Personal Finance

Personal Finance

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Contents

PART I

FACULTY RESOURCES

1. Personal Monthly Budget

Download the Excel File here

Personal Monthly Budget

PROJECTED MONTHLY INCOME	Income 1	$2,500	PROJECTED BALANCE (Projecte income minus expenses)
	Extra income	$500	
	Total monthly income	$3,000	ACTUAL BALANCE (Actual incor minus expenses)
ACTUAL MONTHLY INCOME	Income 1	$2,500	
	Extra income	$500	DIFFERENCE (Actual minus proj
	Total monthly income	$3,000	

HOUSING	Projected Cost	Actual Cost	Difference	ENTERTAINMENT	Projected Cost
Mortgage or rent	$1,500	$1,400	$100	Video/DVD	$0
Phone	$60	$100	-$40	CDs	
Electricity	$50	$60	-$10	Movies	
Gas	$200	$180	$20	Concerts	
Water and sewer			$0	Sporting events	
Cable			$0	Live theater	
Waste removal			$0	Other	
Maintenance or repairs			$0	Other	
Supplies			$0	Other	
Other			$0	Total	$0
Total	$1,810	$1,740	$70		
				LOANS	Projected Cost
TRANSPORTATION	Projected Cost	Actual Cost	Difference	Personal	
Vehicle payment	$250	$250	$0	Student	
Bus/taxi fare			$0	Credit card	
Insurance			$0	Credit card	
Licensing			$0	Credit card	
Fuel			$0	Other	

Maintenance			$0
Other			$0
Total	$250	$250	$0

INSURANCE	Projected Cost	Actual Cost	Difference
Home			$0
Health			$0
Life			$0
Other			$0
Total	$0	$0	$0

FOOD	Projected Cost	Actual Cost	Difference
Groceries			$0
Dining out			$0
Other			$0
Total	$0	$0	$0

PETS	Projected Cost	Actual Cost	Difference
Food			$0
Medical			$0
Grooming			$0
Toys			$0
Other			$0
Total	$0	$0	$0

Total	$0

TAXES	Projected Cost
Federal	
State	
Local	
Other	
Total	$0

SAVINGS OR INVESTMENTS	Projected Cost
Retirement account	
Investment account	
Other	
Total	$0

GIFTS AND DONATIONS	Projected Cost
Charity 1	
Charity 2	
Charity 3	
Total	$0

LEGAL	Projected Cost
Attorney	
Alimony	
Payments on lien or judgment	

PERSONAL CARE	Projected Cost	Actual Cost	Difference
Medical			$0
Hair/nails			$0
Clothing			$0
Dry cleaning			$0
Health club			$0
Organization dues or fees			$0
Other			$0
Total	$0	$0	$0

Other	
Total	$0

TOTAL PROJECTED COST

TOTAL ACTUAL COST

TOTAL DIFFERENCE

2. I Need Help

Need more information about this course? Have questions about faculty resources? Can't find what you're looking for? Experiencing technical difficulties?

We're here to help! Take advantage of the following Lumen customer-support resources. Contact oer@achievingthedream.org for support.

PART II

MODULE 1: PERSONAL BUDGETING

3. Making a Budget

What It Is

What is a budget?

A budget is a plan you write down to decide how you will spend your money each month.

A budget helps you make sure you will have enough money every month. Without a budget, you might run out of money before your next paycheck.

A budget shows you:

- how much money you make
- how you spend your money

Why do I want a budget?

A budget helps you decide:

- what you must spend your money on
- if you can spend less money on some things and more money on other things

For example, your budget might show that you spend $100 on clothes every month. You might decide you can spend $50 on clothes. You can use the rest of the money to pay bills or to save for something else.

For Example

One or more interactive elements has been excluded from this version of the text. You can view them online here: https://library.achievingthedream.org/lfccpersonalfinance/?p=24

Why should I try to save money?

You might need money for an emergency. You also might need to buy something more expensive, like a car. Saving money might help you buy a car, put a security deposit on an apartment, or pay for something else expensive.

What To Know

How do I start a budget?

Start a budget by gathering your bills and pay stubs. Think about how you spend money, besides paying your bills. For example, do you buy a cup of coffee every day? After a month, that coffee money could add up to an expense you might write down.

When you have your bills and pay stubs:

- write down your expenses. An expense is money you spend
- write down how much money you make. This is called income

- subtract your expenses from how much money you make

If the number is less than zero, you are spending more money than you make. Look for things in your budget you can change. Maybe something you do not need, or a way to spend less.

Use this Budget Worksheet to help you.

What if I don't get paid every month?

Some people do not get paid every month. If you expect things to be like they were last year, do this:

- add all the money you earned last year
- divide that number by 12. This is about how much money you will have for each month

For Example

Last year my paychecks added up to $30,000.
$30,000 ÷ 12 = $2,500
I had about $2,500 each month.

How can I use my budget?

A budget is something you use every month. A written budget will help you:

- see where you spend money
- see where you can save
- make a plan for how to spend and save your money

Your budget can help you save money for the future. You can make savings one of your expenses. You might find ways to spend less money. Then you can put money into savings every month – maybe into a bank or credit union.

Why should I save money?

It can be hard to save money. It is very hard when your expenses go up and your income does not. Here are some reasons to try to save money even when it is not easy.

- **Emergencies** – Saving small amounts of money now might help you later. Everyone has expenses they do not expect.
- **Expensive things** – Sometimes, we have to pay for expensive things – like a car, a trip, or a security deposit on an apartment. You will have more choices if you have money to pay for those expensive things.
- **Your goals** – You might want to pay for college classes. Maybe you need to visit family in another country. You can plan for these goals and save money. Then you might not have to use a credit card or borrow money to pay.

How else can I save money?

You can try these ways to help save money:

- For one month, write down everything you spend. Small expenses, like a cup of coffee, can add up to a lot of money. When you know where you are spending your money, you can decide what you might **not** want to buy.
- Pay with your credit card only if you can pay the full amount

when the bill comes. That way, you do not pay interest on what you owe.
- Pay your bills when they are due. That way, you will not owe late fees or other charges.
- Keep the money you are saving separate from the money you spend.
- Consider opening a savings account in a bank or credit union. Read more about opening a bank account.
- If you keep cash at home, keep the money you are saving separate from your spending money. Keep all your cash someplace safe.

For Example

What I did **not** buy this month:

Music downloads	$5.00
Shirt	$30.00
Movie ticket	$10.00
Top off gas tank	$15.00
Cups of coffee	$12.00
What I saved this month:	$72.00

What To Do

A budget is a plan that shows you how you can spend your money every month. Making a budget can help you make sure you do not run out of money each month. A budget also will help you save money for your goals or for emergencies.

How do I make a budget?

Write down your expenses. Expenses are what you spend money on. Expenses include:

Bills:

- bills that are the same each month, like rent
- bills that might change each month, like utilities
- bills you pay once or twice a year, like car insurance

Other expenses, **like**:

- food
- gas
- entertainment
- clothes
- school supplies
- money for family
- unplanned expenses, like car repairs or medical bills
- credit card bills

You might have bills that change every month. Look at what you paid for the same month last year. You might need $200 for your gas bill in January, but $30 in July.

Write down how much money you make. This includes your paychecks and any other money you get, like child support.

Subtract your expenses from how much money you make. This number should be more than zero. If it is less than zero, you are spending more money than you make. Look at your budget to see what you do not need or what you could spend less on.

How do I use my budget?

You can use your budget every month:

- At the beginning of the month, make a plan for how you will spend your money that month. Write what you think you will earn and spend.
- Write down what you spend. Try to do this every day.
- At the end of the month, see if you spent what you planned.
- Use the information to help you plan the next month's budget.

4. Creating Your Budget

Creating a BUDGET may sound complicated, but all you need to do to get started is set aside some time and get organized—the benefits will make the effort worthwhile. The following steps will help you set up your budget and manage your finances by helping you track your income and expenses.

Determine a Time Span for Your Budget
Choose a Tool to Help You Manage Your Budget
Review Your Monthly Income
Identify and Categorize Your Expenses
Save for Emergencies
Balance Your Budget
Maintain and Update Your Budget

Determine a Time Span for Your Budget

You can create your budget for a month, ACADEMIC YEAR, or calendar year. If you are currently attending college or career school, you may want to consider creating a monthly budget for an academic term, such as your fall semester. Keep in mind that your income may vary from month to month, and not all of your expenses will be the same each month. Larger expenses (such as car insurance and books) and seasonal expenses (such as a trip home at the holidays or a higher electricity bill in summer when the air conditioning is on) need to be incorporated into your budget.

