanding of the basic knowledge and skills needed to manage financial resources. Having financial literacy means you are aware of different financial management options and the way each functions. With this knowledge, you can be confident as you manage your money, credit, accounts, and investments. You feel secure in your ability to make these resources work for you.

Tailoring a Budget to Income and Needs

Planning allows you to meet changing needs and goals over your lifetime. It begins with managing day-to-day expenses. A *budget* can help you make the most of your money and avoid financial problems. A **budget** is a spending plan for the use of money over time based on goals and expected income. The purpose of a budget is to take control of your money and spending. Creating a simple, workable budget involves these basic steps.

Financial Goals		
	When Wanted	Estimated Cost
Short-Term		
Boots	In 2 months	$ 65
Christmas gifts	In 3 months	$ 100
Summer trip	In 9 months	$ 350
Medium-Term		
Laptop computer	In 1 year	$ 500
Used car	In 2 years	$ 6,000
Long-Term		
College expenses	In 5 years	$32,000

6-1

Organizing your goals on a chart similar to this can help direct your spending and saving to whatever is most important to you at a given time.

1. Establish Financial Goals.

Well-thought-out goals can help you direct your dollars to those things you consider most important. Make a list of your financial goals. (Chapter 5 covered goal setting in detail.) Include short-, medium-, and long-term goals, 6-1. For example, the goal of getting money for a movie this weekend is fairly immediate. Saving enough money for a week-long camping trip next year with friends is a medium-term goal. A new car or future education are long-term goals. They require saving over a period of time.

Keep in mind that financial goals change over the years. At this moment, your goals may include saving money for a personal media player, a car, travel, or college. However, as you experience college, work, and perhaps marriage and parenthood, your financial goals will evolve.

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2. Estimate and Total Your Income.

Determine your budget period. The period—weekly, biweekly, or monthly—depends on when you receive most of your income. **Income** is any form of money you receive, such as an allowance, a paycheck, and gains from an investment. If you receive a weekly allowance, for example, it makes sense to budget on a weekly basis. If you receive a regular paycheck and pay monthly bills, it may be easier to work with monthly figures.

Estimate your income during a typical budget period. Using a worksheet such as the one in 6-2, write your best estimate of how much money you normally receive from each income source. Total the estimates and write it at the bottom of the sheet. This is your estimated total income for a budgeting period.

3. Estimate and Total Your Expenses.

After figuring your income, the next step is figuring your expenses. An **expense** is the cost of goods and services you buy. It helps to classify your expenses as *fixed or variable* expenses.

Fixed Expenses. A **fixed expense** is a set cost that must be paid each budget period. Fixed expenses may include

- rent or mortgage payments
- tuition
- insurance premiums
- loan payments (auto, educational)

Estimating Income		
Week or Month of ____________		
Income Sources	**Estimated**	**Actual**
Jobs		
Babysitting	$ 25	$______
Yard work	$ 40	$______
Part-time at Pizza Parlor	$ 200	$______
Allowance	$ 40	$______
Gifts	$ 10	$______
Total Income	**$ 315**	**$______**

6-2

Use a form similar to this one to estimate expected income. Review your estimates and fill in with actual figures to stay up-to-date on the amount you have to spend and save.

Business, Management & Administration

Budget Analysts

Budget analysts examine financial plans to make sure all factors have been considered and plans are realistic. They also review financial statements, evaluate economic and market trends, and write budget justifications.

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These expenses tend to increase in number and amount as you move into adult years. As a rule, fixed expenses must be paid when due. Therefore, it is important to list them first.

Variable Expenses. A **variable expense** is a cost that changes both in the amount and time it must be paid. These expenses can often be pared down or cut. When people are short of cash, variable expenses are the first expenses they will scrutinize. Variable expenses include

- food
- clothing
- medical expenses
- entertainment

Most teenagers receive the basic necessities from their families and spend their money on *discretionary expenses*. These expenses do not involve basic needs. They include music, snacks, computer games, and movies. For adults, discretionary expenses often include vacations, gifts, expensive clothing, and other unnecessary goods and services.

Clothing can be both a necessary and a discretionary expense. For example, buying a basic coat to keep you warm during cold weather is a necessary expense. However, a pricey designer coat is a discretionary expense because a less expensive coat would do.

Using the worksheet in 6-3 as a guide, list the general categories for your fixed and variable expenses in the far left column. For example, write *Snacks*, *Clothes*, and so forth. Then write down how much you spend on each.

Estimating Expenses

Week or Month of ____________________

Expense Items	Due Dates	Estimates	Actual
Fixed Expenses			
Bus pass	________	$ 15	$________
Lunches	________	$ 90	$________
Savings	________	$ 15	$________
Variable Expenses			
Snacks	________	$ 20	$________
Movies/concerts/events	________	$ 40	$________
Clothes	________	$ 50	$________
CDs/music files	________	$ 25	$________
Gifts	________	$ 20	$________
Magazines	________	$ 15	$________
Grooming aids	________	$ 25	$________
Total Expenses	________	**$ 315**	**$________**

6-3

Make adjustments to your variable expenses when you are short of cash.

Building Savings into Your Budget

It is wise to include savings in your budget. Save a small amount regularly in a special fund. This way, you will have cash available if an unexpected expense arises. Everyone needs an *emergency fund* when unexpected expenses occur. These can include a hefty car repair bill, unexpected medical expenses, or a home repair cost. An emergency fund is also an important financial cushion to have in case of job loss or some other disruption to income.

With savings, you can plan ahead for major expenses and medium- and long-term goals. For example, to prepare for a camping trip, estimate how much money you will need and the time you have to get it. Suppose the trip will cost $360 and it is five months away.

- How much do you need to save per month? Divide $360 by 5, the number of months. If you save $72 each month, you will have enough.
- How much do you need to save per week? Divide $360 by 20, the number of weeks in five months. If you save $18 each week, you will have enough.

You can use this method to plan for any expense if you know the amount you need and when you need it.

In the future, when you have money left over after expenses, saving that money can increase your resources. Later chapters cover many more ways to preserve and increase your financial resources. Chapter 9, for example, discusses the use of credit to meet goals and manage the peaks and valleys of income and expenses. Chapters 11 and 12 discuss savings in more detail, as well as investments that can improve your financial circumstances.

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Charitable Giving as an Expense

Many people voluntarily contribute money or items of value to charities. A charity usually refers to an organization that aids the poor, the homeless, the sick, and others in need. **Philanthropy** is the act of giving

REAL LIFE CONNECTIONS

Charitable Giving

An organization called Charity Navigator researches charities and provides a rating that ranges from 0 to 4 stars. A charity with a 0 star rating is "exceptionally poor." A four-star group is "exceptional." You want to choose highly rated charities because they make the best use of your contributions. You also want to choose charities with programs that are growing.

