Focus on Personal Finance 6th edition Kapoor Solutions Manual

SKU: 9781259919657-SOLUTIONS

Chapter 2

Money Management Skills

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OVERVIEW OF THE CHAPTER

Successful money management is based on organized financial records, accurate personal financial statements, and effective budgeting. This chapter offers a discussion of the importance and type of financial documents followed by an explanation of the components and procedures for preparing personal financial statements—the balance sheet and the cash flow statement. Next, the chapter covers the basics of developing, implementing, and evaluating a budget. Finally, savings techniques for achieving financial goals are discussed.

2.1 A Successful Money Management Plan

LO: Identify the main components of wise money management.

Successful money management requires a coordination of personal financial records, personal financial statements, and budgeting activities. An organized system of financial records and documents should provide ease of access as well as security for financial documents that may be impossible to replace.

2.2 Personal Financial Statements

LO: Create a personal balance sheet and cash flow statement.

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

2.3 A Plan for Effective Budgeting

LO: Develop and implement a personal budget.

Every decision involves a trade-off with things given up. Personal opportunity costs include time, effort, and health. Financial opportunity costs are based on the time value of money. Future value and present value calculations enable you to measure the increased value (or lost interest) that results from a saving, investing, borrowing, or purchasing decision.

2.4 Money Management and Achieving Financial Goals

LO: Connect money management activities with saving for personal financial goals.

The relationship among the personal balance sheet, cash flow statement, and budget provides the basis for achieving long-term financial security. Future value and present value calculations may be used to compute the increased value of savings for achieving financial goals.

TEACHING RESOURCES

Section	Title
2.1: A Successful Money Management Plan	Top 5 Money Management Apps
	Money Management Tips
	Money Management Home Filing System
2.2: Personal Financial Statements	Creating a personal balance sheet
	Increasing your net worth
	Creating a Cash Flow Statement
	Debt-to-income ratio (Video)
	Supplemental Activity 1
2.3: A Plan for Effective Budgeting	Money Saving Hacks
	Reasons why people overspend
	Backward Budget
	Avoiding budget deficits
2.4: Money Management and Achieving Financial Goals	100 Little Savings Suggestions
	54 Ways to Save Money
	List of Savings Calculators
	How to Cut Your Grocery Budget in Half
	SupplementalActivity 2

2.1 A Successful Money Management Plan

Pages: 45 – 48
PowerPoint Slides 1 – 14

<u>Interactive Resources:</u>
Discussion Questions:
Describe some common money management mistakes that can cause long-term financial concerns?

Answer: Spending more than their income is the main mistake people make. In addition, the overuse of credit, impulse buying, and not monitoring spending are other concerns.

What do you believe are the major characteristics of an effective system to keep track of financial documents and records?

Answer: Students should be encouraged to point out that a system should be relatively simple, should allow quite access to items, and should be updated regularly.

Assignment: Have students suggest methods that could be used to organize and quickly access personal financial documents and records.

<u>Classroom Resources:</u>

How might money management apps result in better financial planning?
Top 5 Money Management Apps

Have students discuss how these money management tips might contribute to successful financial planning
Money Management Tips

Have students discuss methods they use for storing financial records and documents
Money Management Home Filing System

<u>Connect Resources:</u>

End of Chapter Problems (Static & Algorithmic)
Test Bank Problems (Static & Algorithmic)

Videos with assignable questions:
Where to Keep Personal Financial Records

Section 2.1 Key Concepts:

Money management refers to the day-to-day financial activities necessary to handle current personal economic resources while working toward long-term financial security.

Components of Money Management
Personal financial records, financial statements, and spending plans (budget) are the foundation for planning and implementing money management activities.

A System for Personal Financial Records
Organized money management requires a system of financial records including the following categories:

1. money management records
2. personal and employment records
3. tax records
4. financial services records
5. credit records
6. consumer purchase records
7. housing and automobile records
8. insurance records
9. investment records
10. estate planning and retirement records

Note: The *You Can Make a Difference* feature provides examples of organizations empowering people who are living in poverty through financial literacy.

Note: *Exhibit 2-1* provides an overview of a system and suggested locations for storing financial records.

Practice Quiz 2-1

1. What are the three major money management activities?

   The three major money management activities are (1) storing and maintaining financial records and documents, (2) creating personal financial statements, and (3) creating and implementing a budget. (p. 45)

2. What are the benefits of an organized system of financial records and documents?

   An organized system of financial records provides a basis for: (1) handling daily business activities, such as bill paying; (2) planning and measuring financial progress; (3) completing required tax reports; (4) making effective investment decisions; and (5) determining available resources for current and future spending. (pp. 46)

3. For each of the following records, check the column to indicate the length of time the item should be kept. “Short-time period” refers to less than five years.

Document	**Short time period**	**Longer-time period**
Credit card statements	X	
Mortgage documents		X
Receipts for furniture, clothing	X	
Retirement account information		X
Will		X

2.2 Personal Financial Statements

Pages: 48 – 54
PowerPoint Slides 15–24

Interactive Resources:
Discussion Questions:
What information does a cash flow statement provide that is not available on a personal balance sheet?

Answer: A cash flow statement measures the flow of cash in (Income) and out (spending), while the balance sheet measures total assets, liabilities, and net worth.

How might financial ratios be used when planning and implementing financial activities?

Answer: These ratios can be an indication of financial progress. Some should be high (such as savings ratio), while others should be low (debt-equity ratio).

Assignment: Have students list the various sources of income (cash inflows available for spending) of people in our society.

Classroom Resources:

Have students create a personal balance sheet based on their current financial situation
Creating a personal balance sheet

Which of these actions are currently most appropriate for students?
Increasing your net worth

What suggestions would you offer a person about creating a cash flow statement?
Creating a Cash Flow Statement

How does your debt-to-income ratio affect various personal financial decisions?
Debt-to-income ratio (Video)

Supplemental Activity 1

Connect Resources:

End of Chapter Problems (Static & Algorithmic)
Test Bank Problems (Static & Algorithmic)

Videos with assignable questions:
Creating a Personal Balance Sheet
Ratios for Evaluating Financial Progress

Section 2.2 Key Concepts:

- A personal balance sheet and cash flow statement provide information about a person's or household's current financial position and a summary of current income and spending.

Note: *Exhibit 2-2* (textbook page 49) explains the process for creating a balance sheet.

Your Personal Balance Sheet: The Starting Point

- A **balance sheet**, also known as a net worth statement, specifies what you own and what you owe.
  - Items of value minus amounts owed equals net worth.
- **Assets**, the first item on the balance sheet, are cash and other property that has a monetary value.
- **Liquid assets** are cash and items of value that can easily be converted into cash.
- **Real estate** includes a home, condominium, vacation property, or other land that a person or family owns.
- Personal possessions are the major portion of assets for most families.
- Investment assets consist of money set aside for long-term financial needs.
- **Liabilities** are amounts owed to others but do not include items not yet due, such as next month's rent.
- **Current liabilities** are debts that must be paid within a short time, usually less than a year.
- **Long-term liabilities** are debts that are not required to be paid in full until more than a year from now.
- Your **net worth** is the difference between your total assets and your total liabilities: Assets - Liabilities = Net worth
- The balance sheet of a business is usually expressed as: Assets = Liabilities + Net worth
- **Insolvency** is the inability to pay debts when they are due; it occurs when a person's liabilities far exceed his or her available assets.

