What You’ll Learn

- **Section 3.1**
  - Discuss the relationship between opportunity costs and money management.
  - Explain the benefits of keeping financial records and documents.
  - Describe a system to maintain personal financial documents.

- **Section 3.2**
  - Describe a personal balance sheet and cash flow statement.
  - Develop a personal balance sheet and cash flow statement.

- **Section 3.3**
  - Identify the steps of creating a personal budget.
  - Discuss the advantage of increasing your savings.
Money When You Need It

**Q:** Do I need an emergency fund even though I work part time, live at home, and have no bills?

**A:** There is no guarantee that your job will always be there for you. If you become sick or injured, you may have to take time off from work. Even if you have disability insurance, it may pay only a fraction of what you earn. If you own a car, you may have unexpected repair bills. Emergency funds are for those unexpected things.

Go to [finance07.glencoe.com](finance07.glencoe.com) to complete the Standard & Poor’s Financial Focus activity.
Main Idea
Organizing your personal financial records can help you make informed decisions about your spending.
Opportunity Costs and Money Management

Every decision you make represents a trade-off, or opportunity cost. Trade-offs are especially common when it comes to making decisions about money management.

Good money management can help you keep track of where your money goes so that you can make it go farther.
Resolving Tough Opportunity Costs

Consider the factors that influence your decision making by compiling a mental list of your options. Then consider how those options fit your:

- Values
- Current financial situation
- Goal of effective money management

By considering these options, you can make better spending decisions.
Benefits of Organizing Your Financial Documents

The first step in effective money management is to organize your personal financial documents, which include:

- Bank statements
- Paycheck stubs
- Receipts
- Automobile ownership titles
- Birth certificates
- Tax forms
Personal Financial Documents

Creating an organized system for handling your personal financial documents helps you:

- Plan and measure your financial progress
- Handle routine money matters, such as paying bills on time
- Determine how much money you will have now and in the future
- Make effective decisions about how to save money
Section 3.1
Organizing Financial Records

Where to Keep Your Financial Documents

You can keep your financial documents in different places, such as:

- A home file
- A safe-deposit box
- On a computer

To organize your documents as effectively as possible, you may want to use all three.
Home Files
A home file is simple to set up and does not take up much space. You can use:
- A file drawer
- Several folders
- A cardboard box

Whatever method you use, your home file should be simple so that you have quick access to your documents.
Setting up a Home Filing System

To make good use of a home filing system:

- Sort through all your personal financial records.
- Arrange them according to the type of each document.
- Label all folders or boxes.
- File your receipts and other financial papers as soon as possible after receiving them.

Do not keep hard-to-replace documents in a home file.
Safe-Deposit Boxes

More important documents that are commonly kept in safe-deposit boxes include:

- Car titles
- Mortgage loan papers
- Birth certificates and adoption papers
- List of insurance policies
- Valuable collectables such as coins or stamps

As an alternative, some people use home fire-safe boxes that lock.
Home Computers
You can use your computer to:

- Store certain types of financial records.
- Plan your financial future.
- Keep a running summary of checks you have written.
- Track your monthly spending.

You can also generate personal financial documents and statements from the information you have organized by using software.
Main Idea

A personal balance sheet and cash flow statement can help you to analyze your financial situation.
Personal Balance Sheet

For a complete look at your financial situation, you should create a personal balance sheet and a cash flow statement. These personal financial statements can help you:

- Determine what you own and what you owe.
- Measure your progress toward your financial goals.
- Track your financial activities.
- Organize information that you can use when you file your tax return or apply for credit.
Personal Balance Sheet

To evaluate your financial situation, you will first need to create a balance sheet. A personal balance sheet lists:

- Items of value owned
- Debts owed
- A person’s net worth

Use the following steps to create a personal balance sheet.
Step 1: Determine Your Assets

To determine your assets, you need to consider the four categories of wealth:

- Liquid assets
- Real estate
- Personal possessions
- Investment assets
Sections 3.2
Personal Financial Statements

Categories of Wealth
The money in your savings and checking accounts is a liquid asset.
The second category of wealth, real estate, is not as easy to convert into cash.
You can determine the market value of your real estate by looking at the amount recorded on the real estate portion of your balance sheet.

liquid assets
cash and items that can be quickly converted to cash

real estate
land and any structures that are on it that a person or family owns

market value
the price at which property would sell
Personal Possessions

Your personal possessions include items such as:

- Cars
- Any valuable belongings that are not real estate

You will get a better idea of your financial situation by recording these items’ current market value on your balance sheet.
Investment Assets

Investment assets are the fourth category of wealth. These include:
- Retirement accounts
- Securities such as stocks and bonds

You should set aside such assets for long-term financial needs, such as:
- Paying for college
- Buying a house
- Retirement
Step 2: Determine Your Liabilities

When you prepare a personal balance sheet, you must also record your liabilities. There are two main types of liabilities:

- **Current liabilities**—short-term debts that have to be paid within one year
- **Long-term liabilities**—debts that do not have to be fully repaid for at least a year
Step 3: Calculate Your Net Worth
You can determine your net worth by subtracting your liabilities from your assets. Although you may have a high net worth, you can still have trouble paying your bills. This is true when:

- Most of your assets are not liquid.
- You do not have enough cash to meet your expenses.