By typing the name of a charity into www.charitynavigator.org, you can get a detailed report that tells you how much money it collects and spends. The group's "efficiency rating" is based on how much it spends on programs versus administrative costs and fund-raising. Charity Navigator gives the salaries of heads of charities. A "capacity rating" is based on the growth of revenue and programs.

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money, goods, or services for the good of others. You may want to make charitable giving a regular expense in your budget. In addition to helping others, you often get a tax deduction.

Be watchful when giving to charities. Some groups pose as charities but use the funds they collect to enrich themselves. Other groups are genuine but use too much money for nonprogram costs. It pays to do some research before you give.

To determine how much you can give, consider your income, expenses, and outstanding debts. Until you have an income high enough to support charitable giving, you can always volunteer your time and energy.

4. Analyze Current Income and Spending.

Taking a close look at your record of income and spending is an important step in money management. It is easy to overestimate income and underestimate expenses. A detailed record of spending almost always turns up some surprises and some unnecessary spending. Inspect your record of income and expenses. Are your income figures accurate? Subtract your expenses from your income for each budget period. Do you come out even? Do you have money left over for goals?

If you have nothing left or if you are "in the hole," you will need to find ways to increase income or cut expenses. To increase income, explore these possibilities.

- Can you earn extra money by handling more responsibilities at home or for your neighbors? Can you go grocery shopping, wash windows, or reorganize closets and cabinets?
- Can you get a part-time job if you do not have one? Look for help wanted ads. Can you get ideas from family, friends, coaches, and counselors? Have you overlooked any job opportunities?
- If you have a job, can you negotiate an increase in wages? Can you work more hours without sacrificing the time you need for schoolwork and other important activities?

To reduce spending, study your record of expenses.

- Start with your discretionary expenses. Can you eliminate something? reduce the cost of an item? get something for free? For example, perhaps you can make a gift instead of buying one. You can cut back on music downloads and text messaging. You can read your favorite magazines at the library instead of buying them.
- Look at expenses you list under the fixed and variable categories. These expenses may be necessary, but can you reduce their cost by making substitutions? For example, maybe you can bring your lunch from home instead of buying it. Try a generic shampoo instead of an expensive brand.
- Can you cut any expenses unrelated to your priorities and goals? For example, if good health is a priority, you can stop buying soda and potato chips.

After you figure out how to stretch your income to cover your needs, you can move to step 5.

5. Prepare a Trial Budget.

At this point, it is time to bring together your goals, income, and expenses into some form of a plan. A plan reduces the temptation to spend carelessly. The form in 6-4 illustrates one way to organize a budget. You may wish to draft a similar form for your own financial planning.

Keep these records over a period of time so you can review your financial situation now and then. The important thing is to put your budget in writing and keep it up-to-date as you go along. The tips in 6-5 can make a budget work better.

Fill in the "Planned" column of the worksheet using the estimated calculations you made in 6-3. This is your trial budget.

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6. Put Your Budget Into Action.

Once your budget is set up, you need to spend and save according to plans. Keep your budget handy and refer to it often. When the budget period ends, fill in the amounts for actual income and expenses. When an actual expense is greater than the amount you budgeted, identify the

Budget		
Week or Month of October		
Income	**Planned** $ 315	**Actual** $
Expenses		
Fixed Expenses	$ 120	$ 120
Bus pass	$ 15	$ 15
Lunches	$ 90	$ 90
Savings	$ 15	$ 15
Variable Expenses	$ 195	$ 195
Snacks	$ 20	$ 17
Movies/concerts/events	$ 40	$ 39
Clothes	$ 50	$ 55
CDs/music files	$ 25	$ 23
Gifts	$ 20	$ 20
Magazines	$ 15	$ 13
Grooming Aids	$ 25	$ 28
Total Expenses	$ 315	$ 315

6-4

You could use a form similar to this for your trial budget. Use your estimates of income and expenses, financial goals, and record of spending in making up your trial budget.

Quick Tips to Better Budgeting

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

6-5

When planning a budget, keep these tips in mind.

cause. Did you ignore the plan? Was there an unexpected expense? Was your estimate too low? If your estimate was too low, adjust your budget to better reflect actual costs.

7. Evaluate Your Budget Periodically.

From time to time, it is wise to review your money management plan to make sure it is working for you. You can expect your financial plans to change with significant events in your life. These include going to college, starting a new job, leaving home, getting married, having children, or changing jobs.

Consider these questions as you evaluate your budget.

- Is your financial plan working? Is your money doing what you want it to do?
- Are you reaching important goals?
- As you achieve goals, do you set new ones?
- Are you controlling your spending?
- Has your income or pattern of spending changed significantly?
- Are there changes in your life that call for adjustments in your financial planning?

When revisions are needed, make the necessary changes and update your budget. Recheck in a week or two to see if the new entries are an improvement. If you monitor your finances carefully, your income will work well for you over the years.

Cash Flow Statement

Week or Month of October	
	Actual
Income (Cash Inflows) Part-time jobs *(Babysitting, yard work, pizza parlor)* Allowance Gifts	 $265 $ 40 $ 10
Total Income	**$315**
Expenses (Cash Outflows) Fixed expenses *(Bus pass, lunches, savings)*	 $120
Total Fixed Expenses	**$120**
Variable expenses *(Snacks, clothes, cell phone, grooming aids/makeup, movies/concerts/events*	$145
Total Variable Expenses	**$145**
Total Expenses	**$265**
Net Cash Income	**$ 50**

6-6

A cash flow statement shows your actual income and expenses.

Preparing a Cash Flow Statement

A **cash flow statement** is a summary of the amount of money received as well as the amount paid out for goods and services during a specific period. A cash flow statement is also called an *income and expense statement*.

The cash flow statement shown in 6-6 appears very similar to the budget statement shown earlier. However, there are important differences. In the cash flow statement,

- income is called *Cash Inflow*
- expenses are called *Cash Outflow*

- the term *Actual* heads the column of figures instead of *Planned*

The cash flow statement goes beyond the budget to reflect actual money inflow and outflow for the month. Prepared at the end of the budget period, it shows real income and spending, not what was planned for the month.

To get accurate figures for the statement, record cash inflows and outflows in an Income and Expense Log, 6-7. The log is also called a *personal spending diary*. Record any money you receive plus any you spend. For example, write "Snacks," "Clothes," and so forth to record expenses. Then write down how much you spend on each. Also report exactly how much money came in. Do this until you reach the end of your budget period.