Note: The *Money Minute Focus* feature provides an overview of the most commonly held asset types and asks students to think of others that someone may possess.

- A person or household experiences financial improvement if net worth increases over time.
- **Debt-equity ratio—**liabilities divided by net worth—may be used to indicate a person's financial situation; a low debt ratio is desired.
- **Current ratio**—liquid assets divided by current liabilities—how well a person will be able to pay upcoming debts.
- **Liquidity ratio**—liquid assets divided by monthly expenses—indicates the number of months that expenses can be paid if an emergency arises.
- **Debt-payment ratio**—monthly credit payments divided by take-home pay—provides an indication of how much of a person's earnings goes for debt payments (excluding a home mortgage).
- **Savings ratio**—amount saved each month divided by gross income—financial experts recommend a savings rate of about 10 percent.

Note: The *Figure It Out* feature (textbook page 51) allows the student to practice using the financial ratios discussed in this section.

Your Cash Flow Statement: Inflows and Outflows

- **Cash flow** is the actual inflow and outflow of cash during a given time period.
- A **cash flow statement** is a summary of cash receipts and payments for a given period, such as a month or a year.
- **Income** is the inflows of cash to an individual or a household. For most people, the main source of income is money received from a job.
- Cash payments for living expenses and other items make up the second component of a cash flow statement.
- **Fixed expenses** are payments that do not vary from month to month.
- **Variable expenses** are flexible payments that change from month to month.
- The difference between your income and your cash outflows can be either a positive (**surplus**) or negative (**deficit**) cash flow. A deficit exists if more cash goes out than comes in during a month. This amount must be made up by withdrawals from savings or borrowing.

Note: *Exhibit 2-3* (page 52) provides an overview of the process for creating a cash flow statement.

Practice Quiz 2-2

1. What are the main purposes of personal financial statements?

   (1) Report your current financial position in relation to the value of the items you own and the amounts you owe; (2) measure your progress toward your financial goals; (3) maintain information on your financial activities; (4) provide data that you can use when preparing tax forms or applying for credit.

2. What does a personal balance sheet tell you about your financial situation?

   A balance sheet consists of assets (items of value), liabilities (amounts owed to others), and net worth (the difference between the total assets and total liabilities.) (pp. 48-50)

3. For the following items, identify each as an asset (A), liability (L), cash inflow (CI), or cash outflow (CO):

__CO__ monthly rent
__CI__ interest on savings account
__A__ retirement account
__CO__ electric bill
__L__ automobile loan
__A__ collection of rare coins
__L__ mortgage amount
__A__ market value of automobile

4. Jan Franks has liquid assets of $6,300 and monthly expenses of $2,100. Based on the liquidity ratio, she has $\boxed{3}$ months in which living expenses could be paid if an emergency arises.

2.3 A Plan for Effective Budgeting

Pages: 54 – 59
PowerPoint Slides 25 – 33

Interactive Resources:
Discussion Questions:
Discuss how a budget might be changed if a household faced a decline in income. What spending areas might be reduced first?

Answer: This activity can help students better understand problems associated with money management and cash flow. In addition, students can obtain practical advice on coping with this situation. Opinions on this item will vary. Students should be ready to accept different points of views that reflect a person's life situation, goals, and personal values.

Assignment:Have students suggest common financial goals.

Classroom Resources:

Have students discuss how these actions could improve their budgeting activities.
Money Saving Hacks

How do these activities affect budgeting and long-term financial security?
Reasons why people overspend

Have students discuss the validity of the suggestions offered on this article.
Backward Budget

What actions might a household take when encountering a budget deficit?
Avoiding budget deficits

Connect Resources:

End of Chapter Problems (Static & Algorithmic)
Test Bank Problems (Static & Algorithmic)

Videos with assignable questions:
Budget Variances

Section 2.3 Key Concepts:

- A budget, or *spending plan*, is necessary for successful financial planning. The main purposes of a budget are to help you:
  1. live within your income
  2. spend your money wisely
  3. reach your financial goals
  4. prepare for financial emergencies
  5. develop wise financial management habits

- Budgeting may be viewed in seven main steps:
  1. Set financial goals
  2. Estimate income
  3. Budget an emergency funds and savings
  4. Budget fixed expenses
  5. Budget variable expenses
  6. Record spending amounts
  7. Review spending and saving patterns

Step 1. Set Financial Goals

- Financial goals are plans for future activities that require you to plan spending, savings, and investing.
- How much you budget for various items will depend on current needs and plans for the future. Sources that can assist with planning your spending include:
  - your cash flow statement
  - sample budgets from government reports
  - articles in personal financial planning magazines
  - estimates of future income and expected inflation

Step 2. Estimate Income

- Available money should be estimated for a given time period—such as a month.
- Income variations (due to seasonal work or sales commissions) should be based on the recent past and realistic expectations.

Note: The *Money Minute Focus* feature introduces readers to a common rule of thumb of money management: the 50/30/20 rule, which suggests that 50% of income should go to necessities, 30% for wants, and 20% for savings.

Step 3. Budget an Emergency Fund and Savings

- An emergency fund and savings for irregular payments should be first set aside to avoid not having anything left for savings.

Note: *Exhibit 2-6* provides suggested budget allocations for different life situations.

Step 4. Budget Fixed Expenses

- Definite obligations (rent, mortgage, and credit payments) should be allocated first.
- Assigning amounts to spending categories can be based on your cash flow statement, government data, current magazine articles, and estimates of future income and expenses.
- A "spending diary" of past expenses can also assist with this task.

Step 5. Budget Variable Expenses

- Planning for variable expenses is more difficult than fixed expenses.
- These expenses will fluctuate based on household situation, time of the year, health, economic conditions, and other factors.

Step 6. Record Spending Amounts

- A **budget variance** is the difference between amount budgeted and the actual amount received or spent. A **deficit** exists when actual spending exceeds planned spending. A **surplus** is when actual spending is less than planned spending.

Step 7. Review Spending and Saving Patterns

- The results of your budget may be obvious—having extra cash, falling behind in payments. Or the results may need to be reviewed in detail to determine areas of needed changes. The most common overspending areas are entertainment and food, especially away-from-home meals.
- At this point of the budgeting process, you should also evaluate, reassess, and revise your financial goals.

Successful Budgeting

- A successful budget should be:
  - well-planned
  - realistic
  - flexible
  - clearly communicated

Selecting a Budgeting System

Commonly used budgeting systems are: mental, physical, written, and computerized.

Note: The *Financial Literacy in Practice* box suggests guidelines for a SWOT analysis for money management activities and budgeting.

Note: The *Money Minute Focus* feature lists several ways that most households can increase savings by making small changes.

Practice Quiz 2-3

1. What are the main purposes of a budget?

   The main purposes of a budget are to help you: (1) live within your income; (2) spend your money wisely; (3) reach your financial goals; (4) prepare for financial emergencies; and (5) develop wise financial management habits. (p. 54)

2. How does a person's life situation affect goal setting and amounts allocated for various budget categories?

   Different life situations will affect household goals and plans for spending based on needs and desires of those involved. Delayed marriage might mean more spending for travel and leisure; deferred parenthood might be due to plans for advanced career training and returning to school; divorce will affect housing size needs and could mean child care expenses.