If you are unable to pay all your debts, you may experience **insolvency**.
Step 4: Evaluate Your Financial Situation

You can use a balance sheet to track your financial progress.

As a rule, you can increase your net worth by:

- Increasing your savings
- Increasing your investments
- Reducing your expenses
- Reducing your debts
Cash Flow Statement: Income Versus Expenses

Cash flow is divided into two parts:

- Cash inflow—your income
- Cash outflow—all of the money you spend

A cash flow statement is simply a summary of your cash flow during a particular period.
Cash Flow Statement

To create a cash flow statement, follow these steps:

- Record your income.
- Record your expenses.
- Determine your net cash flow.

This summary gives you important information and feedback on your income and spending patterns.
Step 1: Record Your Income

To record your income:

- List all of your sources of income during a given month.
- Record the amounts as your cash inflow.
- Make sure you record the exact amount of cash inflow—your take-home pay plus your interest earnings on investments and savings.

Some financial experts evaluate the strength of a person’s income by measuring discretionary income.
Step 2: Record Your Expenses

Fixed expenses are those that are more or less the same each month. These include:

- Cable television charges
- Rent
- Bus fare for commuting to work or school

Variable expenses may change from month to month and include:

- Food and clothing
- Electricity, medical costs, and recreation

The total of your fixed and variable expenses is your cash outflow.
Step 3: Determine Your Net Cash Flow

You can determine your net cash flow by subtracting your expenses from your income. If you have a **surplus**, you can:

- Place it in an emergency fund savings account for unexpected expenses or to pay living costs if you do not receive a salary.
- Place it in savings and investment plans.

If your cash net flow is negative, you will have a **deficit**.
Your Financial Position

When your net cash flow changes, so does your net worth.

To make up for a deficit, for example, you can:
- Borrow money (increasing your liabilities).
- Draw from your savings (decreasing your assets).

If you end a month with a surplus, you can:
- Save the money (adding to your assets).
- Pay off previous debts (reduce your liabilities).
Main Idea

Learn to budget and achieve financial goals by increasing your savings.

Before You Read

PREDICT

What is your definition of a budget, and what are the advantages of using one?
Preparing a Practical Budget

Having a budget is necessary for successful financial planning. By using a budget, you will learn how to:

- Live within your income.
- Spend your money wisely.

You will also develop good money management skills that will help you reach your financial goals.
Step 1: Set Your Financial Goals

Your financial goals are the things you want to accomplish with your money.

It is important that you:

- Make your financial goals as specific as possible.
- Have a definite time frame for your goals.
- Separate your goals into short-term, intermediate, and long-term goals.
Step 2: Estimate Your Income

When you have set your goals, you can begin working on a budget that is practical for you. To create a budget:

- Record your estimated income for the next month.
- Include all sources of income that you know you will be receiving.
- Do not include money you may or may not get, such as bonuses and gifts.
Step 3: Budget for Unexpected Expenses

You can create special savings accounts to help you:

- Meet unexpected expenses
- Reach your financial goals
Step 4: Budget for Fixed Expenses

Your fixed expenses are those that do not change from month to month. These include:

- Mortgage
- Automobile and student loan payments
- Insurance premiums
Step 5: Budget for Variable Expenses
Planning for variable expenses is not as easy as budgeting for fixed expenses. You should make your best guesses based on costs from previous months.

To determine reasonable expense levels, you can use:

- Guidelines published by financial experts
- The consumer price index (CPI)
- Your friends and relatives

consumer price index (CPI)
a measure of the changes in prices for commonly purchased goods and services in the United States
### Figure 3.5 The Monthly Budget

#### Step 1: Set Financial Goals
- Financial Goals: Pay off car loan, save for college, take vacation trip, and increase investments

#### Step 2: Estimate Your Income
- **Income:**
  - Salary and interest income: $3,550

#### Step 6: Record What You Spend

#### Step 3: Budget for Unexpected Expenses and Savings
- **Unexpected Expenses and Savings:**
  - Emergency fund savings: $100
  - Vacation savings: $30
  - College savings: $70
  - Investment savings: $50
  - Total savings: $250

#### Step 4: Budget for Fixed Expenses
- **Fixed Expenses:**
  - Mortgage: $700
  - Automobile loan: $200
  - Student loan: $150
  - Insurance premiums: $150
  - Total fixed expenses: $1,200

#### Step 5: Budget for Variable Expenses
- **Variable Expenses:**
  - Food: $500
  - Clothing: $250
  - Utilities: $250
  - Entertainment: $200
  - Medical: $250
  - Transportation: $450
  - Personal allowances: $200
  - Total variable expenses: $2,100

#### Total Outflow
- **Total outflow:**
  - Budgeted amounts: $3,550
  - Actual amounts: $3,625
  - Variance: $75

### Keeping Track
You can use this sample monthly budget form to keep track of your own income and expenses so you can manage your finances and reach goals.

