Money Smarts

A Guide to Financial Literacy




Dear Student,

For better or worse, our lives revolve around money. We earn it, save it, invest it, donate it, and of course, spend it. How much money we have can determine where we live and what we're able to buy. But more important than how much money you have is how well your money supports you on your life's journey.

Learning how to manage your money is one of the most important skills you will learn in life. While some of the information in this book will be more useful to you down the road, learning how to manage your finances now will put you ahead of the game—and on your way to financial success.

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Money in the Bank

Banks are not all the same, which is why it's important to understand how banks operate and why they want you as a customer.

Which bank should you choose?

Do some comparison shopping. Visit different banks online and in person to compare their products, services, and fees. Just be sure to choose a bank that's convenient to use, and one that offers free "in network" ATMs.

Which type of bank account is best?

Banks offer a variety of accounts where you can keep and access your money, but you will likely need a **checking account.** With a checking account, you can pay bills, write checks, and use your debit card for purchases. You can also use your ATM card or debit card to withdraw money from an ATM. Just make sure that you have enough money in your checking account to cover the transactions.

Banking is big business

Banks are in business to make money. They do this, in part, by charging customers fees on their accounts and interest on their loans. (Interest is the fee banks charge for letting you borrow their money.) Financially savvy customers do everything they can to avoid or minimize bank fees.

Banks also use their customers' money to make loans to individuals (like college, car, and real estate loans) and loans to companies (business loans). Banks, of course, make money from the interest on these loans.

Something to understand about interest...

You pay interest when you take out a loan, and you receive interest when you have an "interest-bearing account," such as a savings account. The interest you're charged on the loans you take out is always higher than the interest you receive on your interest-bearing accounts. This is how banks make a profit.

Being a Smart Consumer

We seldom have the money for everything we need or want—which makes it important for us to make good choices and spend our money wisely.

Needs vs. wants

To be a smart consumer you must differentiate between *needs* and *wants*. *Needs* are things that are necessary in your life, such as food, clothing, and shelter. *Wants* are things you don't have to have; they're things you would just like to have or do—like a larger TV, new phone, or concert tickets.

Of course, businesses work hard to convince you that you don't just want what they're selling—you *need* it. Smart consumers are aware of these sales tactics and don't let them influence their spending decisions.

Before you spend your hard-earned dollars, ask yourself, *"Is this something I need?"* If it's not, make sure you're being selective and that you're spending your money only on things that are really important to you.

Spending tips

- If you're not sure whether you should buy something, wait a day or two and see how you feel. Waiting helps eliminate bad decisions.
- Beware of online purchases that have additional fees or extravagant shipping and handling charges. Companies use these tactics to hide the actual cost of their products.
- Don't purchase extended warranties. Businesses love for you to buy these, but they are seldom a good deal for the customer.
- Do your research. Read customer reviews, do some comparison shopping, and check out *Consumer Reports*.

As you think about how you want to spend your money, consider donating money to a cause or program that's close to your heart—even if it's only a small amount.

Ways to Pay

The ways you pay for the things you buy can be just as important as how much money you spend, and what you spend it on.

Debit cards

When you open a checking account at a bank or credit union you can get a debit card. Whenever you use the card to make a purchase or get cash from an ATM, the amount you spent or withdrew is automatically deducted from your checking account.

There are some definite advantages to using a debit card. There are no interest charges, no end-of-the month bill to pay, and debit cards are relatively easy to obtain. However, if you don't have enough money in your checking account to cover the cost of a purchase, your card may be declined, or you may get charged an overdraft fee. One thing to note: a debit card does not help you build your credit history (more on this later).

Mobile payments

"Mobile payments" refers to the transfer of money using a mobile app, email, or online account. Mobile payments are also called mobile money, peer to peer (P2P) payments, and digital wallets. Many retailers have embraced this trend and encourage people to use their app to find a store, order ahead, and pay for purchases. Just be aware of fees.

Prepaid cards

Prepaid cards can be purchased online and at retail stores. You load a dollar amount and use these cards as you would a debit or credit card.