3. For each of the following household expenses, indicate if the item is FIXED expense or a VARIABLE expense.

VARIABLE	food away from home	FIXED	cable television
FIXED	Rent	VARIABLE	electricity
FIXED	health insurance premium	VARIABLE	auto repairs

4. The Nollin family has budgeted expenses for a month of $4,560 and actual spending of $4,480.

   This would result in a budget SURPLUS or DEFICIT (circle one) of $ 80

2.4 Money Management and Achieving Financial Goals

Pages: 60 – 62
PowerPoint Slides 34–38

Interactive Resources:
Discussion Questions:
What are common reasons that hold people back from saving regularly?

Answer:
- *individuals without specific savings goals*
- *people who always seem to use up savings for unexpected expenses*
- *those who overuse credit*
- *individuals who lack common financial goals with other family members*

Assignment: Have students allocate budget categories (using percentages) for different household situations.

Classroom Resources:

Which of these suggestions might you start using right away?
100 Little Savings Suggestions

Have students survey friends to determine which of these actions might be commonly used
54 Ways to Save Money

Have students select one of these savings calculators and report on its use to the class
List of Savings Calculators

Ask students to evaluate these wise spending actions
How to Cut Your Grocery Budget in Half

Supplemental Activity 2

Connect Resources:

End of Chapter Problems (Static & Algorithmic)
Test Bank Problems (Static & Algorithmic)

Section 2.4 Key Concepts:

- Personal financial statements and a budget help achieve financial goals with
  1. the balance sheet reporting current financial position—*where you are now*.
  2. the cash flow statement: telling what was *received and spent over the past month*.
  3. a budget for *planning spending and saving to achieve financial goals*.
- People commonly prepare a balance sheet on a periodic basis, such as every three or six months. Between those points in time, a budget and cash flow statement help plan and measure spending and saving activities.

Selecting a Savings Technique

- Since most people find saving difficult, financial advisers suggest several methods:
  - write a check each payday and deposit it in a distant financial institution
  - use payroll deduction, direct deposit
  - save coins
  - spend less on certain items

Note: The *Money Minute Focus* feature mentions a few apps that can help with financial tasks and concerns.

Calculating Savings Amounts

- To achieve financial objectives, you should convert your savings goals into specific amounts.
- Your use of an interest-earning savings plan is vital to the growth of your money and the achievement of your financial goals.

Note: The *From the Pages of Kiplinger's Personal Finance* feature (textbook page 61) presents an article on budgeting and how to use a budgeting to track spending.

Note: *Exhibit 2-7* (textbook page 62) shows the relationship between a financial goal, saving method, interest rates, and money saved.

Practice Quiz 2-4

1. What relationship exists among personal financial statements, budgeting, and achieving financial goals?

   The balance sheet and cash flow statement provide information about a person's current financial situation. These allow a person to plan his or her budget to set spending and saving plans that relate to achieving financial goals.

2. What are some suggested methods to make saving easy? What are long-term effects of low savings for both individuals and the economy of a country

   Low savings for individuals will result in not having funds available for emergencies and poor long-term financial security. For the economy, a low savings/investment rate will limit the funds available for use by companies to expand and create jobs.

3. If you wanted to obtain the following information, check the box for the document that would be most useful.

Financial information needed	**Balance sheet**	**Cash flow statement**	**Budget**
Amounts owed for medical expenses	X		
Spending patterns for the past few months		X	
Planned spending patterns for the next month			X
Current value of investment accounts	X		
Amounts to deposit in savings accounts			X

Concluding Activities

- Discuss "Your Personal Finance Dashboard" and possible financial planning actions.
- Point out the chapter summary and key terms in the text margin.
- Assign and discuss selected end-of-chapter Problems, Questions, Real Life Personal Finance Case, and Continuing Case.
- Encourage students to maintain a "Daily Spending Diary"
- Discuss "Your Personal Financial Plan" worksheets.
- Use the Chapter Quiz in the *Instructor's Manual*.

CHAPTER 2 QUIZ ANSWERS

True-False	*Multiple Choice*
1. F (p. 46)	6. A (p. 54)
2. T (p. 48)	7. C (p. 49)
3. F (pp. 49-50)	8. D (p. 50)
4. T (p. 51)	9. B (p. 52)
5. T (p. 57)	10. B (p. 55)

Name ________________________________ Date ______________________

CHAPTER 2 QUIZ
TRUE- FALSE

_____1. Most financial records should be kept in a safe-deposit box.

_____2. A personal balance sheet reports the financial position of a person or family on a given date.

_____3. Assets represent amounts owed to others that must be paid within the next year.

_____4. Spending less than your income will increase net worth.

_____5. A budget deficit exists when actual spending exceeds projected spending.

MULTIPLE CHOICE

_____6. A(n) __________ is a specific plan for spending.
a. budget
b. balance sheet
c. income statement
d. bank statement

_____7. An example of a liquid asset would be
a. a home.
b. an automobile.
c. a checking account.
d. retirement account.

_____8. __________ represents amounts owed to others.
a. Current assets
b. Expenses
c. Mutual funds
d. Liabilities

_____9. A personal cash flow statement presents
a. amounts earned from savings.
b. income and payments.
c. assets and liabilities.
d. amounts owed to others.

_____10. Definite financial obligations are referred to as
a. variable expenses.
b. fixed expenses.
c. equity.
d. Liquid assets.

Supplemental Activity 1

Financial Ratios to Measure and Evaluate Financial Progress

Type	Calculations	Example
A. Debt-equity ratio	liabilities divided by net worth	$50,000/$40,000 = 1.25

Interpretation: These items express the relationship between your debts and personal net worth. A lower debt ratio is desired.

B. Current ratio	liquid assets divided by current liabilities	$7,000/$4,000 = 1.75

Interpretation: Indicates how well you will be able to pay upcoming debts. A higher number is more desirable.

C. Liquidity ratio	liquid assets divided by monthly expenses	$7,000/$2,800 = 2.5

Interpretation: Indicates the number of months a person will be able to pay expenses if an emergency situation arises. Again, a higher number is desired especially if uncertainty exists regarding continual employment.

D. Solvency ratio	total assets divided by total liabilities	$98,000/$67,000 = 1.46

Interpretation: Shows the relationship between the value of assets and what is owed. A higher number is desired.

E. Debt Payments ratio	monthly credit payments divided by monthly take	$450/$2,500 = 0.18

Interpretation: Expresses portion of monthly earnings going for credit payments. A lower ratio is desired.

F. Savings ratio	additions to savings plans divided by take-home pay	$2,080/$32,800 = 0.065

Interpretation: Presents the portion of annual earnings that has been saved.

G. Investment assets ratio	investment assets divided by net worth	\$77,000/\$101,000 = 0.76

Interpretation: Indicates portion of net worth that contributes to long-term financial goals.

Supplemental Activity 2

Money Management Troubles and Debt

Difficult economic conditions often createdifficult personal financial situations, often in the form of increased debt.