With a cash flow statement in hand, you can prepare a budget for the next month more quickly. You will find that careful recording of cash inflows and outflows leads to more accurate budgeting.

Business, Management & Administration

Bookkeepers

Bookkeepers update and maintain accounting records. They calculate expenditures, receipts, accounts payable and receivable, and profit and loss. They may also handle payroll, make purchases, prepare invoices, and keep track of overdue accounts.

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Preparing a Net Worth Statement

It is wise to evaluate your total financial situation at least annually. A *financial* or *net worth statement* can help you do this accurately. A **net worth statement** is a written record of your current financial situation. Your **net worth** is the difference between what you own and what you owe. It measures your financial standing at a particular point in time.

This may not seem important now, but as you move into the adult world, your circumstances can change rapidly and tracking your finances can become complicated.

As you revise this statement, you see the progress you are making toward your goals. The net worth statement helps you chart your financial future. On it, you list *assets* and *liabilities* and subtract what you owe from what you own to determine net worth, 6-8.

Income and Expense Log

Date	Item	Income	Expense
9/10 Fri.	Bus fare—round-trip		$4
	Lunch		$5
	Snack		$2
9/11 Sat.	Babysitting	$20	
	Snack		$3.50
	School supplies		$17
	Movie ticket		$7
9/12 Sun.	Gift from uncle	$10	
	New sneakers		$34

6-7

Keeping a detailed log of your income and spending will help you develop a more accurate and realistic budget.

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Net Worth Statement	
Assets	
Liquid Assets:	
Cash on hand	$________
Cash in savings, checking, and money market accounts	________
Cash value of insurance	________
Other	________
Total Liquid Assets	**$________**
Investment Assets:	
Stocks and bonds	$________
Mutual funds	________
Individual Retirement Accounts	________
Other	________
Total Investment Assets	**$________**
Use Assets: (market values)	
Auto	$________
Home	________
Furniture and equipment	________
Other	________
Total Use Assets	**$________**
Total Assets	**$________**
Liabilities	
Current Liabilities:	
Credit cards and charge account balances due	$________
Taxes due	________
Other	________
Total Current Liabilities	**$________**
Long-term Liabilities:	
Auto loan	$________
Home mortgage	________
Other	________
Total Long-term Liabilities	**$________**
Total Liabilities	**$________**
Net Worth (total assets less total liabilities)	**$________**

6-8

A net worth statement helps you determine your net worth at a given point in time.

Assets

An *asset* is an item of value you own, such as cash, stocks, bonds, real estate, and personal possessions. Assets are divided into three categories.

- ***Liquid assets*** include cash and savings that quickly and easily convert to cash.
- ***Investment assets*** include stocks, bonds, and invested funds that are set aside for long-term goals, such as the education of children or retirement needs.
- ***Use assets*** include a home, auto, personal possessions, and other durable goods that enrich your life through use.

Assets tend to change in value from year to year so you will want to list them at their *current* or *market value*. This is their estimated worth at the time you make your net worth statement.

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Liabilities

A **liability** is a financial obligation that you currently owe or will owe in the future. Liabilities include unpaid bills, credit card charges, mortgages, personal loans, and taxes. These are divided into two categories:

- ***Current liabilities*** are items due soon, usually within the year. They include medical bills, taxes, and unpaid bills from credit cards and charge accounts.
- ***Long-term liabilities*** include obligations to be paid over a long period of time, such as a home mortgage or auto loan.

Your Net Worth

Subtract liabilities from assets to arrive at your net worth. If you own more than you owe, you have positive net worth. This means that you can meet your financial obligations. You may also have assets you can use to meet financial goals that go beyond your obligations.

Wealthy individuals will have assets far in excess of their liabilities. The term **wealth** refers to an abundance of assets that are accumulated over time. It includes investments, property, a business, and other items of value that contribute significantly to financial security and a high standard of living and giving.

If your net worth is a negative figure, your debts exceed your assets. You need to find ways to reduce expenses or increase income. Start with a careful look at expenses. Try to reduce or eliminate all the items that are not essential. Pay off credit debts and do not take on more credit obligations. Consider ways to increase income by working more hours or assuming more responsibilities on the job. A job change or additional training may also lead to higher income in some situations. In some families unemployed family members may be able to find work that pays. Take every possible measure to create a positive net worth.

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Planning Family Finances

As you enter the adult world, your money management activities will expand. Teens eagerly await the day when they can afford to live on their own. Once independent, their eyes are opened to the many expenses they must handle that were previously paid by their parents. Managing finances well to remain independent becomes their number one challenge.

Often young adults who are newly independent try to hold down costs by sharing living expenses with one or more friends. After a period of living with others or on their own, many adults eventually form families. Their financial responsibilities increase dramatically. There are family as well as personal expenses to cover. Perhaps the most important factors affecting your adult budgeting decisions will be your age and the stage you occupy in the family life cycle.

Family life cycle refers to the stages a family passes through from formation to aging. Your goals and needs, as well as earning and spending patterns, will change with each stage. Becoming familiar with these patterns can provide you with a framework for your own financial planning. See 6-9.

Financial Aspects of the Family Life Cycle

Stages in the Family Life Cycle	Career and Income Characteristics	Typical Expenses and Obligations
Beginning Stage		
Marriage Getting started as a couple Establishing a home	Finishing education Making career decisions Entering the workforce Low or no income, with gradual increases	Living expenses Tuition and/or repayment of education loans Auto loan payments and insurance Life, health, and other insurance Home furnishings Savings and retirement contributions Income tax
Expanding Stage		
Birth/adoption of first child The infant years	Increasing income and job responsibilities One or two full-time incomes Decreased income if wife leaves work for childbearing	Child care and baby equipment Education fund Increased insurance coverage Prenatal, birth, and postnatal health care Income taxes Retirement contributions

(Continued.)

6-9

Career and income characteristics along with typical expenses and obligations tend to follow a general pattern at different stages of the life cycle.