Choose a Tool to Help You Manage Your Budget

To create a budget, you'll want to use a tool for tracking your income and expenses. You can use pen and paper, a simple automated spreadsheet, or a budgeting app. Many banks offer budgeting tools, so see what works best for you.

The Financial Awareness Counseling Tool (FACT) is a free interactive tool that can help you manage your finances. FACT covers topics ranging from managing your budget to avoiding DEFAULT. Plus, you can access your loan information and receive personalized feedback to help you better understand your financial obligations.

Review Your Monthly Income

First, estimate how much money you will have coming in each month. Here are some tips for assessing your income:

- Your income may come from sources such as your pay from work, financial contributions from family members, or financial aid (scholarships, grants, WORK-STUDY, and loans).
- If you're working while in school, review your records to determine how much your take-home pay is each month. If you earn most of your money over the summer, you may want to estimate your yearly income then divide it by 12.
- Include income from any financial aid credit balance refunds—money that may be left over for other expenses after your financial aid is applied toward tuition and fees.

Monthly Income Tracking Example

Income Source	Monthly Income
Income from work	$1,200
Tax refund ($360 total divided by 12)	$30
Estimated financial aid credit balance refund ($2,100 total divided by 12)*	$175
Monthly support from parents and/or family member	$250
Other income	
Total Monthly Income	**$1,655**

*Note: If you are getting ready to attend school, you'll want to estimate your federal aid credit balance by taking your estimated financial aid and subtracting your expected tuition and fees. If you have not yet received an aid offer from your school, you can use FAFSA4*caster* to get an early estimate of your eligibility for FEDERAL STUDENT AID.

Identify and Categorize Your Expenses

To estimate your monthly expenses, you'll want to start by recording everything you spend money on in a month. This may be a bit time-consuming but will definitely be worthwhile in helping you understand where your money is going and how to better manage it. After that, gather your bank records and credit card statements that will show you other expenditures that may be automatically paid.

If you are currently attending college or career school or getting ready to go, you'll also need to estimate your college costs. In addition to tuition and fees (unless covered by financial aid), you'll want to make sure to include books and supplies, equipment and room materials, and travel expenses. Find details on what's included in the cost of college and tips on how to reduce college costs.

If you are still researching your school options, keep in mind that college and career school costs can vary significantly from school to school. We have resources to help you estimate and compare school costs.

Once you've identified your expenses, you should group them into two categories—fixed expenses and variable expenses.

- Fixed expenses stay about the same each month and include items such as rent or mortgage payments, car payments, and insurance. These obligations are generally nonnegotiable until you realize that you are spending too much money on rent and take steps to find a cheaper place! When creating a monthly budget, divide the amount due by the number of months the bill covers. For example, take your yearly $1,200 insurance bill that's paid in two $600 installments six months apart, and divide it by 12 to know you need to set aside $100 per month.
- Variable expenses are those that are flexible or controllable and can vary from month to month. Examples of variable expenses include groceries, clothing, eating out, and entertainment. You'll want to examine these expenses to make sure they stay under control and don't bust your budget at the end of the month.

Monthly Expenses Tracking Example

Fixed Expenses	**Projected Cost**
Rent or dorm fee	$500
Books	$70
Electricity	$35
Gas and water	$22
Cable and Internet	$50
Car insurance ($600 divided by 12 months)	$50
Parking fee ($84 divided by 12)	$7
Car maintenance and repairs ($480 divided by 12 months)	$40
Cell phone (basic charges)	$60
Car loan payment	$125
Money set aside for savings	$50
Total Fixed Expenses	**$1,009**
Groceries	$250
Dining out	$50
Entertainment (example: concerts)	$50
Music downloads	$20
Movies (theater and downloads)	$48
Medical (including prescriptions)	$40
Hair and nails	$40
Clothing	$50
Laundry and dry cleaning	$10
Health club	$40
Credit card monthly payment	$25
Public transportation	$25
Gas for car	$60
Total Variable Expenses	**$708**
Total Expenses	**$1,717**

Save for Emergencies

Include “Savings” as a fixed expense in your monthly budget. Pay yourself first every month! Your savings can be used as an emergency fund to help you deal with unexpected expenses. The ideal amount of an emergency fund typically covers three to six months of your expenses.

Balance Your Budget

Now that you’ve identified your sources of income and expenses, you’ll want to compare the two to balance your budget. To do so, you simply subtract your expenses from your income.

Total Monthly Income	$1,655
Minus Total Expenses	$1,717
= + / − Difference	($62)

If you have a positive balance, then your income is greater than your expenses. In other words, you’re earning more money than you’re spending. If you have a positive balance, you shouldn’t start looking at new ways to spend your money. Instead, focus on putting the extra money toward your savings to cover your emergency fund or to support future goals such as buying a car. Also, if you have a positive balance but you’ve borrowed student loan funds, pay back some of your loans and consider borrowing less in the future.

If you have a negative balance, then you are spending more money than you have. You’ll want to balance your budget and make sure your expenses don’t exceed your income. Balancing your budget may include monitoring your variable expenses, reducing your expenses, and/or finding ways to increase your income. Spending less can be a lot easier than earning more. Consider eating out less frequently and making your own lunch. Rent books rather than buying them, or buy books to download to your computer. Use a shopping list when grocery shopping, and buy only what you need. Ask yourself before buying anything, “Do I really need this?”

Get budgeting tips to keep in mind as you create and maintain your budget.

Maintain and Update Your Budget

Now that you’ve created your budget, you’ll want to make sure it remains a living document and you update it over time. Here are some smart practices to keep in mind:

- **Review your budget on a monthly basis.** Regular review and maintenance of your budget will keep you on top of things and may help you avoid being blindsided by something unexpected.
- **Forgive yourself for small spending mistakes and get back on track.** Most people overspend because they buy things on impulse. The next time you’re tempted to make an impulse buy, ask yourself the following questions:
    - What do I need this for?
    - Can I afford this item?
    - If I buy this item now, will I still be happy that I bought it a month from now?
    - Do I need to save this money for a financial goal?
    - Will this item go on sale? Should I wait to buy it?
    - Does it matter if I buy brand-name or can I get by with generic?

If you take a moment to think about what you’re buying, you’re more likely to make a choice that fits your budgeting goals.

Quick Links

- Budgeting
- Budgeting Tips

Glossary

Budget

A financial plan that helps you track your money, make informed spending decisions, and plan for your financial goals.

Academic Year

This is the amount of the academic work you must complete each year, and the time period in which you are expected to complete it, as defined by your school. For example, your school's academic y...

Default

Failure to repay a loan according to the terms agreed to in the promissory note. For most federal student loans, you will default if you have not made a payment in more than 270 days. You may ...

Work-Study

A federal student aid program that provides part-time employment while you are enrolled in school to help pay your education expenses.

Federal Student Aid

Financial aid from the federal government to help you pay for education expenses at an eligible college or career school. Grants, loans and work-study are types of federal student aid. You must com...

5. Understanding College Costs

The cost of college can include a variety of items including some you might not expect. By understanding college costs, you can compare schools and explore options for how to lower your costs.

What is included in the cost of college?
How can I lower the cost of college?
How can I compare the costs of colleges?

What is included in the cost of college?

College costs include more than tuition and ROOM AND BOARD. Here are common costs:

Item	Description
Tuition	The cost of taking courses. Course costs vary by school.
Room and board	Lodging and food costs vary by school.
Books and school supplies	Books can be expensive. School supplies include • book bags; • notebooks; • pens and pencils; • paper and computer paper; and • desk accessories such as folders, trays, and pen holders.
Fees	Fees depend upon your school. Examples include activity fees and parking decal fees. Schools can provide a list of fees.
Equipment and room materials	This category might include • a computer and printer; • reading lamps; • a microwave and refrigerator; and • sheets, towels, etc.
Travel and miscellaneous expenses	• If you commute to school, include transportation costs. • If you live on campus, include travel during school breaks. • You may also want to include clothing and mobile phone costs.

Make sure colleges and career schools give you a clear statement of their tuition and fees.

How can I lower the cost of college?