The process of getting out of debt mayinclude actions to:

- Evaluate your credit situation
- Track your spending
- Plan to make payments on time
- Consider other income sources
- If appropriate, seek assistance

PROBLEMS

1. Based on the following data, determine the amount of total assets, total liabilities, and net worth. (LO 2.2)

Liquid assets, $3,870	Investment assets, $8,340
Current liabilities, $2,670	Household assets, $87,890
Long-term liabilities, $76,230	

a. Total assets $________________

b. Total liabilities $______________

c. Net worth $__________________

Total assets = $100,100 ($3,870 + 8,340 + 87,890)
Total liabilities = $78,900 ($2,670 + $76,230)
Net worth = $21,200 ($100,100 - $78,900)

2. Using the following balance sheet items and amounts, calculate the total liquid assets and total current liabilities: (LO 2.2)

Money market account $2,600	Medical bills $262
Mortgage $158,000	Checking account $780
Retirement account $87,400	Credit card balance $489

a. Total liquid assets $\boxed{\$3,380}$

b, Total current liabilities $\boxed{\$751}$

3. Use the following items to determine the total assets, total liabilities, net worth, total cash inflows, and total cash outflows. (LO 2.2)

Rent for the month, $650	Monthly take-home salary, $2,185
Spending for food, $345	Cash in checking account, $450
Savings account balance, $1,890	Balance of educational loan, $2,160
Current value of automobile, $8,800	Telephone bill paid for month, $65
Credit card balance, $235	Loan payment, $80
Auto insurance, $230	Household possessions, $3,400
Video equipment, $2,350	Payment for electricity, $90
Lunches/parking at work, $180	Donations, $160
Personal computer, $1,200	Value of stock investment, $860
Clothing purchase, $110	Restaurant spending, $130

a. Total assets = \$18,950 (\$450 + 1,890 + 8,800 + 2,350 + 1,200 + 3,400 + 860)

b. Total liabilities = \$2,395 (\$235 + \$2,160)

e. Net worth = \$16,555 (\$18,950 - \$2,395)

f. Total cash inflows = \$2,235

g. Total cash outflows = \$2,040 (\$650 + 345 + 230 + 180 + 110 + 65 + 80 + 90 + 160 + 130)

4. For each of the following situations, compute the missing amount. (LO 2.2)

a. Assets \$65,000; liabilities \$18,000; net worth $\boxed{\$47,000}$

b. Assets \$86,500; liabilities $\boxed{\$67,800}$; net worth \$18,700

c. Assets \$34,280; liabilities \$12,965; net worth $\boxed{\$21,315}$

d. Assets $\boxed{\$90,999}$; liabilities \$38,345; net worth \$52,654

5. Based on this financial data, calculate the ratios requested: (LO 2.2)

Liabilities, \$7,800
Liquid assets, \$4,600
Monthly credit payments, \$640
Monthly savings, \$130

Net worth, \$58,000
Current liabilities, \$1,300
Take-home pay, \$2,575
Gross income, \$2,850

a. Debt ratio $\boxed{7,800/58,000 = 0.134}$

b. Current ratio $\boxed{4,600/1,300 = 3.54}$

c. Debt-payments ratio $\boxed{640/2,575 = 0.2485}$

d. Savings ratio $\boxed{130/2,850 = 0.046}$

6. The Fram family has liabilities of \$128,000 and a net worth of \$340,000. What is the debt ratio? How would you assess this? (LO 2.2)

\$128,000 / \$340,000 = .376 represents a ratio of less than 40 percent, which would need to be assessed in relation to previous trends and the ratio of comparable households.

7. Carl Lester has liquid assets of $2,680 and current liabilities of $2,436. What is his current ratio? What comments do you have about this financial position? (LO 2.2)

$2,680 / $2,436 = 1.1, which could be viewed as lower than would be desirable.

8. For the following situations, calculate the cash surplus or deficit: (LO 2.2)

Cash Inflows	Cash Outflows		Difference (surplus or deficit)	
$3,460	$3,306	=	$154	surplus
$4,693	$4,803	=	$110	deficit
$4,287	$4,218	=	$69	surplus

9. The Brandon household has a monthly income of $5,630 on which to base their budget. They plan to save 10 percent and spend 32 percent on fixed expenses and 56 percent on variable expenses. (LO 2.3)

a. What amount do they plan to set aside for each major budget section?

Savings	$ 563
Fixed Expenses	$1,801.60
Variable Expenses	$3,152.80

b. After setting aside these amounts, what amount would remain for additional savings or for paying off debts?

$112.60

10. Fran Powers created the following budget and reported the actual spending listed. Calculate the variance for each of these categories, and indicate whether it was a *deficit* or a *surplus.* (LO 2.3)

Item	Budgeted	Actual	Variance	Deficit/Surplus
Food	$360	$298	________	________
Transportation	320	334	________	________
Housing	950	982	________	________
Clothing	110	134	________	________
Personal	275	231	________	________

Food $62 surplus; transportation $14 deficit; housing $32 deficit; clothing $24 deficit; personal expenses $44 surplus.

11. Use future value and present value calculations (see tables in the appendix for Chapter 1) to determine the following: (LO 2.4)

a. The future value of a $600 savings deposit after eight years at an annual interest rate of 6 percent.

$600 × 1.594 = $956.40

b. The future value of saving $1,800 a year for five years at an annual interest rate of 5 percent.

$1,800 × 5.526 = $ 9,946.80

c. The present value of a $2,000 savings account that will earn 3 percent interest for four years.

$2,000 × 0.885 = $1,770

12. Brenda plans to reduce her spending by $50 a month. What would be the future value of this reduced saving over the next 10 years? (Assume an annual deposit to her savings account, and an annual interest rate of 3 percent.) (LO 2.4)

$50 X 12 = $600 X 11.464 (future value of annuity) = $6,878.40

13. Kara George received a $5,000 gift for graduation for her uncle. If she deposits this in a account paying 3 percent, what will be the value of this gift in 12 years? (LO 2.4)

$5,000 X 1.426 = $7,130

APPLY YOURSELF FOR FINANCIAL LITERACY

1. Talk to two or three people regarding wise and poor money management actions they have taken in their lives. Also, ask about the system they use to keep track of their financial documents and records. Based on this information, develop a recordkeeping system for your financial documents as shown in Exhibit 2-1. (LO2.1)

Answers will vary.

2. (a) Prepare a balanced sheet and a cash flow statement on a regular basis to monitor your financial situations and progress (see the “Personal Financial Statements” section). (b) Use online research to obtain information about the assets commonly held by households in the United States. How have the values of assets, liabilities, and net worth of U.S. consumers changed in recent years? (LO2.2)

Answers will vary.

3. Conduct research to identify various budgeting and money management apps. Determine the features, ease of operation, and information provided by these apps. Which app would you consider using for your budgeting and money management activities? (LO2.3)

Answers will vary.

4. Create a visual representation for the steps of the budgeting process using photos or a video format. (LO2.3)

Answers will vary.

5. Talk to a young single person, a young couple, and a middle-aged person about their financial goals and saving habits. What actions do they take to determine and achieve various financial goals? (LO2.4)

Answers will vary.

6. Develop a regular savings plan to set aside some amount each week. Start small… but save something. For savings ideas, go to www.americasaves.org or www.choosetosave.org. (LO2.4)

Answers will vary.

Real Life Personal Finance

1. What situations might have created the budget deficit for the Constantine family?

Possible answers include: a lack of planning, not monitoring spending actions, not setting financial goals, and unexpected expenses due to an emergency or other circumstances.

2. What amounts would you suggest for the various categories for the family budget?

While student answers will vary, some suggested actions might include reduced spending in certain areas (food away from home, cable and internet, and more careful spending for groceries) along with a revised budget and perhaps actions to increased household income.

3. Describe additional actions for the Constantine family related to their budget or other money management activities.

Possible answers might include: involve all family members in the budgeting process, assessing current and future insurance needs, setting financial goals and regular savings to achieve those goals.

Continuing Case

1. According to the text, a personal balance sheet is a statement of your net worth. It is an accounting of what you own as well as what you owe.
Using the information provided, prepare a personal balance sheet for Jamie Lee.