Developing Stage		
Toddler, preschool, and elementary school years: Children become primary focus	Job advancement likely Increasing income Increasing job responsibilities	Move to larger living space Additional home furnishings Property and income tax increases Increased living expenses Retirement contributions
Adolescent years: Involvement in school activities Preparation for launching stage	Continuing job advancement or possible career change Possible return of mother to the workforce Income still increasing	School expenses for extracurricular activities Savings and investments Savings for education Charitable contributions Travel Adolescents' spending Income and property taxes
Launching Stage		
Children leave home Parents adjust to "empty nest"	Heavier job responsibilities Peak performance years Income may peak as well Benefits may increase Retirement planning becomes a priority	Home improvements or new, smaller home Replacement furnishings Education and tuition costs Travel Retirement savings Income and property taxes Weddings of children
Aging Stage		
Parents focus on each other Children marry Grandchildren arrive Elderly parents may require care	Job responsibilities and earnings begin to level off Retirement and estate planning take form	Travel, recreation, and adult education Care for aging parents Increased savings and investments Gifts to help children get established Income and property taxes Long-term care insurance
Retirement years: Establishing new routines, interests, and hobbies Grandparenting	Part-time or volunteer work Social Security income Income from retirement savings Wills and estate plans are revised as needed	Health insurance Possible relocation to a retirement area Travel Health care and medications Taxes Long-term care

6-9

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Beginning Stage

From age 18 to the late 20s, young people are getting established on the job and in life. Those who marry begin the first stage of the family life cycle, called the *beginning stage.* Income for most young adults starts low and gradually increases with time on the job. Two-income couples enjoy the benefits of combined incomes. People who marry later may have established careers and higher incomes.

Expenses at this time are likely to include education, college loans, home furnishings, and insurance. The down payment on a home is often the largest single expense of young couples. Other major expenses include an auto, savings, or contributions to a retirement fund. Couples need to revise their savings and investment programs to meet their changing needs as they move to later stages in the life cycle.

Case Study: Making Plans

Looking Ahead

Maria and Tony plan to be married in six months. Maria is a nursery school teacher, and Tony is a welder. Their combined annual income is almost $60,000.

During their first few years of marriage, Maria and Tony plan to buy a house and some furniture. Tony owns a car. They both use credit cards, but have little debt.

After four to five years, they hope to start a family. Maria wants to work as a substitute teacher until their children reach school age. By then, Tony's income may be higher. His work benefits include health care coverage, and life and disability insurance.

Case Review

1. What expenses will this couple likely have in the first year or two of marriage?
2. What steps do Maria and Tony need to take now in order to drop to one steady income when children come?
3. What big expenses are likely to come with the purchase of a home? with their first child? with later children?
4. What contributions should Maria and Tony make for unexpected emergencies and expenses?

Expanding Stage

For adults under age 40, life is often characterized by job advancement, rising income, and increasing responsibilities. With the birth or adoption of the first child, couples enter the *expanding stage* with all its joys and responsibilities.

If one spouse leaves the workforce to raise children, income declines. At the same time, expenses increase. Child-related expenses include child care, children's clothing, baby equipment, toys, and medical expenses. With children may come the decision to move to a larger home, 6-10. This is a good time to review and expand insurance protection. An educational fund for children may be started. It is important to draw up a will, too.

6-10
The arrival of children will call for major adjustments in financial planning.

Developing Stage

School-age children and adolescents bring a new set of circumstances for families. Family life tends to revolve around the children and their school life. Expenses include a larger clothing budget, sports and hobby equipment, lessons and tutoring, allowances, and savings for future education. Another expenditure for some is a second car.

During this stage, a spouse who left the workforce may return either to satisfy career goals or to supplement income. This may require at least a brief return to school to update education and skills. While income may still climb during parenting years, expenses grow as well. They include housing, insurance, taxes, education, savings, and retirement planning.

Launching Stage

Parents in their 40s and 50s share another set of common experiences. Families enter this stage as the children leave home for college, jobs, or homes of their own. During these years, job advancements often bring higher incomes. Earnings may peak. It is also a time when some may seek a job or career change.

Many families at this stage need extra income to cover college expenses and retirement savings. Retirement planning is critical.

In some families, this is a time when aging parents become a concern. Those in this situation are often called the "sandwich generation." Parents find themselves "sandwiched" between college-bound teens and their own aging parents. Both financial and emotional demands are great when this happens.

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Aging Stage

From the late 50s to retirement, people often need to adjust to new events. Earnings level off. Aging parents may require attention and assistance. Children have left home, creating the "empty nest." Many parents become grandparents. Married couples often renew their focus on each other. They may choose to travel or become more active in the community.

Individuals and couples often focus on retirement planning during these years. Empty-nest families may choose to move to a smaller home and simplify their lives for retirement. Those caring for elderly parents may face heavy health and nursing-care costs. Couples need to have reliable health insurance and consider buying long-term care insurance for themselves. At this stage, estate planning is important. It is also the time to review and revise wills.

For most people, this stage marks formal retirement. Some retirees seek part-time work or volunteer opportunities. For many, free time is a welcome luxury. It is a good time to downsize, live more simply, and conserve energy and income. Those in good health may travel more. Grandchildren are frequently important at this time of life.

Income and most living expenses usually decline during retirement years. Security and comfort depend on the financial planning that occurred in earlier stages. For those who have not planned, the retirement years can bring financial hardship as income drops. Serious spending cutbacks may be required, especially as medical costs rise. Retired adults need to review wills and estate plans. They should go over the provisions in each with their adult children.