Cash and checks

Dollar bills and coins are the old school way to pay, but they are still a good payment option, especially for making small in-person purchases. Although checks are less popular these days, they are still widely used—and are sometimes the required form of payment.

Credit cards

A credit card allows you to borrow money from a bank or business to make purchases. You are then given a period of time (usually a month) to repay the loan. If you do not pay the balance within the designated time period, you are charged interest on the unpaid amount.

Here are some important things to know about credit cards.

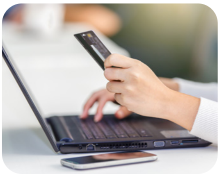
Credit card companies want you as a customer.

Credit card companies make a lot of money off their customers through annual fees, late fees, and by charging interest on unpaid balances. Before you apply for a credit card, check out their fees, interest rates, and rewards programs.

Pay the balance in full.

When you pay off your entire balance each month, you don't pay any interest. This is smart. The majority of credit card holders, however, make minimum or partial payments each month. Because they carry a balance on the card, the following month they will be charged interest on the unpaid balance—and also on the prior month's interest. So now they are paying interest on the interest. This is called **compounding interest**—and it's how a lot of people get into financial trouble.

There's a credit limit.



Every credit card holder has a credit limit (the maximum amount they can charge). A credit card will be rejected when a person reaches their limit—which is about $800 for the average first-time credit card user.

Some people, however, do not let a maxed-out credit card stop them from making additional purchases. They use a second card—or a third, fourth, or fifth card. They buy more and more stuff, max out multiple cards, and accrue more and more debt. *This is a formula for financial disaster.*

Most young people use a debit card instead of a credit card because people under 21 can't have heir own credit card unless they earn an income, have a co-signer, or are an authorized user on a parent's card.

Building Good Credit

Just like your high school GPA tells others how well you did in school, your credit record lets others know how well you manage your money.

Your credit history is important

Banks and businesses want to give loans and extend credit to people whose past behavior has shown them to be financially responsible. This means that before a bank or business will loan you money or give you credit, they want to feel reasonably certain that you will make the agreed upon payments. *This is why having good credit is so important.*

How do you build good credit?

The best way to build good credit is to *always* pay your bills on time. Being late with just one or two payments can adversely affect your credit report. Other things are taken into consideration when determining your credit rating, but paying your bills on time is the most important factor.

Credit reports include credit scores

When you have a credit card, take out a loan, or open a bank account, lenders and creditors provide information on your accounts (and your performance) to one or more of the three major credit bureaus (Experian, TransUnion, and Equifax). The credit bureaus use this information to create a **FICO credit score**. Credit scores range from 300 to 850. A score of 700 or higher is generally considered good.

Most young adults have low credit scores simply because they haven't yet established a strong credit history, but a bad credit score can have negative consequences. Your score can mean the difference between being denied or approved for a loan or credit. It can also mean the difference between getting a low or high interest rate.

Anyone can request a free credit report from *annualcreditreport.com.* Certain banks and credit card companies also offer free credit reports, and sometimes free credit scores.

Borrowing Money

At some point, you will likely make a purchase that requires you to take out a loan. Just make sure that you're getting the best interest rate possible—and that you can afford to make the payments in full and on time.

The application process

When people need a loan, they typically go to their bank or credit union and complete a loan application. The bank or credit union then checks their credit report and/or credit score to determine if they are a good risk.

If the bank approves the loan application, they will go over the terms of the loan with the borrower, including the interest rate, monthly payment amount, and length of the loan.

If the loan is rejected, the bank should provide a written explanation of why. If the rejection was the result of a credit search, the person requesting the loan might want to check their credit report for errors. *When people are turned down for a loan or credit, they should view it as a wake-up call—and as a message telling them to take control of their finances.*

Terms to know

When you apply for a loan, you should be familiar with the following terms:

co-signer – an additional person who signs the loan documents and agrees to be responsible for the loan if the payments aren't made

default – failure to repay a loan

down payment – the initial amount you must pay when you purchase something on credit

installment loan – a loan with a set number of payments

interest – the amount you're charged for borrowing money

term – the length of the loan

title – a document that shows ownership

Creating a Budget

If you have an income and expenses, it's a good idea to create a budget.