Here are some suggestions on how you might be able to lower the cost of college. For many of these suggestions, you'll want to follow up with the colleges or career schools you are interested in to get additional details.

- Set a BUDGET and stick to it! Having a budget will help you compare anticipated college or career school expenses against your potential available income and financial aid. You also can use a budget to compare costs between different schools. Learn about budgeting.

- College or career school costs can vary significantly and there are many schools with affordable tuition and generous financial assistance. Make sure to research all schools that may meet your academic and financial needs. To find colleges or career schools, use our college search tool, *College Navigator*.

- You may be able to get school credit based on your knowledge or life experiences, and you can manage your course work to reduce costs.
    - Ask your school whether it's possible to "test out of" any classes. If you don't take a class, you may not have to pay for the credits.
    - Some colleges give credit for life experiences, thereby reducing the number of credits needed for graduation.
    - Most schools charge a set price for a specific number of credits taken in a semester. If academically possible, take the maximum number of credits allowed. This strategy reduces the amount of time needed to graduate.
    - Some schools offer combined degree programs or three-year programs that allow you to take all of the courses needed for graduation in three years, instead of four, thereby eliminating one year's educational expenses.

- Colleges and career schools may offer discounts on tuition if
    - you are a child of an alumnus or alumna (i.e., if your parent

went to the school);
  - more than one family member is enrolled at the school;
  - you are a student government leader or the editor of the college newspaper or yearbook;
  - you are an older student;
  - your family's main wage earner is unemployed; or
  - you or a member of your family works at the school.

- Housing costs can add up. Here are some tips for reducing your housing costs:
  - If you go to a college or career school near home, consider living with your parents or other family.
  - If you live off-campus, consider sharing a house or apartment with multiple housemates to cut down the cost of rent, and carpool to save on gas and parking.
  - Most colleges and universities sponsor resident advisor programs that offer reduced tuition or reduced room and board costs if you work in a residence hall.
- You may be eligible for health care benefits including the following:
  - Most young adults can stay on their parents' family plan until they turn 26, even if they are married or still living with their parents.
  - If you have been uninsured because of a pre-existing condition, you may be eligible to join the Pre-Existing Condition Insurance Plan.
  - If you are in a new insurance plan, insurance companies cannot charge you a deductible or copays for recommended or preventive services such as flu shots or other immunizations.
- You can work part-time to pay part of your costs. Be sure your work and school schedules don't conflict and that you have enough time for studying. Here are a couple of options:
  - The Federal Work-Study Program provides an opportunity

    to earn money while going to school. Ask schools if they participate in the program.
  - Cooperative education programs allow students to alternate between working full-time and studying full-time.
  - Most schools have placement offices that help students find employment and personnel offices that hire students to work on campus.
- Taking small steps can add up. For example, you can lower the cost of textbooks if you buy used books or rent textbooks (if you won't need the books once you finish the class).

A credit card can help you build a credit history, if you use it wisely. But use it for emergencies only and don't spend more than you can afford to pay. If you decide to get a credit card, make sure you understand the terms.

How can I compare the costs of colleges?

You can find information about whether the cost of a college is low, medium, or high by using the *College Scorecard*. Keep in mind that a higher-priced school might have more financial aid available to help you pay for your education, so take a look at the school's net price if you want an idea of how much it might cost you after financial aid is taken into account.

Quick Links

- Applying to Schools
- Taking Required Tests

- Types of Aid
- Things to Consider

Glossary

Room and Board

An allowance for the cost of housing and food while attending college or career school.

Budget

A financial plan that helps you track your money, make informed spending decisions, and plan for your financial goals.

6. Saving and Investing

Find popular topics about saving and investing.

What's on This Page

- Manage Finances and Save Money
- Steps to Make a Budget
- Saving for Retirement
- Savings Bonds
- Treasury Securities
- Trusts
- Things to Consider Before You Invest
- Tools to Research Investments
- Choose a Financial Professional
- Pyramid Schemes

Manage Finances and Save Money

To help you manage your money and reach your saving goals:

Create a Budget

A budget is your plan for how you will spend money over a set period of time. It shows how much money you make and how you spend your money. Creating a budget can help you:

- Pay your bills on time.

- Save for unplanned expenses in the future.
- Prepare for retirement.

Download a budget spreadsheet that you can use to create your own to manage your monthly income and expenses.

Consider Ways to Save

Saving money involves looking for deals and buying the quality items you need at the best price. You can save money by comparison shopping, comparing the prices and quality of products you plan to buy. MyMoney.gov offers ways to manage your spending and build your savings accounts to achieve your saving goals.

Invest in Long Term Goals

Investing is a way to make money grow, by buying shares of stocks, mutual funds, bonds, or real estate. When you invest, there is risk that you could lose the money you invest; in general the greater the earnings you can make, the greater the risk. You can save for long term goals, such as retirement (PDF, Download Adobe Reader) and college education, by investing. Learn how to savefor emergencies, short term and long term goals, and become an informed investor.

Steps to Make a Budget

See this video to learn how to make a budget and plan your finances.

One or more interactive elements has been excluded from this version of the text. You can view them online here: https://library.achievingthedream.org/lfccpersonalfinance/?p=27

Show the Video Transcript

Saving for Retirement

As you approach retirement, there are many things to think about. Experts advise that you will need about 80 percent of your pre-retirement income to continue your current quality of life. The exact amount depends on your individual needs. Some important factors to consider include:

- At what age do you plan to retire?
- Can you participate in an employer's retirement savings plan, such as a 401(k) plan, or a traditional pension plan?
- Will your spouse or partner retire when you do?
- Where do you plan to live when you retire? Will you downsize, rent, or own your home?
- Do you expect to work part-time?
- Will you have the same medical insurance you had while working? Will your coverage change?
- Do you want to travel or pursue a new hobby that might be costly?

Resources to Help You Prepare for Retirement

To help you plan for retirement:

- Find practical tips for building retirement savings in the Top 10 Ways to Prepare for Retirement(PDF, Download Adobe Reader).
- Use a retirement calculator to find out the best age to claim your Social Security benefits.
- myRA can help you start saving for retirement when you don't have access to an employer-sponsored plan or lack other options to save.
- Find out the trade-offs between taking your pension in a monthly payment or in a lump sum(PDF, Download Adobe Reader).
- Social Security pays benefits that are on average equal to about 40 percent of your pre-retirement earnings. You may be able to estimate your benefits.
- Learn how you can boost your retirement savings at Investor.gov.
- If you have a financial advisor, talk to him or her about your plans.

Savings Bonds

U.S. savings bonds are one of the safest types of investments because they are endorsed by the federal government and, therefore, are virtually risk free.

Visit TreasuryDirect, a website from the U.S. Department of the Treasury, to learn about savings bonds, treasury bonds, and securities: how to buy and redeem your investments, what to do in the event of the death of an owner, and much more. TreasuryDirect is your one-stop shopping site for government securities where you can find information about the wide range of savings options, including EE/E, HH/H, and I savings bonds.

Manage and determine the value of savings bonds using these tools:

- Savings Bond Calculator
- Savings Bond Wizard
- Redemption Tables

You can give savings bonds for many occasions, such as birthdays, weddings, and graduations. Learn how to give savings bonds as gifts.

Treasury Securities

Treasury securities are debts issued by the federal government's Bureau of Fiscal Service. When you buy a treasury security, you are lending money to the federal government for a set amount of time. In return the government promises to pay you back the entire amount, also known as the face value, when the security matures.

There are several types of treasury securities:

- Treasury Bills—Short term securities that mature between a few days and 52 weeks.
- Treasury Notes—Medium term securities that mature between one and 10 years.
- Treasury Bonds—Long term securities, with a 30 year term that pays interest every six months, until the bond matures.
- Treasury Inflation-Protected Securities (TIPS)—Securities with principle values that adjust based on inflation, but with fixed interest rates for five, 10, or 30 year maturities.
- Savings Bonds—Securities that offer a fixed interest rate over a

fixed period of time.
- Floating Rate Notes (FRNs)—Securities with variable interest rates, so that as bank interest rates increase or decrease, the interest rates on the FRNs change in the same direction.