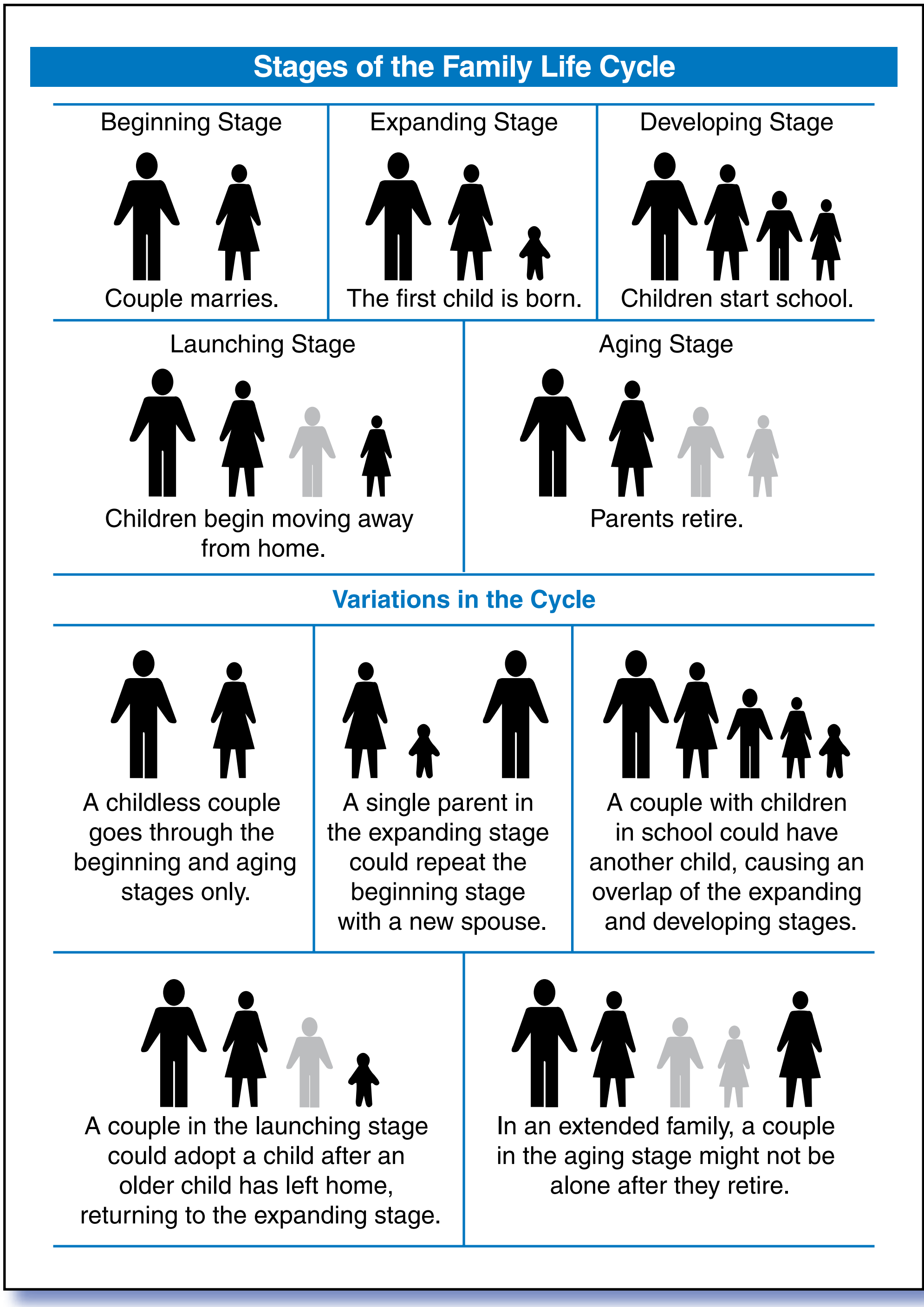
Variations in the Cycle

Not every family follows the stages of the family life cycle in order, 6-11. The number of children and spacing between them can cause the cycle to vary from family to family. Some families skip, overlap, or repeat stages of the family life cycle. For example, couples that do not have children skip the expanding, developing, and launching stages. Parents with children in school could have more children. This would cause an overlap of the developing and expanding stages. Single parents who remarry may repeat stages with their new spouses.

As family conditions change, financial planning concerns change, too. For example, single individuals, childless couples, single-parent families, and divorced or separated people have these added considerations.

Singles and Childless Couples

Singles and couples with no dependents do not have the expenses related to childrearing, such as school and medical expenses. Both groups may spend more throughout the life cycle on travel, leisure, and other extras. Some may choose to give more to charitable causes. Both groups often feel a greater responsibility to help their aging parents.



6-11

Not all families proceed through all stages of the family life cycle in the same way.

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Single-Parent Families

Females lead most single-parent families. Their income is typically less than that of two-parent families and single-parent families led by males. Saving and planning for future security is sometimes difficult as these families struggle to meet current expenses. Government and community services and assistance can be very helpful for single-parent families.

Case Study: Making Plans

The Single Life

At 28, Myra has no plans to marry and no children. She is a top-notch photographer and earns $50,000 annually. She also receives outstanding benefits through her job, including health, disability, and life insurance. Myra's parents are in good health and they both work. Her two brothers have jobs and families of their own. Myra lives in a rented apartment and is thinking about buying a home, something she has always dreamed.

Case Review

1. What changes in Myra's situation could alter her financial needs and plans?
2. Suppose one of Myra's parents becomes ill, resulting in financial problems. How could this affect Myra's financial plans?
3. Suppose Myra's brother and his wife die in an accident and Myra is named guardian of their children. How might this change her financial plans?
4. What are some financial steps Myra should take before purchasing a home? What steps should she take after becoming a homeowner? What additional expenses will home ownership bring?
5. What are some key differences in financial planning for those with and without dependents?
6. How does an individual's age relate to financial planning and decisions?

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Separated and Divorced People

Separated and divorced people face a unique set of financial concerns. They may have the following expenses: legal fees, alimony, child support, and property settlement costs. The costs of establishing and maintaining two homes rather than one is another expense, especially if there are children. A divorce or separation may require additional furnishings and moving costs.

No matter what your situation will be, it is wise to begin a savings and investment program and to insure against financial risks early in your adult life. These two steps are the foundation of financial security in later life. Savings can cover unexpected expenses and emergencies and help to reach goals. Insurance protects against major disasters. With both, you can feel reasonably comfortable with your financial situation. Start with a personal savings plan. The longer you save, the more you will accumulate.

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Financial Decisions in a Changing World

Besides the family life cycle, other important factors and forces will impact your life. These include economic, social, cultural, and technological forces. Individually and together, these factors will cause you to redefine your financial needs, priorities, and goals.

The Economy and Your Finances

When the economy is on the upswing, people are generally optimistic. Businesses make money, grow, and hire more workers. People who want work can find good jobs. Most consumers who want to can find a job. Their future income is fairly secure and they can pay their bills. If they plan carefully, they can even save and invest for the future. However, when the economy is plagued by problems, such as recession, inflation, or unemployment, managing your finances becomes even more important and challenging.

Recession, a period of slow or no economic growth, can have a major impact on personal money management. This is especially true for those who are out of work or whose incomes are stagnant. Recessions spread uncertainty and pessimism over the entire economy. Consumers spend less and save more if possible. Businesses cut back and unemployment rises.

ECONOMICS in ACTION

Severe Recessions Hit Home

When recessions hit the U.S. economy, the impact is felt in millions of homes across the country. Young adults struggle with finding work as businesses shed jobs and curtail growth. Financial institutions make fewer loans. Long-term goals, such as increasing one's education and buying a home, must be put on hold.

When people lose their jobs or have their hours reduced, entire families feel the pain. Many lose the health insurance that was provided through their jobs. Unemployment often pushes many families out of their homes.

Loss of income means lifestyle changes for almost everyone. There is less money and much more anxiety. Retirement savings drop with the stock market. People who were retired or nearing retirement are forced to work beyond their planned retirement age, if they can find work.