**In this sample, how might the Thompsons’ budget be affected if they had to buy a second automobile?”**
Step 6: Record What you Spend

To find out how practical your budget is, you will need to keep track of your expenses during an entire month and then revise your budget if necessary.

Your spending will not always work out as planned. The *budget variance* can either be a:

- Surplus (if you spend less than you had expected)
- Deficit (if you spend more than you had expected)
Step 7: Review Spending and Saving Patterns

Budgeting is a continual process. You may need to:

- Review your budget each month.
- Consider making changes based on the nature of your expenses.

Even if your budget generally seems to be on target, it is a good idea to prepare an occasional budget summary to review your progress.
Section 3.3
Budgeting for Financial Goals

How to Budget Successfully
A budget should have several important characteristics:

- A good budget is carefully planned.
- A good budget is practical.
- A good budget is flexible.
- A good budget must be written and easily accessible.
Ways to Increase Your Savings

Increasing your savings is the key to establishing a sound financial future. While learning to save is not easy, you can improve your savings rate by using several savings strategies.
Pay Yourself First

One method you can adopt is to set aside a fixed amount as savings before you sit down to pay your bills.

As an alternative to writing a check each month, many banks will:

- Automatically deduct a certain amount from your checking amount each month.
- Deposit that amount into your savings account.
Pay or Save?
Be a smart consumer and pay off your credit card bills before you put money away in a savings account. The interest rate charged on credit cards is usually higher than the interest you can earn from your savings account.

*How do you determine the interest rate on your credit card?*
Section 3.3
Budgeting for Financial Goals

Payroll Savings

Your employer may offer a similar option called a payroll savings deduction. A payroll savings deduction is a portion of your earnings that is:

- Automatically taken out of your paycheck
- Put into your savings or retirement account
Spending Less to Save

A third way to save is to start small. Make a conscious effort to spend less each day. How you save, though, is less important than the action of saving. The earlier you start, the better. Even small amounts of savings can:

- Grow quickly
- Help you reach your financial goals
Key Term Review

- money management
- safe-deposit box
- personal financial statement
- personal balance sheet
- net worth
- assets
- wealth
- liquid assets
- real estate
- market value
- liabilities
- insolvency
- cash flow
- income
- take-home pay
- discretionary income
- surplus
- deficit
- budget
- consumer price index (CPI)
- budget variance
Reviewing Key Concepts

1. List at least three examples from your own experience of opportunity costs.

Some examples of opportunity costs may include:

- Deciding to go to the movies instead of reading a book for your English homework assignment.
- Choosing to play with the neighbor’s dog on a Saturday afternoon instead of watching television or playing with your Xbox.
- Choosing to spend your paycheck on clothes rather than putting it in the bank to earn interest.
Reviewing Key Concepts

2. Explain the benefits of keeping and organizing financial records and documents.

Organizing your financial documents makes it easier to:

- Plan and measure progress.
- Handle routine money matters.
- Know how much money is available.
- Make effective decisions.
Reviewing Key Concepts

3. Identify documents to store in home files, safe-deposit boxes, or on a computer.

Some personal financial documents that should be stored in a safe place include:

- Birth certificates and Social Security cards
- Mortgage loan papers
- Title deeds
- Copy of will
- Tax records
- Résumé
Reviewing Key Concepts


A personal balance sheet helps you to:

- Determine your net worth.
- Manage your money to meet financial goals.

A personal cash flow statement helps you to:

- Determine the amount of cash you receive.
- Determine how you use this cash.
Reviewing Key Concepts

5. List the steps in preparing a personal balance sheet and a personal cash flow statement.

To create a personal balance sheet, you will need to:
- Determine your assets
- Determine your liabilities
- Calculate your net worth
- Evaluate your financial situation

To create a personal cash flow statement, you will need to:
- Record your income
- Record your expenses
- Determine your net cash flow
6. Identify the steps in preparing a personal budget.

To create a budget, you will need to:

- Set financial goals.
- Estimate your income.
- Budget for unexpected expenses and savings.
- Budget for fixed expenses.
- Budget for variable expenses.
- Record what you spend.
- Review your spending and saving patterns.
Reviewing Key Concepts

7. Explain how you can use your budget to identify ways to increase your savings.

By creating and using a budget, you can decide to:

- Set aside a fixed amount as savings before you sit down to pay your bills.
- Take advantage of your employer’s payroll savings deduction.
- Make an effort to spend less each day.
Newsclip: Ways to Save

Best-selling personal finance authors advise finding ways to save by cutting small luxuries and saving money from summer jobs.

Log On  Go to finance07.glencoe.com and open Chapter 3. Read the article. Then make a record of expenses. Ask yourself: What are your spending and saving habits?