You can purchase treasury securities for yourself or as gifts. You can purchase them in several ways:

- Banks, brokers, and other financial institutions through the Commercial Book-Entry System.
- Online through Treasury Direct
- Payroll savings plans
- Public auctions

Trusts

A trust (or trust fund) is a legal entity that allows a person (the grantor, donor, or settlor) to transfer assets to another person or organization (the trustee). Once the grantor establishes the trust, the trustee controls and manages the assets for the grantor or for another beneficiary—someone who will ultimately benefit from the trust. To help you decide if a trust is right for you, first consult a licensed attorney experienced with estate planning and trust matters.

Reasons to Set Up a Trust

Some common reasons for setting up a trust include:

- Providing for minor children or family members who are inexperienced or unable to handle financial matters
- Arranging for management of personal assets, if you become

unable to handle them yourself

- Avoiding probate and immediately transferring assets to beneficiaries upon death
- Reducing estate taxes and providing liquid assets to help pay for them
- The terms of a will are public while the terms of a trust are not, so privacy makes a trust an appealing option.

Types of Trusts

Trusts can be living (inter vivos) or after-death (testamentary). A living trust is one that a grantor sets up while still alive and an after-death trust is usually established by a will after one's death. Living trusts can be irrevocable (can't be changed) or revocable (can be changed), although revocable trusts don't get the same tax shelter benefits as irrevocable ones do.

The most common type of trust is the revocable living trust. If there's a specific purpose in mind for the trust, dozens of different options exist (charitable trusts, bypass trusts, spendthrift trusts, and life insurance trusts). Two types of trusts can help pay for long-term care services:

- **Charitable Remainder Trusts** – This trust allows you to use your own assets to pay for long-term care services while contributing to a charity of your choice and reducing your tax burden at the same time. You can set up the trust so that you receive payments from the trust to pay for long-term care services while you are alive.
- **Medicaid Disability Trusts** – These trusts are limited to persons with disabilities who are under age 65 and qualify for public benefits. Parents, grandparents, and legal guardians often set up these trusts to benefit people with disabilities and a non-profit organization manages the assets. This is the only

kind of trust that is exempt from rules regarding trusts and Medicaid eligibility.

Trust Scams and Fraud

If someone approaches you to set up a trust, be careful. Before signing any papers to create a living trust, will, or other kind of trust, make sure to explore all options and shop around to compare services. Some other tips to avoid trust scams and fraud include:

- Avoid high-pressure sales tactics and high-speed sales pitches.
- Stay away from salespeople who give the impression that specific organizations and recognized brands back or sell the trust.
- Research and get information about local probate laws from the Clerk or Register of Wills.
- If someone tries to sell a living trust to you, ask if they are an attorney. Some states restrict the sale of living trusts to licensed attorneys.
- If you buy a trust in your home or in another location that is not the seller's permanent place of business, remember you have the right to take advantage of the Cooling Off Rule and cancel the transaction within three business days.

Things to Consider Before You Invest

Do you have a financial goal in mind, such as saving for retirement, paying for college, or buying a new house? If so, then you may decide to invest your money to earn enough to fund your goals.

Before you invest, make sure you have answers to all of these questions:

- **How quickly can you get your money back?** Stocks, bonds, and shares in mutual funds usually can be sold at any time, but there is no guarantee that you will get back all the money you invested. Other investments, such as limited partnerships, certificates of deposit (CDs), or IRAs, often restrict your ability to cash out your holdings.
- **What can you expect to earn on your money?** While bonds generally promise a fixed return, earnings on most other securities go up and down with market changes. Keep in mind, just because an investment has done well in the past, there is no guarantee it will do well in the future.
- **What type of earnings can you expect?** Will you get income in the form of interest, dividends, or rent? Some investments, such as stocks and real estate, have the potential for earnings and growth in value. What is the potential for earnings over time?
- **How much risk is involved?** With any investment, there is always the risk that you will not get your money back or the earnings promised. There is usually a trade-off between risk and reward–the higher the potential return, the greater the risk. While the U.S. government backs U.S. Treasury securities, it does not protect against loss on any other investments.
- **Are your investments diversified?** Some investments perform better than others in certain situations. For example, when interest rates go up, bond prices tend to go down. One industry may struggle while another prospers. Putting your money in a variety of investment options can reduce your risk.
- **Are there any tax advantages to a particular investment?** U.S. savings bonds are exempt from state and local taxes. Municipal bonds are exempt from federal income tax and, sometimes, state income tax as well. Tax-deferred investments for special goals, such as paying for college and retirement, are available

that let you postpone or even avoid paying income taxes.

More Information on Investing

To learn more about investing, refer to these resources:

- You can find useful tips on investing at Investor.gov, a website from the Securities and Exchange Commission (SEC).
- For all of your investment-related questions, contact the SEC's Office of Investor Education and Advocacy.
- To get help preparing to invest, consult the Financial Industry Regulatory Authority (FINRA).

Tools to Research Investments

To help you make informed decisions when investing and avoid investment fraud, there are a variety of research tools available:

- Find investor news and alerts and a guide to investment products at Investor.gov, a website from the Securities and Exchange Commission (SEC).
- The SEC requires public companies to disclose financial and other information to help you make sound decisions. You can view the text of these files on EDGAR.
- The Financial Industry Regulatory Authority (FINRA) has up-to-date market data and information for a wide range of stocks, bonds, mutual funds, and other securities.
- If you are considering investing in collectible coins, refer to the U.S. Mint. Before you purchase coins or coin-related products, research the seller with a government agency, such as your state consumer protection office or the Federal Trade

Commission (FTC).

Choose a Financial Professional

A financial professional can have multiple titles and be authorized to provide various services, including investment, financial planning, and insurance products. When researching a financial professional, find out what the titles and licenses mean, as well as the educational, work experience, and ethical requirements. Keep in mind that a professional title is not the same as a license. The Securities and Exchange Commission (SEC), the Financial Industry Regulatory Authority (FINRA), and state regulators do not grant or endorse any professional titles.

When choosing a broker or investment adviser, research the person's education and professional history as well as the firm the person works for. Make sure you have answers to all of these questions:

- **Has the person worked with others who have circumstances similar to yours?**
- **Is the person licensed in your state?** Your state securities regulator lists individuals and firms that are registered in your state. Ask whether the regulatory office has any other background information. To find out how to contact your state securities regulator, consult the North American Securities Administrators Association (NASAA).
- **Has the person had any run-ins with regulators or received serious complaints from investors?** Contact your state securities regulator or the SEC. To review licensing, employment, and disciplinary information, use FINRA's BrokerCheck tool.
- **How is the person paid?** Is it an hourly rate, a flat fee, or a commission that depends on the investments you make? Does

the person get a bonus from their firm for selling you a particular product?
- **What are the fees for setting up and servicing your account?**

Resources to Help You Choose a Financial Professional

For more information on choosing a financial professional, refer to these resources:

- The Commodity Futures Trading Commission's (CFTC's) SmartCheck allows you to check the background of financial professionals and stay informed on the latest fraud schemes.
    - To ask a question, report information, or file a complaint, contact the CFTC.
- The Financial Industry Regulatory Authority (FINRA) has information on the professional designations of financial professionals and the organizations that offer them.
- Both the North American Securities Administrators Association (NASAA) and the National Futures Association can offer helpful information on saving and investing.

Pyramid Schemes

A pyramid scheme, also known as Ponzi scheme, is an illegal form of multilevel marketing. In these scams, your ability to earn profits is based on the number of new participants you recruit, instead of the amount of products or services you sell. Sometimes there actually aren't any real products that are being sold. These types of schemes are common with investment and independent direct selling opportunities.

These schemes rely on the income from new participants in order to pay fake "profits" to people that have been part of the scheme for longer amounts of time. However, the scheme falls apart when there aren't enough new recruits to pay into the system, so the earlier participants no longer receive earnings.

Tips to Avoid Being a Victim

Take steps to protect yourself from being a victim of a pyramid scheme:

- Be wary of "opportunities" to invest your money in franchises or investments that require you to bring in more investors to increase your profit, or recoup your initial investment.
- Be wary if the company sells non-tangible products or technical services, rather than physical items.
- Independently verify the legitimacy of any franchise or investment with the Better Business Bureau, your state Attorney General, or any licensing agencies.
- Be skeptical of success stories and testimonials of fantastic earnings.

File a Complaint

If you are aware of a pyramid scheme or have been the victim of one, file a complaint with your state consumer protection office, state Attorney General, or the Better Business Bureau (BBB). If the pyramid scheme involved securities, you should also file a complaint with your state's securities administrator, or the Securities and Exchange Commission.