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Inflation, or a period of rising prices, also relates to personal money management. As prices go up, the value of a dollar goes down. If income does not rise at the same rate that prices rise, buying power is reduced. Consumers cannot buy as much or save as much. Financial planning and saving can help consumers cope with challenging economic conditions.

Demographics and Your Finances

To some extent, the way you manage your money and your life in the years ahead will depend on *demographics*. **Demographics** refer to the statistical characteristics of the population. *Vital statistics* include records of births, deaths, and marriages. *Social statistics* include population breakdowns by age, sex, and race with geographic distributions and growth rates.

Other social-economic statistics concern education levels, income levels, employment, religion, crime, immigration, and ethnic representation. A current almanac is a good place to look for the latest demographic statistics. Recent demographic trends have an impact on the overall economy, and in turn, on the financial life of consumers. Consider some of the following trends and their economic implications:

- Couples are marrying and having children later in life.
- The percentage of single-parent families is growing, 6-12.
- The average age of the overall population is increasing.
- Educational requirements for jobs are rising and job markets are changing.
- Skilled workers are in greater demand.
- More young adults are living at home with their parents.
- The number of unmarried adults is increasing.
- More mothers are working away from home.
- The number of births to single mothers is increasing.

All these and other factors will affect your financial future.

6-12
The growing number of single-parent families is one demographic factor that has affected the economy.

Culture and Your Finances

Most urban areas include a variety of racial and ethnic groups. Each group makes an impact on consumer attitudes and buying habits, community services, schools, and many other consumer and family issues.

Relationships and marriages between people of different races, cultures, and religions are on the increase. This creates a blending of ethnic traditions, religious beliefs, languages, and concepts of "family." Cultural and ethnic traditions affect many everyday choices and routines. They may dictate the role each partner plays in the family, who makes financial and spending decisions, whether both partners work, how the family uses credit, and how the family manages its money.

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Technology and Your Finances

New developments and discoveries in communications, medicine, science, and other areas change the way we live in the world. For example, medical advances may result in a longer, healthier life for you and others. New findings on healthful lifestyles include fitness routines, nutritious diets, and stress reduction. You now know how to improve your own health and quality of life. However, living longer makes financial planning even more critical. Your savings must sustain you over a longer life span.

Technology brings other changes in the way you live and deal with financial matters. For example, the Internet has altered the way people buy goods and services. You can buy everything from groceries to autos to movie tickets online. Information technology can bring you the latest information from around the world about consumer products, services, and issues. Money management software brings you up-to-the-minute tools for managing money and performing many financial tasks online. You can do your banking, bill paying, investing, and fund transfers online in your own home, 6-13. The Internet brings an international marketplace to your fingertips.

6-13

With a computer and an Internet connection, you can manage your finances almost anywhere.

Human Services

Certified Financial Planners

Certified financial planners have met certification requirements issued by the Certified Financial Planner Board of Standards. They assess the financial needs of clients and use their knowledge of investments, tax law, and insurance to recommend the most beneficial financial options for their clients.

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Advanced technology creates new markets and brings more and cheaper goods and services to consumers. It also creates new jobs in many fields. Unfortunately it also has fueled *offshore outsourcing* in some fields. This is the business practice of moving factories and jobs overseas and across borders to take advantage of cheap labor and business-friendly government regulations. As a result, many American workers must compete for jobs with lower-paid workers in other countries. This has caused layoffs and unemployment, especially among those who work in manufacturing and information technology industries. Today and in the future, the higher-paying jobs will require higher levels of education and training. Education has never been more important than in today's economy.

Working Through Financial Problems

You can often avoid financial trouble by living within your means and keeping debt under control. This involves taking responsibility for your life, including your financial choices and decisions.

Preparation will help you weather a crisis situation if it arises. Getting the best education and job training possible are ways to be prepared. With a good education and job skills, you are better able to find work and advance on the job. Staying current in your field through continuing education and training programs also helps. Usually higher earnings and greater job security result.

An emergency fund equal to several months' pay is another way to prepare for the unexpected. The amount of money needed in the fund differs from one person to another. However, it should equal your monthly income multiplied by the number of months you are likely to be out of work. In some cases, such as during a recession or if you work in a competitive field, the emergency fund should equal as much as eight to ten months of pay.

Preventive measures also help. Those discussed here and in other chapters include

- sound money management
- practical credit controls
- regular savings
- insurance protection
- reasonable caution in financial matters
- regular discussions of financial matters with household members old enough to understand the fundamentals of money management

Prevention, when possible, is the most painless way to deal with potential disasters.

Unexpected Crisis

There may be times when financial disaster strikes because of circumstances beyond your control. A **family crisis** is a major problem that impacts the future of the family and its lifestyle. Examples include job loss, divorce, death, disability, serious illness, and natural disaster. When such events occur, you may need to make some serious changes in your financial planning and behavior. If debt problems reach the crisis stage, you must take drastic steps to correct the situation.

In many cases, you should start by discussing the problem with adult members of the household, including older children. Make sure that everyone understands the potential impact on their standard of living and what they can do to help. For example, college-bound teens may need to consider work/study programs or a community college near enough to live at home while going to school. Knowing they have a stake in resolving the crisis will encourage cooperation of all family members and reduce conflict.

Make a list of financial and non-financial resources available to you. In analyzing your situation, consider the following steps you can take to minimize negative financial or other consequences.

- Accept and acknowledge the crisis.
- If debt is a part of the crisis, contact creditors promptly.
- Avoid making any new credit purchases.
- Look for affordable credit and financial counseling.
- Adjust spending habits and cut expenses.
- Look for every possible source of income.
- Ask unemployed family members to seek work.
- Check the availability of assistance from your extended family, employers, insurance, government programs, and community or charitable organizations.
- Sell some assets, such as real estate, investments, autos, and valuable possessions.
- As a last resort, consider bankruptcy.

Some situations may call for the help of professionals such as health care providers, family counselors, financial advisors, and lawyers to determine the full scope of the crisis.

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Keeping Important Documents

As you enter the world of work and adult responsibilities, certain documents and papers will become important in managing your affairs. It is important to find a safe place for these documents and to set up a system so you can find them, 6-14. The process of setting up and maintaining an organized system for your financial affairs is called **recordkeeping**.