The formula for a personal balance sheet (as seen on page 49) is as follows:

Items of Value (*what you own*) **-Amounts owed** (*what you owe*) = **Your net worth** (*your wealth*)

ASSETS (WHAT YOU OWN)	MINUS	LIABILITIES (WHAT YOU OWE)	= NET WORTH (YOUR WEALTH)
CHECKING ACCOUNT: $1,250		STUDENT LOAN: $5,400	
EMERGENCY FUND SAVINGS ACCOUNT: $3,100		CREDIT CARD BALANCE: $400	
CAR: $4,000			
$8,350	-	$5,800	= $2,550

Jamie Lee has a positive net worth of $2,550.
2. Using the table found in *Ratios for Evaluating Financial Progress* on page 51, what is Jamie Lee's debt ratio?

When comparing Jamie Lee's liabilities and her net worth, is the relationship a favorable one?

The formula for calculating her debt ratio is as follows:

Liabilities/Net Worth = Debt Ratio
$5,800 / $2,550 = 2.27

Jamie Lee's debt ratio is 2.27.
No, it is not a favorable relationship; her liabilities are over twice as much as her net worth.

3. Using the table found in *Ratios for Evaluating Financial Progress* on page 51, what is Jamie Lee's savings ratio?
Using the rule of thumb recommended by financial experts, is she saving enough?

The formula for calculating her savings ratio is as follows:

Amount Saved Each Month/ Gross Income = Savings Ratio
$175/ $2,125 = 0.08

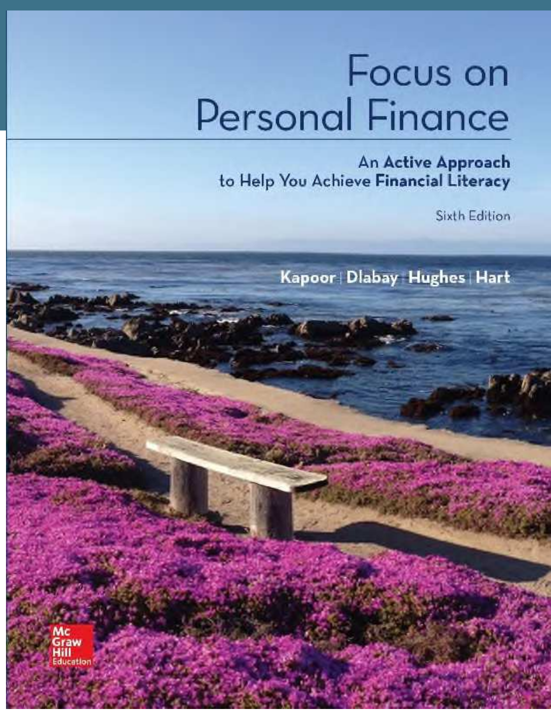
Jamie Lee's savings ratio is .08 or 8%.
The amount to deposit in to savings per month, as recommended by financial experts, is between 5% and 10% of the gross income amount.
Jamie is saving 8% of her gross income amount, so she is in an optimal range.

4. Using Exhibit 2-6: *Typical After-Tax Budget Allocations for Different Life Situations* found on page 57, calculate the budget allocations for Jamie Lee, using her Net Monthly Salary (or After-tax Salary) amount.
Is she within the recommended parameters for a student?

BUDGET CATEGORY	RECOMMENDATION % FOR STUDENT	JAMIE LEE'S AMOUNT	WITHIN RECOMMENDED PARAMETERS?
HOUSING (RENT, UTILITIES)	0-25%	($275+$175)/$1,560 = 25%	YES
TRANSPORTATION	5-10%	$100/$1,560 = 6%	YES
ENTERTAINMENT AND RECREATION	5-10%	$85/$1,560 = 5%	YES
SAVINGS	0-10%	$175/$1,560 = 11%	NO

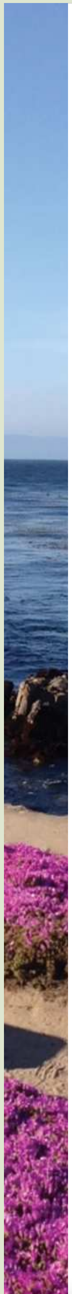
Jamie Lee is within all the recommended parameter set for a student life situation in the budget categories of housing, transportation, entertainment, and savings. Her savings is slightly over the recommendation of 10%, with her ratio calculating at 11%.

Note: These calculations use after tax (Net Monthly Salary) amounts versus other ratios shown in the text that utilize gross monthly amounts.



Chapter 2

Money Management Skills



Money Management Skills
Chapter Learning Objectives

LO2.1 Identify the main components of wise money management.

LO2.2 Create a personal balance sheet and cash flow statement.

LO2.3 Develop and implement a personal budget.

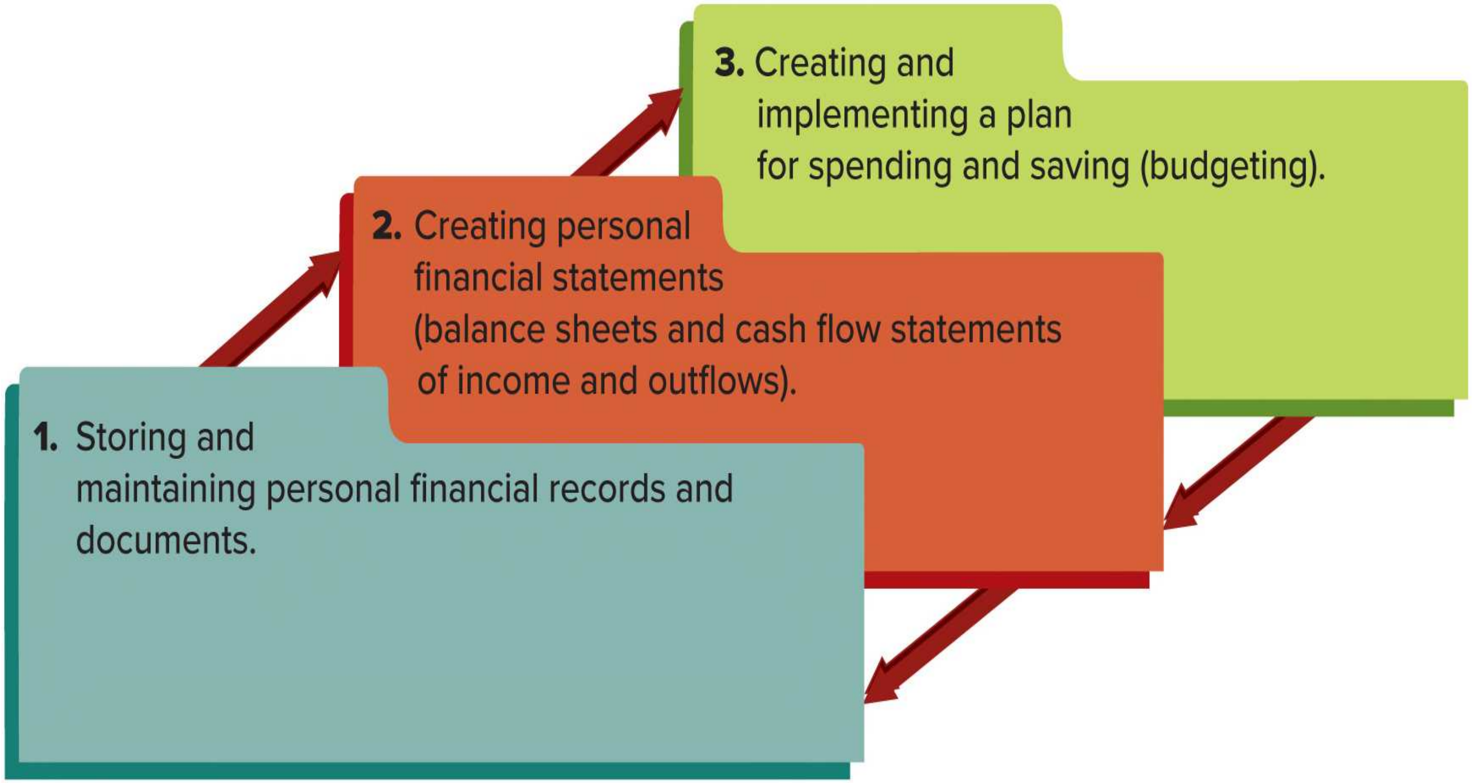
LO2.4 Connect money management activities with saving for personal financial goals.