PART III

MODULE 2: PERSONAL BALANCE SHEET

7. Financial Statements

Introduction

Man is the measure of all things; of that which is, that it is; of that which is not, that it is not.

Protagoras (ca. 490–421 BC), in Plato's Protagoras

Man is also the measurer of all things. Measuring by counting, by adding it all up, by taking stock, is probably as old as any human activity. In recorded history, there are "accounts" on clay tablets from ancient Sumeria dating from ca. 3,700 BC.[1] Since the first shepherd counted his sheep, there has been accounting.

In financial planning, assessing the current situation, or figuring out where you are at present, is crucial to determining any sort of financial plan. This assessment becomes the point of departure for any strategy. It becomes the mark from which any progress is measured, the principal from which any return is calculated. It can determine the practical or realistic goals to have and the strategies to achieve them. Eventually, the current situation becomes a time forgotten with the pride of success, or remembered with the regret of failure.

Understanding the current situation is not just a matter of measuring it, but also of putting it in perspective and in context,

1. Gary Giroux, http://acct.tamu.edu/giroux/AncientWorld.html (accessed January 19, 2009).

relative to your own past performance and future goals, and relative to the realities in the economic world around you. Tools for understanding your current situation are your accounting and financial statements.

3.1 Accounting and Financial Statements

LEARNING OBJECTIVES

1. Distinguish accrual and cash accounting.
2. Compare and contrast the three common financial statements.
3. Identify the results shown on the income statement, balance sheet, and cash flow statement.
4. Explain the calculation and meaning of net worth.
5. Trace how a bankruptcy can occur.

Clay tablets interested Sumerian traders because the records gave them a way to see their financial situation and to use that insight to measure progress and plan for the future. The method of accounting universally used in business today is known as accrual accounting, in which events are accounted for even if cash does not change hands. That is, transactions are recorded at the time they occur rather than when payment is actually made or received. Anticipated or preceding payments and receipts (cash flows) are recorded as accrued or deferred. Accrual accounting is the opposite of cash accounting, in which transactions are recognized only when cash is exchanged.

Accrual accounting defines earning as an economic event signified by an exchange of goods rather than by an exchange of cash. In this way, accrual accounting allows for the separation in time of the exchange of goods and the exchange of cash. A transaction can be completed over time and distance, which allows for extended—and extensive—trade. Another advantage of accrual accounting is that it gives a business a more accurate picture of its present situation in reality.

Modern accounting techniques developed during the European Age of Discovery, which was motivated by ever-expanding trade. Both the principles and the methods of modern accrual accounting were first published in a text by Luca Pacioli in 1494,[2] although they were probably developed even before that. These methods of "keeping the books" can be applied to personal finance today as they were to trading in the age of long voyages for pepper and cloves, and with equally valuable results.

Nevertheless, in personal finance it almost always makes more sense to use cash accounting, to define and account for events when the cash changes hands. So in personal finance, incomes and

2. Luca Pacioli, *Summa de arithmetica, geometria, proportioni et proportionalita* (Venice: Luca Pacioli, 1494). For more information on Pacioli, see http://en.wikipedia.org/wiki/Luca_Pacioli (accessed November 23, 2009).

expenses are noted when the cash is received or paid, or when the cash flows.

The Accounting Process

Financial decisions result in transactions, actual trades that buy or sell, invest or borrow. In the market economy, something is given up in order to get something, so each trade involves at least one thing given up and one thing gotten—two things flowing in at least two directions. The process of accounting records these transactions and records what has been gotten and what has been given up to get it, what flows in and what flows out.

In business, accounting journals and ledgers are set up to record transactions as they happen. In personal finance, a checkbook records most transactions, with statements from banks or investment accounts providing records of the rest. Periodically, the transaction information is summarized in financial statements so it can be read most efficiently.

Bookkeeping—the process of recording what and how and by how much a transaction affects the financial situation—is how events are recorded. Since the advent of accounting software, bookkeeping, like long division and spelling, has become somewhat obsolete, although human judgment is still required. What is more interesting and useful are the summary reports that can be produced once all this information is recorded: the income statement, cash flow statement, and balance sheet.

Income Statement

The income statement summarizes incomes and expenses for a period of time. In business, income is the value of whatever is sold, expenses are the costs of earning that income, and the difference is profit. In personal finance, income is what is earned as wages or salary and as interest or dividends, and expenses are the costs of things consumed in the course of daily living: the costs of sustaining *you*while you earn income. Thus, the income statement is a measure of what you have earned and what your cost of living was while earning it. The difference is personal profit, which, if accumulated as investment, becomes your wealth.

The income statement clearly shows the relative size of your income and expenses. If income is greater than expenses, there is a surplus, and that surplus can be used to save or to spend more (and create more expenses). If income is less than expenses, then there is a deficit that must be addressed. If the deficit continues, it creates debts—unpaid bills—that must eventually be paid. Over the long term, a deficit is not a viable scenario.

The income statement can be useful for its level of detail too. You can see which of your expenses consumes the greatest portion of your income or which expense has the greatest or least effect on your bottom line. If you want to reduce expenses, you can see which would have the greatest impact or would free up more income if you reduced it. If you want to increase income, you can see how much more that would buy you in terms of your expenses (Figure 3.3 "Alice's Situation (in Dollars)"). For example, consider Alice's situation per year.

Figure 3.3 Alice's Situation (in Dollars)

Gross wages	44,650
Income taxes and deductions	8,930
Rent expense	10,800
Living expenses	14,400

She also had car payments of $2,400 and student loan payments of $7,720. Each loan payment actually covers the interest expense and partial repayment of the loan. The interest is an expense representing the cost of borrowing, and thus of having, the car and the education. The repayment of the loan is not an expense, however, but is just giving back something that was borrowed. In this case, the loan payments break down as follows (Figure 3.4 "Alice's Loan Payments (Annually)").

Figure 3.4 Alice's Loan Payments (Annually)

	Interest	Debt Repayment
Car Loan	240	2,160
Student Loan	4,240	3,480

Breaking down Alice's living expenses in more detail and adding in her interest expenses, Alice's income statement would look like this (Figure 3.5 "Alice's Income Statement for the Year 2009").

Figure 3.5 Alice's Income Statement for the Year 2009

Gross wages		**44,650**
Income taxes and deductions	8,930	
Disposable income		35,720
Rent expense	10,800	
Food	3,900	
Car expenses	3,600	
Clothing	1,800	
Cell phone	1,200	
Internet and cable TV	1,200	
Entertainment, travel, etc.	2,700	
Total living expenses		25,200
Car loan interest	240	
Student loan interest	4,240	
Total interest expenses		4,480
Net income		6,040

Alice's disposable income, or income to meet expenses after taxes have been accounted for, is $35,720. Alice's net ncome, or net earnings or personal profit, is the remaining income after all other expenses have been deducted, in this case $6,040.

Now Alice has a much clearer view of what's going on in her financial life. She can see, for example, that living expenses take the biggest bite out of her income and that rent is the biggest single expense. If she wanted to decrease expenses, finding a place to live with a cheaper rent will make the most impact on her bottom line. Or perhaps it would make more sense to make many small changes rather than one large change, to cut back on several other expenses. She could begin by cutting back on the expense items that she feels are least necessary or that she could most easily live without. Perhaps she could do with less entertainment or clothing or travel, for example. Whatever choices she subsequently made would be reflected in her income statement. The value of the income statement is in presenting income and expenses in detail for a particular period of time.

Cash Flow Statement

The cash flow statement shows how much cash came in and where it came from, and how much cash went out and where it went over a period of time. This differs from the income statement because it may include cash flows that are not from income and expenses. Examples of such cash flows would be receiving repayment of money that you loaned, repaying money that you borrowed, or using money in exchanges such as buying or selling an asset.

The cash flow statement is important because it can show how well you do at creating liquidity, as well as your net income. Liquidity is nearness to cash, and liquidity has value. An excess of liquidity can be sold or lent, creating additional income. A lack of liquidity must be addressed by buying it or borrowing, creating additional expense.

Looking at Alice's situation, she has two loan repayments that are not expenses and so are not included on her income statement. These payments reduce her liquidity, however, making it harder for her to create excess cash. Her cash flow statement looks like this (Figure 3.6 "Alice's Cash Flow Statement for the Year 2009").