Many people are uncertain as to how much they owe, what they can afford, and how much they spend. They often spend more than they can afford, and then wonder how they're going to pay off all of their debt. The first step in avoiding this situation is to create and maintain a budget. *A budget is simply a plan used to decide the amount of money that can be spent—and how it will be spent.*

Select a tool and a time period

To create a budget, you need to track your income (money coming in) and expenses (money you spend). You can do this using an app, a spreadsheet, or just a pen and paper. Some people organize their budget by the month (or six months); others prefer to create a weekly budget. Select the time period that works best for you.

Create your own custom budget

- **Enter your estimated income.**
  Consider your sources of income and enter the amount you expect to have available to spend during your selected time period.

- **Categorize your expenses.**
  Think about what you spend your money on and create a list of expense categories that makes sense to you. For example, you might include eating out, school supplies, phone, clothes, and car loan.

- **Determine if a category is a fixed or flexible expense.**
  Fixed expenses are the same every time period, like a car payment. Flexible expenses vary—$30 for clothes one month, $75 the next.

- **Budget an amount for each expense category.**
  Take each category and budget a dollar amount for that time period. Put your fixed expenses into your budget first. This will help determine how much you have available for your flexible expenses.

Keep track of your income and your expenses

Enter your income and all of your expenses into your spreadsheet or app. When you sit down to review and balance your budget, you'll know exactly how much money you've spent in each category.

Review and balance your budget

At the end of your budget period, compare your income with your expenses. If your income exceeds your expenses, you've achieved a "positive balance." Good for you! You have savings for the future.

A "negative balance" reveals that your expenses have exceeded your income. You are spending more money than you're taking in. How is this possible? You're either eating away at your savings or you're running up debt. If you have a negative balance, think about how you can reduce your expenses and/or increase your income.

John created a budget and kept track of his spending. At the end of the month, he realized that he'd spent more than he should have.

John's Budget Worksheet

Monthly Income: $1100		
Expenses	Budgeted	Spent
Rent	$250	$250
Utilities	$60	$60
Car insurance	$150	$150
Car payment	$220	$220
Internet/cable	$25	$25
Cell phone	$80	$80
Gas	$65	$80
Groceries	$100	$130
Entertainment	$50	$90
Clothes	$50	$150
Misc. (shopping, going out)	$115	$0
Total Expenses	$1050	$1225
		Balance - $180

Paying Taxes

Anyone who works and receives a paycheck needs to have a basic understanding of the taxes they are required to pay.

Required forms and information

When you're hired for a job, you are required to complete IRS Form I-9 (to establish your identity and eligibility to work in the U.S.). You must also complete IRS Form W-4 (Employee's Withholding Allowance Certificate).

Your employer is required to give you information on your pay for each pay period—and also provide you with an IRS W-2 Form at year's end.

What is a W-4?

The W-4 form you complete when you get a new job tells your employer how much money you want withheld from your paycheck for federal taxes. Completing your W-4 accurately will ensure that you don't overpay your taxes or owe a lot of money at tax time.

What is a W-2?

The IRS requires employers to report your wage and salary information to them on Form W-2. Your employer must also send you a W-2 by January 31. (This will be a summary of your pay stubs from the previous year.) You need the information on your W-2 to complete your tax return.

Tax returns must be filed on or before the deadline

Taxes can be very confusing, and many people need some assistance the first time they file an income tax return. Just be sure to start early. Tax returns are due each year around the middle of April.

If your employer withheld more money than you owe, the government will send you a refund. If it turns out that you owe the government additional money, you will need to include the money you owe with your tax return. Most young people end up getting a refund.