A Successful Money Management Plan

LO2.1

- Daily spending and saving decisions are central to financial planning.
    - Must be coordinated with needs, goals, and personal situations
- **Money management** refers to the day-to-day financial activities necessary to manage current personal economic resources, while working toward long-term financial security.

Components of Money Management



Components of Money Management, continued

- **Personal financial records and documents** help you plan the use of your resources.
  - Provide written evidence of business transactions, ownership of property, and legal matters
- **Personal financial statements** measure and guide your financial position and progress.
- Your spending plan, or **budget**, is the basis for effective money management.

A System for Personal Financial Records

- Provides a basis for:
  - Handling daily business affairs, such as bill paying
  - Planning and measuring financial progress
  - Completing required tax reports
  - Making effective investment decisions
  - Determining available resources for current and future buying

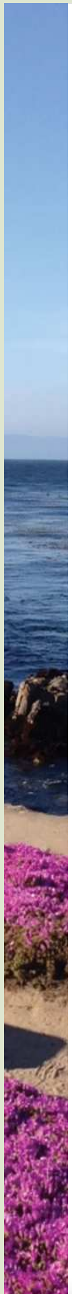
Records in Your Home File

Items you refer to often, including:

- Personal and employment records
- Money management records
- Tax records
- Financial services records
- Credit records
- Consumer purchase and auto records
- Housing records
- Insurance records
- Investment records
- Estate planning and retirement records

How Long Should Records be Kept?

Records	Retention Period
Birth certificates, wills, and Social Security information	Permanently
Personal property and investments	As long as you own them
Documents re: purchase and sale of real estate	Indefinitely
Copies of tax returns and supporting data	At least 7 years; 10 years is better



Safe Deposit Box

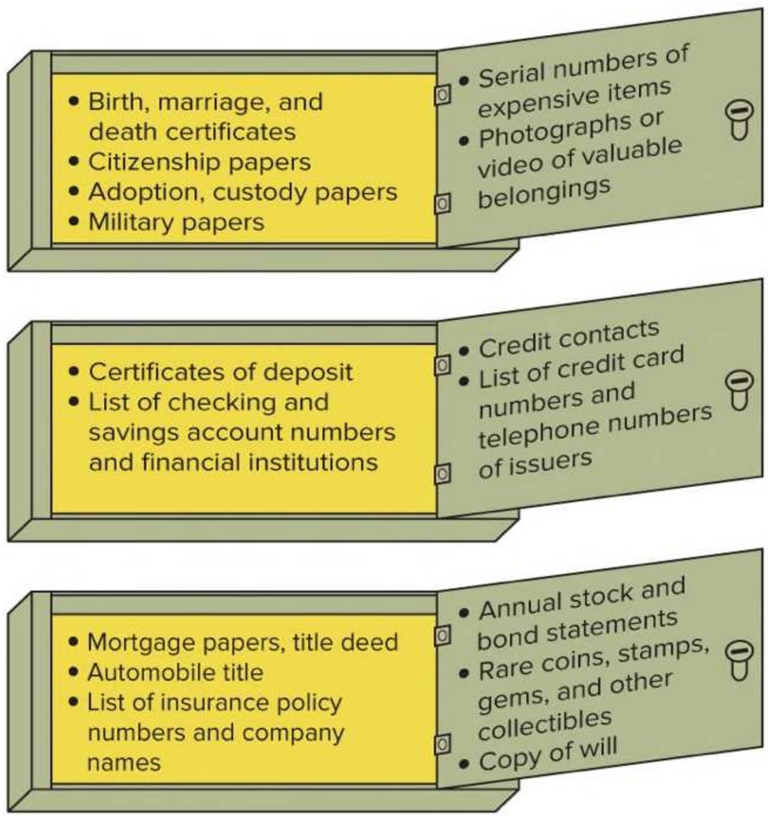
Private storage area at a financial institution with maximum security for valuables and difficult-to-replace documents

Houses records and items that would be hard to replace, such as:

- Birth, marriage, wills, and death certificates
- List of checking, savings, and financial institution account numbers
- Citizenship and military papers
- Adoption and custody papers
- Serial numbers and photos of valuables
- CDs and credit and banking account numbers
- Mortgage papers and titles
- List of insurance policy numbers
- Stock and bond certificates
- Coins and other collectibles

What to Keep in a Safe Deposit Box or Fireproof Home Safe

Safe Deposit Box or Fireproof Home Safe



Keeping Computer Records Safe

As more documents are provided electronically and people are storing financial records "in the cloud," consider the following actions:

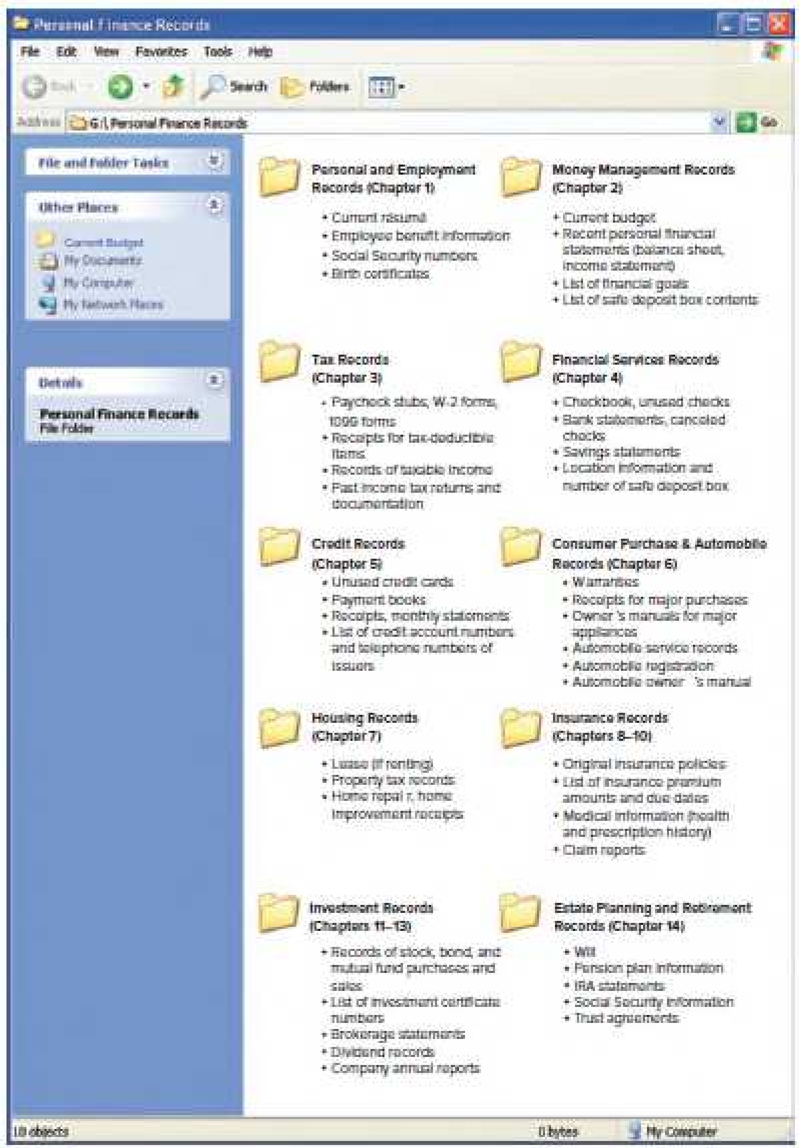
- Download copies of all statements and forms to local storage and use logical filenames and folders.
- Back up files externally or online.
- Secure data with complex passwords or encryption.
- Scan copies of documents.
  - Hard copies of some documents may be required.
- Completely erase files.