You will need these documents for a variety of financial and legal transactions and purposes. You may need to refer to your records when you do the following:

- apply for jobs
- make budget and financial planning decisions

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- prepare and file income tax returns
- make loss estimates and insurance claims
- verify bill payments, tax deductions, insurance claims, and property ownership

Documents and Records You May Need

Personal

- Birth/marriage/death certificates
- Passports
- Adoption and custody papers
- Military papers
- Separation agreements
- Divorce degree
- Social Security card
- Citizenship papers

Employment

- Résumés
- Copies of completed job applications
- Employment contracts
- Letters of recommendation
- Employment benefit information and documents
- College transcripts and training certificates

Finances

- Budget
- Financial statements
- Bank statements
- Canceled checks
- Credit card and charge account statements and records of payment
- Loan papers and receipts of payments

Insurance

- Original policies
- List of premium amounts and due date
- Claims information
- List of policies, numbers, company names, and types of coverage
- List of beneficiaries and amounts of expected benefits
- Medical history with names of physicians and record of current prescriptions

Taxes

- Copies of past tax returns
- Record and receipts of deductible expenses
- Record of taxable income
- Paycheck stubs
- W-2 Forms

Property

- Lease/mortgage papers
- Property tax statements and receipts of payments
- Deeds and title papers to property
- Inventory of personal possessions with purchase prices, estimated value, and photos of valuables
- Warranties and instruction manuals
- Service and repair records
- Bills of sale and receipts of payments for valuable purchases
- Receipts for improvements of real estate property
- Appraisals of real estate and valuables

Savings and Investments

- Purchase and sale records for stocks, bonds, and mutual funds
- Investment certificates
- Savings and account records

Estate Planning

- Will (original and copies)
- Individual Retirement Account (IRA) statements
- Pension information
- Social Security records
- Retirement plan documents

6-14

Keeping these documents organized and handy will help you be a better manager.

- file for employee or Social Security benefits
- make savings and investment decisions
- work on retirement and estate planning
- draw up a will
- settle an estate

Key Lists to Keep Current and Available

Along with important documents and records, you should keep several lists handy to help manage your financial affairs. Important information should be readily available to the person who would handle your financial and legal affairs if you were unable to do so. Make a list of the following items and keep it in a secure place:

- ***savings and checking accounts*** with account numbers, names on each account, name of financial institution where each account is located
- ***credit card and charge accounts*** with account numbers, name of issuer, expiration dates, and names of persons authorized to use each account
- ***PINs (personal identification numbers)*** for cash or debit cards and passwords for online accounts
- ***securities and investment records*** including stocks, bonds, mutual funds with identifying numbers, names of issuers, estimated values, purchase prices and dates, names of brokers, and location of certificates and accounts
- ***other records*** including wills and trusts, insurance policies with claims information, mortgage papers, other loan contracts, tax records, property deeds and titles, pension plans and employee benefit documents, Social Security and Medicare records
- ***names, addresses, and phone numbers*** for lawyers, investment brokers, physicians, insurance agents, financial advisers and consultants, executors, guardians, business partners or co-owners, real estate brokers, and others who should be consulted in the management of your legal and financial affairs; names and contact information for people named in your will
- ***property, possessions, and valuables*** with their location, estimated market value, appraisals, details of their purchase, and intentions for their disposition
- ***household product information and warranties*** to explain product features, use and care, and servicing options
- ***instructions for the management of your affairs***, including provisions for your dependents, disposal of your property and possessions, and other wishes you want carried out

A good record-keeping system will be simple and convenient. You will need to keep many of these records and lists readily available in a secure home file. Use a desk drawer, file cabinet, or box to keep important papers together in one place.

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You may want to safely keep important documents, such as insurance policies, in a safedeposit box at a financial institution with copies in your files. All this will be more important as you find yourself dealing with the details of adult life.

Information that is stored on your computer should also be organized and saved. This may include contracts; past tax forms; and e-mail correspondence with employers, insurance companies, product manufacturers, and others. Set up an online filing system. For example, create a file to hold all your correspondence with a health insurer.

To prevent losing important documents if your computer fails, create backup copies. You also need to install security software to protect yourself from thieves who target financial information on unprotected computers.

Scheduling Bills

If you lose track of your bills, you run the risk of paying them late or not at all. Set aside a basket, box, or drawer where you immediately put every bill that comes in. If you do not receive a bill that you expected, contact the source right away. Thieves sometimes take mail and use the financial information it contains to steal from unsuspecting people.

Keep track of due dates. Many people pay bills on a regular schedule, such as every Sunday night or at the end of the month, 6-15. The due dates and your paydays will dictate your bill scheduling. You can pay bills online or by mailed check. You may not have enough in your checking account to pay all of your bills in one sitting. Pay the bills that are due first. Bill paying is easier if you keep stamps, address labels, and envelopes on hand.

Keeping Budgeting Records

Keeping organized records can help you stay within your budget and make adjustments as needed. It is helpful to keep these records over a period of time so you can review your financial situation now and earlier.

Keep your budget with other money management material. Then you will have all the information when you want to evaluate and make necessary revisions in your financial planning. Your files should contain financial records related to your income, spending, and savings. Income records to keep include

- paycheck stubs
- statements of interest earned on savings accounts
- records of dividends
- amounts of cash gifts, tips, and bonuses

If you receive cash for a job, such as lawn work or babysitting, keep a written account of what you are paid. Spending records include

- canceled checks
- receipts from bills paid
- statements from credit accounts
- cash register receipts

Receipts are especially important for fixed expenses, such as loan payments, and for major purchases, such as a road bike. Receipts for these items serve as proof of payment. They may be needed for warranty services or settling disputes.

You need not save receipts for minor purchases, such as cosmetics or movie tickets. However, if you have trouble staying within your budget, you may want to record all purchases for a while. Then you will have a clear idea of where your money goes. Also, keep receipts for any purchases you may need to return, exchange, or have serviced. Proof of purchase is often required for these transactions.

Financial records are an important part of your money management. In later years, you will need detailed records for savings, credit transactions, investments, real estate, taxes, and insurance.