Figure 3.6 Alice's Cash Flow Statement for the Year 2009

Cash from gross wages	**44,650**
Cash paid for:	
Income taxes and deductions	(8,930)
Rent expense	(10,800)
Food	(3,900)
Car expenses	(3,600)
Clothing	(1,800)
Cell phone	(1,200)
Internet and cable TV	(1,200)
Entertainment, travel, etc.	(2,700)
Car loan interest	(240)
Student loan interest	(4,240)
Cash for repayment of car loan	(2,160)
Cash for repayment of student loan	(3,480)
Net cash flow	400

Note: On a cash flow statement, negative and positive numbers indicate direction of flow. A negative number is cash flowing out, and a positive number is cash flowing in. Conventionally, negative numbers are in parentheses.

As with the income statement, the cash flow statement is more useful if there are subtotals for the different kinds of cash flows, as defined by their sources and uses. The cash flows from income and expenses are operating cash flows, or cash flows that are a consequence of earning income or paying for the costs of earning income. The loan repayments are cash flows from financing assets or investments that will increase income. In this case, cash flows from financing include repayments on the car and the education. Although Alice doesn't have any in this example, there could also be cash flows from investing, from buying or selling assets. Free cash flow is the cash available to make investments or financing decisions after taking care of operations and debt obligations. It is calculated as cash flow from operations less debt repayments.

The most significant difference between the three categories of cash flows—operating, investing, or financing—is whether or not the cash flows may be expected to recur regularly. Operating cash flows recur regularly; they are the cash flows that result from income and expenses or consumption and therefore can be expected to occur in every year. Operating cash flows may be different amounts in different periods, but they will happen in every period. Investing and financing cash flows, on the other hand, may or may not recur and often are unusual events. Typically, for example, you would not borrow or lend or buy or sell assets in every year. Here is how Alice's cash flows would be classified (Figure 3.7 "Alice's Cash Flow Statement for the Year 2009").

Figure 3.7 Alice's Cash Flow Statement for the Year 2009

Cash from gross wages	44,650	
Cash paid for:		
Income taxes and deductions	(8,930)	
Rent expense	(10,800)	
Food	(3,900)	
Car expenses	(3,600)	
Clothing	(1,800)	
Cell phone	(1,200)	
Internet and cable TV	(1,200)	
Entertainment, travel, etc.	(2,700)	
Car loan interest	(240)	
Student loan interest	(4,240)	
Operating cash flows		6,040
Cash for repayment of car loan	(2,160)	
Cash for repayment of student loan	(3,480)	
Financing cash flows		(5,640)
Net cash flow		400

This cash flow statement more clearly shows how liquidity is created and where liquidity could be increased. If Alice wanted to create more liquidity, it is obvious that eliminating those loan payments would be a big help: without them, her net cash flow would increase by more than 3,900 percent.

Balance Sheet

In business or in personal finance, a critical piece in assessing the current situation is the balance sheet. Often referred to as the "statement of financial condition," the balance sheet is a snapshot of what you have and what you owe at a given point in time. Unlike the income or cash flow statements, it is not a record of performance over a period of time, but simply a statement of where things stand at a certain moment.

The balance sheet is a list of assets, debts or liabilities, and equity or net worth, with their values. In business, assets are resources that can be used to create income, while debt and equity are the capital that financed those assets. Thus, the value of the assets must equal the value of the debt and the equity. In other words, the value of the business's resources must equal the value of the capital it borrowed or bought in order to get those resources.

assets = liabilities + equity

In business, the accounting equation is as absolute as the law of gravity. It simply must always be true, because if there are assets, they must have been financed somehow—either through debt or equity. The value of that debt and equity financing must equal or balance the value of the assets it bought. Thus, it is called the "balance" sheet because it *always* balances the debt and equity with the value of the assets.

In personal finance, assets are also things that can be sold to create liquidity. Liquidity is needed to satisfy or repay debts. Because your assets are what you use to satisfy your debts when they become due, the assets' value should be greater than the value of your debts. That is, you should have more to work with to meet your obligations than you owe.

The difference between what you have and what you owe is your net worth. Literally, net worth is the share that you own of everything that you have. It is the value of what you have *net of* (less) what you owe to others. Whatever asset value is left over after you meet your debt obligations is your own worth. It is the value of what you have that you can claim free and clear.

assets − debt = net worth

Your net worth is really your equity or financial ownership in your own life. Here, too, the personal balance sheet must balance, because if

assets − debts = net worth,

then it should also be

assets = debts + net worth.

Alice could write a simple balance sheet to see her current financial condition. She has two assets (her car and her savings account), and she has two debts (her car and student loans) (Figure 3.8 "Alice's Balance Sheet, December 31, 2009").

Figure 3.8 Alice's Balance Sheet, December 31, 2009

Assets		Liabilities	
Car	5,000	Car Loan	2,700
Savings	250	Student Loan	53,000
Total	5,250	Total	55,700
		Net Worth	(50,450)

Alice's balance sheet presents her with a much clearer picture of her financial situation, but also with a dismaying prospect: she seems to have negative net worth. Negative net worth results whenever the value of debts or liabilities is actually greater than the assets' value. If

$$\text{liabilities} < \text{assets}$$

then assets – liabilities>0; net worth>0 (net worth is positive) Ifliabi lities>assets then assets – liabilities<0; net worth<0 (net worth is ne gative)

Negative net worth implies that the assets don't have enough value to satisfy the debts. Since debts are obligations, this would cause some concern.

Net Worth and Bankruptcy

In business, when liabilities are greater than the assets to meet them, the business has negative equity and is literally bankrupt. In that case, it may go out of business, selling all its assets and giving whatever it can to its creditors or lenders, who will have to settle for less than what they are owed. More usually, the business continues to operate in bankruptcy, if possible, and must still repay its creditors, although perhaps under somewhat easier terms. Creditors (and the laws) allow these terms because creditors would rather get paid in full later than get paid less now or not at all.

In personal finance, personal bankruptcy may occur when debts are greater than the value of assets. But because creditors would rather be paid eventually than never, the bankrupt is usually allowed to continue to earn income in the hopes of repaying the debt later or with easier terms. Often, the bankrupt is forced to liquidate (sell) some or all of its assets.

Because debt is a legal as well as an economic obligation, there are laws governing bankruptcies that differ from state to state in the United States and from country to country. Although debt forgiveness was discussed in the Old Testament, throughout history it was not uncommon for bankrupts in many cultures to be put to death, maimed, enslaved, or imprisoned.[3] The use of another's property or wealth is a serious responsibility, so debt is a serious obligation.

However, Alice's case is actually not as dismal as it looks, because Alice has an "asset" that is not listed on her balance sheet, that is, her education. It is not listed on her balance sheet because the value of her education, like the value of any asset, comes from how useful it is, and its usefulness has not happened yet, but will happen over her lifetime. It will happen in her future, based on how she chooses to use her education to increase her income and wealth. It is difficult to assign a monetary value to her education now. Alice knows what she paid for her education, but, sensibly, its real value is not its cost but its potential return, or what it can earn for her as she puts it to use in the future.

Current studies show that a college education has economic value, because a college graduate earns more over a lifetime than a high school graduate. Recent estimates put that difference at about \$1,000,000.[4] So, if Alice assumes that her education will be worth \$1,000,000 in extra income over her lifetime, and she includes that

3. BankruptcyData.com, http://www.bankruptcydata.com/Ch11History.htm (accessed January 19, 2009).
4. Sandy Baum and Jennifer Ma, "Education Pays: The Benefits of Higher Education for Individuals and Society" (Princeton, NJ: The College Board, 2007).

asset value on her balance sheet, then it would look more like this (Figure 3.10 "Alice's Balance Sheet (revised), December 31, 2009"):

Figure 3.10 Alice's Balance Sheet (revised), December 31, 2009

Assets		Liabilities	
Car	5,000	Car Loan	2,700
Savings	250	Student Loan	53,000
Education	1,000,000	Total	55,700
Total	1,005,250	Net Worth	949,550

This looks much better, but it's not sound accounting practice to include an asset—and its value—on the balance sheet before it really exists. After all, education generally pays off, but until it does, it hasn't yet and there is a chance, however slim, that it won't for Alice. A balance sheet is a snapshot of one's financial situation at one particular time. At this particular time, Alice's education has value, but its amount is unknown.