Records on Your Personal Computer*

- Current and past budgets
- Summary of checks written and other banking transactions
- Past income tax returns
- Account summaries, performance results of investments
- Digital versions of wills, estate plans, and other documents

* Keep a backup!

Records on Your Personal Computer



What NOT to Keep and What to Shred

Personal Financial Statements
LO2.2

The main purposes of personal financial statements are to:

1. Report your current financial position
2. Measure your progress toward financial goals
3. Maintain information about your financial activities
4. Provide data for preparing tax forms or applying for credit

Your Personal Balance Sheet:
The Starting Point

A **balance sheet** is a financial statement that reports what an individual or family owns and owes as of a specific date.

- Also called:
  - ***Net worth statement***
  - ***Statement of financial position***

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

Creating a Personal Balance Sheet

- **Step 1 – List items of value**
  - Liquid assets
  - Real estate
  - Personal possessions
  - Investment assets
- **Step 2 – Determine amounts owed**
  - Current liabilities (liabilities = amounts owed to others)
    - Debts that must be paid within a short time, usually a year
  - Long term liabilities
    - Debts that are not required to be paid in full for more than a year
- **Step 3 - Compute your net worth**

Sample Balance Sheet

Exhibit 2-2

Exhibit **2–2** Creating a Personal Balance Sheet

Step 1

Total all items of value (assets). Include amounts in bank accounts, investments, and the cost (or estimated current value) of your possessions.

Step 2

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

Step 3

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

Sandra and Mark Scott
Personal Balance Sheet as of October 31, 2019

Assets		
Liquid Assets		
Checking account balance (Chap. 4)	$ 1,450	
Savings/money market accounts (Chap. 4)	5,235	
Cash value of life insurance (Chap. 10)	3,685	
Total liquid assets		$ 10,370
Real Estate		
Current market value of home (Chap. 7)		$ 189,900
Personal Possessions		
Market value of automobile	8,000	
Furniture and appliances	5,900	
Home entertainment system	2,600	
Home computer	1,400	
Jewelry	2,200	
Total household assets		$ 20,100
Investment Assets (Chaps. 11–13)		
Retirement accounts (Chap. 14)	26,780	
Mutual funds (Chap. 12)	11,890	
Total investment assets		38,670
Total assets		$ 259,040
Liabilities		
Current Liabilities		
Medical bills (Chap. 9)	$ 150	
Charge account and credit card balances (Chap. 5)	3,340	
Balance due on auto loan	1,750	
Total current liabilities		$ 5,240
Long-Term Liabilities		
Mortgage (Chap. 7)	91,600	
Home improvement loan (Chap. 5)	1,760	
Student loan	1,200	
Total long-term liabilities		94,560
Total liabilities		$ 99,800
Net worth (assets minus liabilities)		$ 159,240

Net Worth, Assets, and Insolvency

Assets - Liabilities = Net Worth

- Measurement of current financial position
- Net worth ≠ cash available
- The amount you would have left if all assets were sold for the listed values and all debts were paid in full

Assets = Liabilities + Net worth

- **Insolvency**:
  - Inability to pay debts when due
  - Liabilities far exceed assets

Ways to Increase Net Worth

- Increase savings
- Reduce spending
- Increase the value of investments and other possessions
- Reduce amounts owed

The Cash Flow Statement

- **Cash flow** is the actual inflow and outflow of cash during a given time period.
- **Cash flow statement** is also known as a *personal income and expenditure statement.*
  - Summary of cash receipts and payments for a given period

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

The Cash Flow Statement
Inflows and Outflows

- **Inflows** are deposits made into your account.
- **Outflows** include:
  - Checks written
  - Cash withdrawals
  - Debit card payments

Creating a Cash Flow Statement

Step 1 – Record Income

- **Income** is the the inflows of cash for an individual or a household.
  - **Take-home**, or *net pay*, is earnings after deductions for taxes and other items; also called *disposable income.*
  - **Discretionary income** is money left over after paying for housing, food, and other necessities.
  - Other income
    - Commissions, self-employment income, interest, dividends, gifts, grants, scholarships, government payments, pensions, retirement income, alimony, and child support

Step 2 – Record cash outflows

  - *Fixed* and *variable* expenses

Step 3 – Determine Net Cash Flow

  - Use this statement as a basis for creating a spending, saving and investment plan.

Sample Cash Flow Statement

Exhibit 2-3

Exhibit 2–3 Creating a Cash Flow Statement

Step 1

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

Step 2

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

Step 3

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

Kim Walker
Cash Flow Statement for the Month Ended September 30, 2019

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

A Plan for Effective Budgeting
LO2.3

- **Budget**, or *spending plan*, is necessary for successful financial planning.
- Helps you:
  - Live within your income
  - Spend money wisely
  - Reach financial goals
  - Prepare for financial emergencies
  - Develop wise financial management habits

Developing a Monthly Budget

Step 1: Set Financial Goals

Step 2: Estimate Income

Step 3: Budget an Emergency Fund and Savings

Step 4: Budget Fixed Expenses

Step 5: Budget Variable Expenses

Step 6: Record Spending Amounts

Step 7: Review Spending and Saving Patterns

- Review financial progress
- Revise goals and budget allocations

Ratios for Evaluating Financial Progress

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

Common Financial Goals
Exhibit 2-4

Personal Situation	Short-Term Goals (less than 2 years)	Intermediate Goals (2–5 years)	Long-Term Goals (over 5 years)
Single person	• Complete college • Pay off auto loan	• Take a vacation to Europe • Pay off education loan • Attend graduate school	• Buy a vacation home in the mountains • Provide for retirement income
Married couple (no children)	• Take an annual vacation • Buy a new car	• Remodel home • Build a stock portfolio	• Buy a retirement home • Provide for retirement income
Parent (young children)	• Increase life insurance • Increase savings	• Increase investments • Buy a new car	• Accumulate a college fund for children • Move to a larger home

Exhibit 2–4 Common Financial Goals

Developing a Monthly Budget

Exhibit 2-5

Exhibit 2–5 Developing a Monthly Budget

Step 1
Set financial goals.