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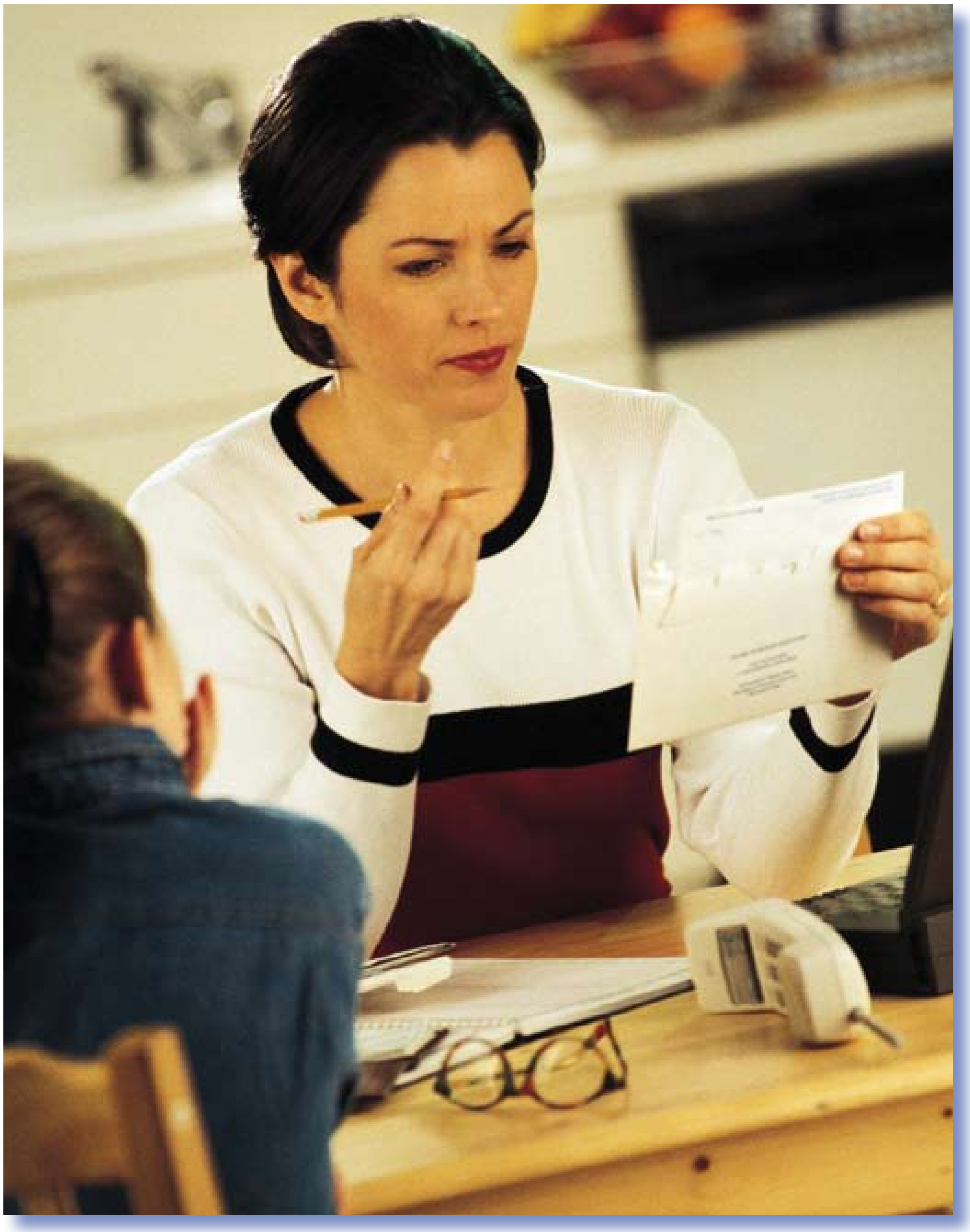

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Keeping track of your bills and their due dates will help you pay them on time and avoid late fees.

Chapter Summary

Achieving financial security requires financial literacy and lifetime planning. A budget can guide you through financial decisions.

As you enter the adult world, your money management activities will expand. A periodic net worth statement charts progress and is an important tool. Financial goals and priorities change as people move through the stages of the family life cycle.

You will not only find personal finances more involved, but you will discover that the world around you will affect your economic life as well. Demographic and cultural factors will affect your financial decisions. Technology will change the way you live and earn and spend. The changing economic climate will affect your earning power, job choices, and financial life.

Attention to warning signals can help you avoid serious financial problems. Another component of achieving financial security is learning to deal with crises. Coping methods are vital tools to use when faced with unexpected financial setbacks.

It also becomes increasingly important to develop a system for keeping necessary financial and legal documents. Knowing what to keep and where to file different papers can be a significant help in managing your financial and legal affairs over your lifetime.

Review

1. Give three examples of each kind of expense: fixed and variable.
2. What financial facts are included in a net worth statement?
3. What are three types of assets?
4. Name two types of liabilities.
5. Identify the five stages of the family life cycle and a typical feature of each.
6. Name three events in life that call for a change in financial plans.
7. Name four ways to prevent financial crises.
8. What are the steps families can take to cope with financial disaster?

Critical Thinking

9. Why do you think people often delay serious financial planning?
10. What are the advantages of beginning savings and investment programs at an early age? What are the consequences of putting off saving until age 30? age 40? age 50?

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11. How do you think financial security, financial insecurity, and financial crises affect each of the following groups?
    A. Single individuals with no dependents and no sources of income other than their own earnings.
    B. Married couples with no children.
    C. Married couples with dependent children.
    D. Retired couples.
12. How would a financial crisis in your family affect you personally?
13. Cite an example of ways each of the following can influence personal and family money management and lifestyles.
    A. The economy.
    B. Demographics.
    C. Cultural and ethnic traditions.
    D. Technology.

Academic Connections

14. **Social studies.** Research local government agencies and community organizations that offer assistance to individuals and families who are facing financial hardships. Develop a brief directory of available services.
15. **Research, writing.** Choose one of the following topics. Write a three-page report using at least five reliable sources of information.
    - The role of savings in achieving financial security.
    - Dealing with financial crises.
16. **Research, speech.** Interview two couples: one that has been married less than 5 years and one that has been married more than 15 years. Ask the couples to list some of the adjustments people need to make in financial planning and decisions when they marry.

Math Challenge

17. Lena Chang, 23, lives alone in a rented apartment. She earns $2,300 a month after taxes and payroll deductions. She has a savings account containing $1,500. She also owns $2,000 in stocks and some jewelry worth about $1,000. Her largest asset is a car that could sell today for $10,000. She still owes $15,000 on a student loan.

    Her monthly expenses include
    - $250 savings
    - $750 rent
    - $250 student loan payment
    - $250 utilities
    - $200 gas, car insurance, and registration
    - $230 groceries
    - $50 donations to a charity
    - $350 extras such as entertainment, eating out, and clothing

    Create a net worth statement for Lena. Is her net worth statement positive or negative?

Tech Smart

18. Find the Web sites of three private charitable organizations that you may want to support someday. Check out each organization on www.charitynavigator.org for an evaluation of its effectiveness. What group does each organization serve? What types of contributions, besides money, might be needed?
19. Investigate online several available money management software programs and outline the key features of one of them. Discuss ways money management software could help you with financial planning and management over your lifetime.

Answer to *Math Challenge*

17. negative