It is easy to see, however, that the only thing that creates negative net worth for Alice is her student loan. The student loan causes her liabilities to be greater than her assets—and if that were paid off, her net worth would be positive. Given that Alice is just starting her adult earning years, her situation seems quite reasonable.

KEY TAKEAWAYS

- Three commonly used financial statements are the income statement, the cash flow statement, and the balance sheet.
- Results for a period are shown on the income statement and the cash flow statement. Current conditions are shown on the balance sheet.
- The income statement lists income and expenses.
- The cash flow statement lists three kinds of cash flows: operating (recurring), financing (nonrecurring), and investing (nonrecurring).
- The balance sheet lists assets, liabilities (debts), and net worth.
- Net worth = assets − debts.
- Bankruptcy occurs when there is negative net worth, or when debts are greater than assets.

EXERCISES

1. Prepare a personal income statement for the past year, using the same format as Alice's income statement in this chapter. Include all relevant categories of income and expenses. What does your income statement tell you about your current financial situation? For example, where does your income come from, and where does it go? Do you have a surplus of income over expenses? If, so what are you doing with the surplus? Do you have a deficit? What can you do about that? Which of your expenses has the greatest effect on your bottom line? What is the biggest expense? Which expenses would be easiest to reduce or eliminate? How else could you reduce expenses? Realistically, how could you increase your income? How would you like your income statement for the next year to look?
2. Using the format for Alice's cash flow statement, prepare your cash flow statement for the same one-year period. Include your cash flows from all sources in addition to your operating cash flows—the income and expenses that appear on your income statement. What, if any, were the cash flows from financing and the cash flows from investing? Which of your cash flows are recurring, and which are nonrecurring? What does your cash flow statement tell you about your current financial situation? If you wanted to increase your liquidity, what would you try to change about your cash flows?
3. Now prepare a balance sheet, again based on Alice's form. List all your assets, liabilities and debts, and your equity from all sources. What does the balance sheet show about your financial situation at this moment in time? What is your net worth? Do you have positive or negative net worth at this time, and what does that mean? To increase your liquidity, how would your balance sheet need to change? What would be the

relationship between your cash flow statement and your budget?

4. Read the CNNMoney.com article “How Much Are You Worth?” (October 3, 2003, by Les Christie, at http://money.cnn.com/2003/09/30/pf/millionaire/networth/), and use the data and calculator to determine your net worth. How does you net worth compare to that of other Americans in your age and income brackets?
5. The Small Business Administration’s Personal Financial Statement combines features of an income statement and a balance sheet. You would fill out a similar form if you were applying for a personal or business loan at bank or mortgage lender. Go to http://www.sba.gov/sbaforms/sba413.pdf and compare and contrast the SBA form with the statements you have already created for this chapter’s exercises.

3.2 Comparing and Analyzing Financial Statements

LEARNING OBJECTIVES

1. Explain the use of common-size statements in financial analysis.
2. Discuss the design of each common-size statement.
3. Demonstrate how changes in the balance sheet may be explained by changes on the income and cash flow statements.
4. Identify the purposes and uses of ratio analysis.
5. Describe the uses of comparing financial statements over time.

Financial statements are valuable summaries of financial activities because they can organize information and make it easier and clearer to see and therefore to understand. Each one—the income statement, cash flow statement, and balance sheet—conveys a different aspect of the financial picture; put together, the picture is pretty complete. The three provide a summary of earning and expenses, of cash flows, and of assets and debts.

Since the three statements offer three different kinds of information, sometimes it is useful to look at each in the context of the others, and to look at specific items in the larger context. This is the purpose of financial statement analysis: creating comparisons and contexts to gain a better understanding of the financial picture.

Common-Size Statements

On common-size statements, each item's value is listed as a percentage of another. This compares items, showing their relative size and their relative significance (see Figure 3.11 "Common Common-Size Statements"). On the income statement, each income and expense may be listed as a percentage of the total income. This shows the contribution of each kind of income to the total, and thus the diversification of income. It shows the burden of each expense on total income or how much income is needed to support each expense.

On the cash flow statement, each cash flow can be listed as a percentage of total positive cash flows, again showing the relative significance and diversification of the sources of cash, and the relative size of the burden of each use of cash.

On the balance sheet, each item is listed as a percentage of total assets, showing the relative significance and diversification of assets, and highlighting the use of debt as financing for the assets.

Figure 3.11 Common Common-Size Statements

	Income Statement	Cash Flow Statement	Balance Sheet
Items as a % of	Total Income	Total Positive Cash Flows	Total Assets

Common-Size Income Statement

Alice can look at a common-size income statement by looking at her expenses as a percentage of her income and comparing the size of each expense to a common denominator: her income. This shows her how much of her income, proportionately, is used up for each expense (Figure 3.12 "Alice's Common-Size Income Statement for the Year 2009").

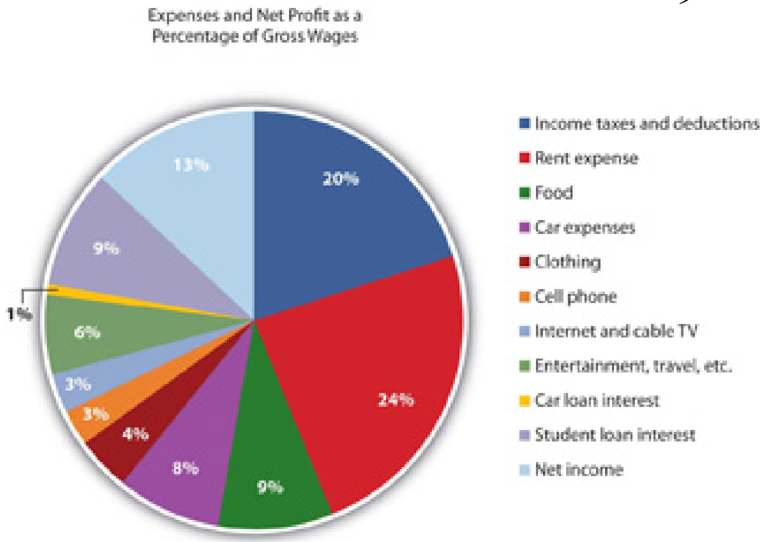
Figure 3.12 Alice's

Common-Size Income Statement for the Year 2009

Gross wages		44,650		100.00%
Income taxes and deductions	8,930		20.00%	
Disposable income		35,720		80.00%
Rent expense	10,800		24.19%	
Food	3,900		8.73%	
Car expenses	3,600		8.06%	
Clothing	1,800		4.03%	
Cell phone	1,200		2.69%	
Internet and cable TV	1,200		2.69%	
Entertainment, travel, etc.	2,700		6.05%	
Total living expenses		25,200		56.44%
Car loan interest	240		0.54%	
Student loan interest	4,240		9.50%	
Total interest expense		4,480		10.03%
Net income		6,040		13.53%

Seeing the common-size statement as a pie chart makes the relative size of the slices even clearer (Figure 3.13 "Pie Chart of Alice's Common-Size Income Statement for the Year 2009").

Figure 3.13 Pie Chart of Alice's Common-Size Income Statement for the Year 2009



The biggest discretionary use of Alice's wages is her rent expense, followed by food, car expenses, and entertainment. Her income tax expense is a big use of her wages, but it is unavoidable or nondiscretionary. As Supreme Court Justice Oliver Wendell Holmes, Jr., said, "Taxes are what we pay for a civilized society."[5] Ranking expenses by size offers interesting insight into lifestyle choices. It is also valuable in framing financial decisions, pointing out which expenses have the largest impact on income and thus on the

5. U.S. Department of the Treasury, http://www.treas.gov/education/faq/taxes/taxes-society.shtml (accessed January 19, 2009).

resources for making financial decisions. If Alice wanted more discretionary income to make more or different choices, she can easily see that reducing rent expense would have the most impact on freeing up some of her wages for another use.