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

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

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

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

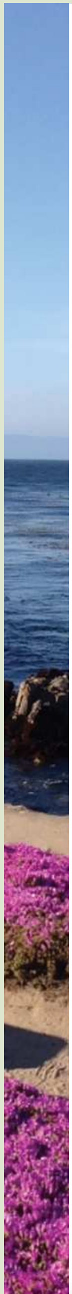
Step 6
Record actual amounts for inflows and outflows. Compare actual amounts with budgeted amounts to determine variances.

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

Monthly Budget for the Robinson Family

Financial goals
• reduce credit card debt
• increase amount in emergency fund

	Budgeted Amounts (dollars)	(percent)	Actual Amounts	Variance
Projected Inflows (income)				
Salary	2874	100	2874	–
Projected Outflows (disbursements)				
Emergency Fund and Savings:				
Emergency fund savings	115	4	115	–
Savings for auto insurance	29	1	29	–
Savings for vacation	57	2	57	–
Savings for investments	57	2	57	–
Total savings	258	9	258	–
Fixed Expenses				
Mortgage payment	518	18	518	–
Property taxes	115	4	115	–
Auto loan payment	144	5	144	–
Life insurance	29	1	29	–
Total fixed expenses	806	28	806	–
Variable expenses				
Food	402	14	417	–15
Utilities (telephone, heat, electric, water)	172	6	164	+8
Clothing	116	4	93	+23
Transportation (automobile operation, repairs, public transportation)	460	16	471	–11
Personal and health care	172	6	163	+9
Entertainment	172	6	201	–29
Reading, education	86	3	78	+8
Gifts, donations	144	5	150	–6
Personal allowances, miscellaneous expenses	86	3	90	–4
Total variable expenses	1,810	63	1,827	–17
Total outflow	2,874	100	2,891	–17



Typical Budget Allocations

Exhibit 2-6

Exhibit 2–6 Typical After-Tax Budget Allocations for Different Life Situations

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

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

A Money Management SWOT Analysis

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

Characteristics of a Successful Budget

- Well planned
- Realistic
- Flexible
- Clearly communicated

Selecting a Budgeting System

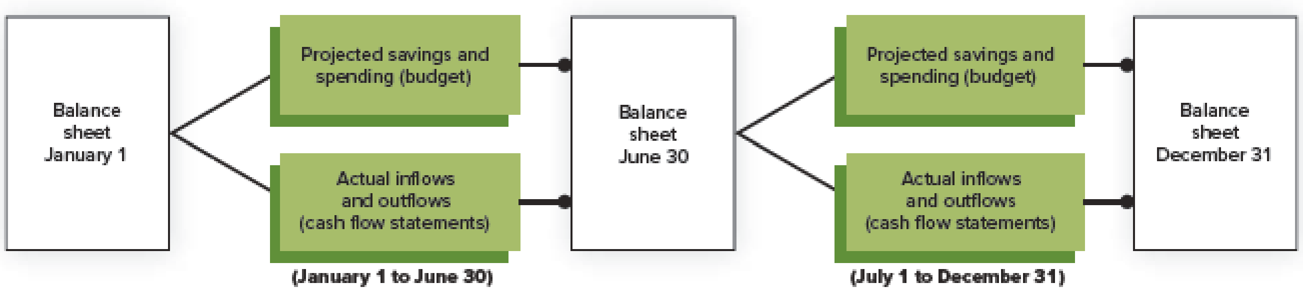
- **Mental Budget**
  - Appropriate if financial resources and responsibilities are limited
- **Physical Budget**
  - Envelopes, folders, or containers
- **Written Budget**
  - On paper (ex. notebook or multicolumn accounting paper)
- **Computerized Budget**
  - Spreadsheet or specialized software

Money Management and Achieving Financial Goals
LO2.4

1. **Your Balance Sheet**:
   - Snapshot of where you are now
2. **Your Cash Flow Statement**:
   - What you received and spent over a specific period
3. **Your Budget**:
   - Planning spending and saving to achieve financial goals

Changes in Net Worth

- Changes in Net Worth result from cash inflows and outflows.
  - Outflows > Inflows
    - Draw from savings or borrow (buy on credit)
    - Problem/Result: Lower assets or higher liabilities
  - Inflows > Outflows
    - Put money into savings or pay off debts
    - Result: Higher net worth



Selecting a Saving Technique

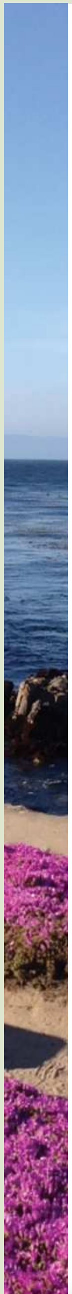
1. Write a check each payday, or electronic transfer, to deposit in a savings account.

2. Use payroll deduction to deposit a certain amount in savings (direct deposit).

3. Save coins or spend less on certain items.
   - Example: Bring lunch instead of buying and put money saved into a savings or investment account.

Calculating Savings Amounts

1. Convert savings goals into specific amounts.
2. Use savings and investments plans to grow your money.
3. Use time value of money to calculate progress toward financial goals.



Using Savings to Achieve Financial Goals

Exhibit 2–7 Using Savings to Achieve Financial Goals

Financial Goal	Saving Method	Annual Interest Rate	Savings Balance after:		
			2 years	**5 years**	**10 years**
Set aside $6,000 for unexpected expenses and financial emergencies	A single deposit from past savings	7%	$6,870*	$8,418	$11,802
Save for retirement living expenses	Deposit $2,000 a year	8%	$4,160**	$11,734	$28,974☆
Save for a down payment to purchase a home	Deposit $200 every three months	12%	$1,778†	$5,374	$15,080

* Based on the future value of $1 tables in Chapter 1 and Chapter 1 Appendix.
** Based on the future value of a series of deposits tables in Chapter 1 and Chapter 1 Appendix.
☆ With annual $2,000 deposits, this same retirement account would grow to over $500,000 in 40 years.
† Based on quarterly compounding, explained in Chapter 4.

Chapter Summary

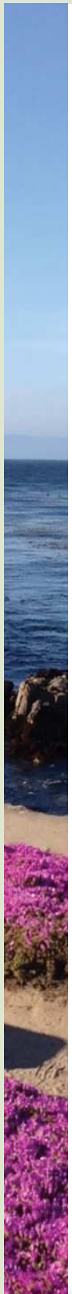
LO2.1: Identify the main components of wise money management.

- Successful money management requires coordination of personal financial records, personal financial statements, and budgeting activities.
- An organized system of financial records and documents should provide ease of access as well as security for financial documents that may be impossible to replace.

Chapter Summary

LO2.2: Create a personal balance sheet and cash flow statement.

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



Chapter Summary

LO2.3: Develop and implement a personal budget.

- The 7 Step Budgeting process:
  1. Set Financial Goals
  2. Estimate Income
  3. Budget an Emergency Fund and Savings
  4. Budget Fixed Expenses
  5. Budget Variable Expenses
  6. Record Spending Amounts
  7. Review Spending and Saving Patterns

Chapter Summary

LO2.4: Connect money management activities with saving for personal financial goals.

- Connect money management activities with saving for personal financial goals.
  - Basis for achieving financial security = relationship between the personal balance sheet, cash flow statement, and budget.
  - Use Time Value of Money calculations to determine increased value of savings and amounts needed to reach future goals.