Paychecks and pay stubs

When you have a job, you will receive a paper check or your pay will be electronically deposited into your bank account (direct deposit). You will also be provided a pay stub that summarizes your gross wages (how much you have earned) and your net pay (how much you actually get to keep after deductions). *As you can see in the sample pay stub below, Sophia earned $400 (gross) but took home $296.05 (net).*

Johnson's Diner

EMPLOYEE	Sophia Adams	PAY PERIOD	June 15 - June 22
SOC SEC #	XXX-XX--6789	PAY DATE	June 23
CHECK NO.	06501	NET PAY	$296.05

EARNINGS			TAXES & DEDUCTIONS		
Desc	Hrs	Amount	Desc	Current	YTD
Regular	40	$400.00	Federal Tax	$48.25	$386.00
			State Tax	$16.15	$129.20
			Local Tax	$8.75	$70.00
			Social Sec	$24.80	$198.40
GROSS YTD		$3,200.00	Medicare	$6.00	$48.00
NET YTD		$2,368.40	Total	$103.95	$831.60

Where did my money go?

Payroll deductions are the amounts withheld from your paycheck by your employer. While taxes will account for most, if not all, of your deductions, additional deductions may be taken for retirement, insurance, and more. Here are the major deductions you are likely to see on your pay stub.

FICA Social Security tax and FICA Medicare tax – Federal Insurance Contributions Act (FICA) tax is a U.S. federal payroll tax imposed on both employees and employers to fund Social Security and Medicare (federal programs that provide benefits for retirees, the disabled, and others). You chip in 6.2% of your gross income for Social Security and 1.45% for Medicare. Your employer chips in the same.

Federal tax – This portion of your salary goes to the federal government to fund a budget that's over $4 trillion a year. Federal tax dollars are used to pay for education, defense, roads, and much more.

State and local taxes – These tax deductions vary depending on the city and state in which you live and work.

Growing Your Money

The earlier you start investing, the more time your money has to grow.

Investing

People who have a lot of money to invest generally work with an investment banker, stockbroker, or financial advisor—but you don't need a lot of money or an expert at your side to begin investing. You just need a small sum of money, an interest in growing your money, and the willingness to do a little research. The following are common types of investments.

Stocks

When you purchase stocks, you're purchasing shares in a company. If the company does well, the value of the shares will increase, and you'll make a profit when you sell them. If a company doesn't do well, its shares become less valuable and you could lose some, or all, of your investment.

Bonds

The government, cities, and companies sell bonds to raise money. When you purchase a bond, you are loaning your money to the bond issuer for a specific period of time. At the end of the term, you get your money back with interest. The safer the bond, the lower the interest rate.

Mutual funds

When you invest in a mutual fund, you add your money to a pool that's made up of many other people's money. This pool of money is managed by financial professionals, and it's used to buy shares of stock in a number of different companies. This makes the investment less risky.

401(k) plans

When you invest in a 401(k) plan, your employer deducts the amount that you've designated from your paycheck and puts it into your account. The money in your account is then invested in an option of your choosing. The biggest advantage of a 401(k) plan is that many employers will make a matching contribution—*which means that they will add their money to your account.*

Protecting Your Assets

Protecting your money is easy, but to protect your health, your property, and your identity, you need to take certain steps and precautions.

Protecting yourself with insurance

Having insurance provides peace of mind. If you have the proper insurance coverage, you know that if you're dealing with an accident, illness, or theft, your insurance will cover some or all or the costs—minus your deductible (the amount you must pay before your insurance kicks in).

For example, if your car insurance policy has a $500 deductible and you have an accident that costs $4,000, you pay the first $500. Your insurance company will then cover the remaining $3,500.

Auto insurance

Purchasing insurance of any kind (health, property, life) is optional except for auto liability insurance, which is mandatory in virtually every state.

Auto liability coverage has two components:

1) Bodily injury liability helps pay for costs related to another person's injuries if you cause an accident.
2) Property damage liability helps pay for the damage you cause to another person's car or property while driving.

Collision insurance helps pay to repair or replace your car if it's damaged in an accident.

Comprehensive coverage protects your car against damage not resulting from a collision, such as vandalism, fire, or theft.

Protecting your identity (and your assets) online

Be aware of the dangers of doing business online, and protect yourself from disreputable people and companies trying to steal your identity, money, and/or personal information. Use only reputable websites to make purchases, use a variety of uncommon passwords, and regularly check your bank and credit card statements for fraudulent activity.

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