Common-Size Cash Flow Statement

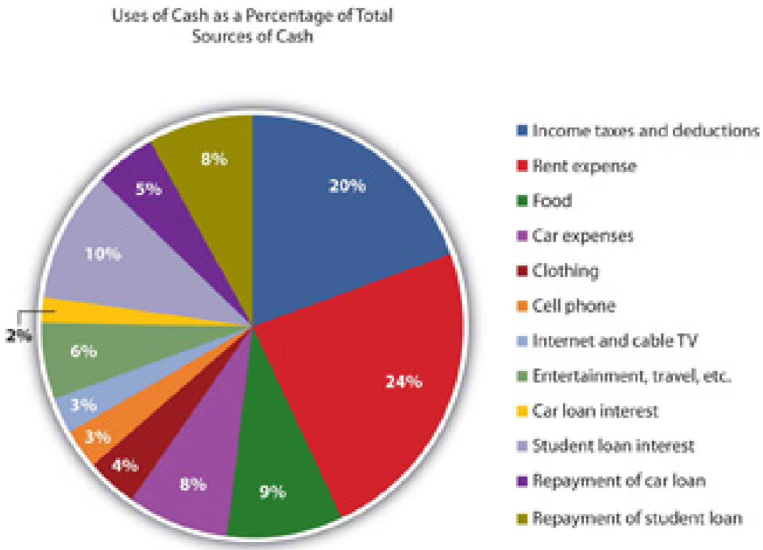
Looking at Alice's negative cash flows as percentages of her positive cash flow (on the cash flow statement), or the uses of cash as percentages of the sources of cash, creates the common-size cash flows. As with the income statement, this gives Alice a clearer and more immediate view of the largest uses of her cash (Figure 3.14 "Alice's Common-Size Cash Flow Statement for the Year 2009"and Figure 3.15 "Pie Chart of Alice's Common-Size Cash Flow Statement").

Figure 3.14 Alice's

Common-Size Cash Flow Statement for the Year 2009

Cash from gross wages	**44,650**		**100.00%**
Cash paid for:			
Income taxes and deductions	(8,930)		−20.00%
Rent expense	(10,800)		−24.19%
Food	(3,900)		−8.73%
Car expenses	(3,600)		−8.06%
Clothing	(1,800)		−4.03%
Cell phone	(1,200)		−2.69%
Internet and cable TV	(1,200)		−2.69%
Entertainment, travel, etc.	(2,700)		−6.05%
Car loan interest	(240)		−0.54%
Student loan interest	(4,240)		−9.50%
Operating cash flows		6,040	13.53%
Cash for repayment of car loan	(2,160)		−4.84%
Cash for repayment of student loan	(3,480)		−7.79%
Financing cash flows		(5,640)	−12.63%
Net cash flow		400	0.00%

Figure 3.15 Pie Chart of Alice's Common-Size Cash Flow Statement



Again, rent is the biggest discretionary use of cash for living expenses, but debts demand the most significant portion of cash flows. Repayments and interest together are 30 percent of Alice's cash—as much as she pays for rent and food. Eliminating those debt payments would create substantial liquidity for Alice.

Common-Size Balance Sheet

On the balance sheet, looking at each item as a percentage of total assets allows for measuring how much of the assets' value is obligated to cover each debt, or how much of the assets' value is claimed by each debt (Figure 3.16 "Alice's Common-Size Balance Sheet, December 31, 2009").

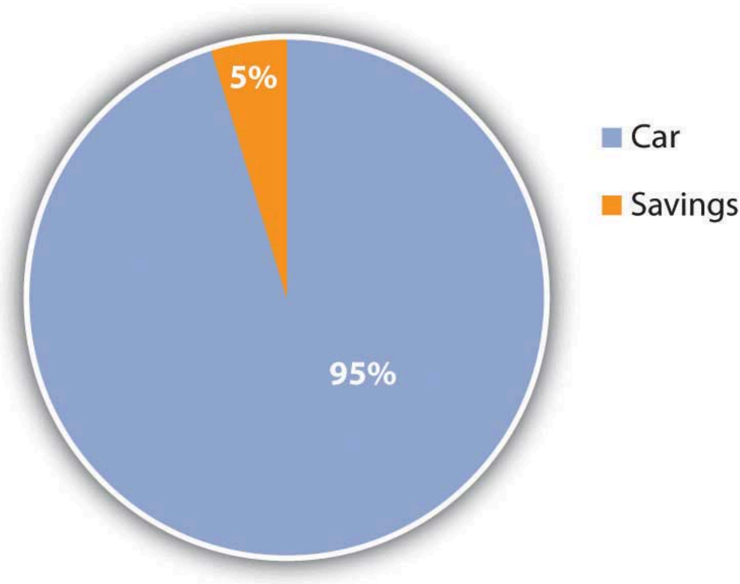
Figure 3.16 Alice's Common-Size Balance Sheet, December 31, 2009

Assets			Liabilities		
Car	5,000	95%	Car Loan	2,700	51%
Savings	250	5%	Student Loan	53,000	1,010%
Total	5,250	100%	Total	55,700	1,061%
			Net Worth	(50,450)	(961%)

This common-size balance sheet allows "over-sized" items to be more obvious. For example, it is immediately obvious that Alice's student loan dwarfs her assets' value and creates her negative net worth.

Common-size statements allow you to look at the size of each item relative to a common denominator: total income on the income statement, total positive cash flow on the cash flow statement, or total assets on the balance sheet. The relative size of the items helps you spot anything that seems disproportionately large or small. The common-size analysis is also useful for comparing the diversification of items on the financial statement—the diversification of incomes on the income statement, cash flows on the cash flow statement, and assets and liabilities on the balance sheet. Diversification reduces risk, so you want to diversify the sources of income and assets you can use to create value (Figure 3.17 "Pie Chart of Alice's Common-Size Balance Sheet: The Assets").

Figure 3.17 Pie Chart of Alice's Common-Size Balance Sheet: The Assets



For example, Alice has only two assets, and one—her car—provides 95 percent of her assets' value. If something happened to her car, her assets would lose 95 percent of their value. Her asset value would be less exposed to risk if she had asset value from other assets to diversify the value invested in her car.

Likewise, both her income and her positive cash flows come from only one source, her paycheck. Because her positive net earnings and positive net cash flows depend on this one source, she is exposed to risk, which she could decrease by diversifying her sources of income. She could diversify by adding earned income—taking on a second job, for example—or by creating investment income. In order to create investment income, however, she needs to have a surplus of liquidity, or cash, to invest. Alice has run head first into Adam Smith's "great difficulty"[6] (that it takes some money to make money; see Chapter 2 "Basic Ideas of Finance").

Relating the Financial Statements

Common-size statements put the details of the financial statements in clear relief relative to a common factor for each statement, but each financial statement is also related to the others. Each is a piece of a larger picture, and as important as it is to see each piece, it is also important to see that larger picture. To make sound financial decisions, you need to be able to foresee the consequences of a decision, to understand how a decision may affect the different aspects of the bigger picture.

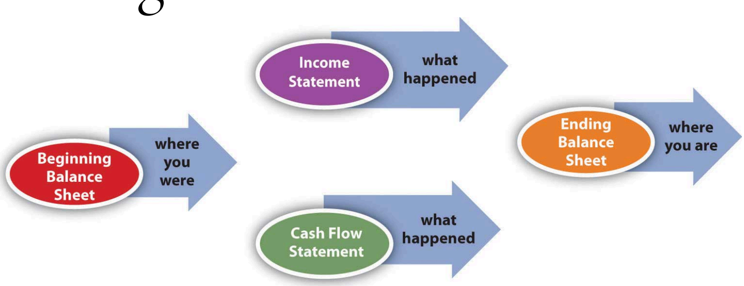
For example, what happens in the income statement and cash flow statements is reflected on the balance sheet because the earnings and expenses and the other cash flows affect the asset values, and the values of debts, and thus the net worth. Cash may be used to purchase assets, so a negative cash flow may increase assets. Cash may be used to pay off debt, so a negative cash flow may decrease liabilities. Cash may be received when an asset is sold,

6. Adam Smith, *The Wealth of Nations* (New York: The Modern Library, 2000), Book I, Chapter ix.

so a decrease to assets may create positive cash flow. Cash may be received when money is borrowed, so an increase in liabilities may create a positive cash flow.

There are many other possible scenarios and transactions, but you can begin to see that the balance sheet at the end of a period is changed from what it was at the beginning of the period by what happens during the period, and what happens during the period is shown on the income statement and the cash flow statement. So, as shown in the figure, the income statement and cash flow information, related to each other, also relate the balance sheet at the end of the period to the balance sheet at the beginning of the period (Figure 3.18 "Relationships Among Financial Statements").

Figure 3.18 Relationships Among Financial Statements



The significance of these relationships becomes even more important when evaluating alternatives for financial decisions. When you understand how the statements are related, you can use that understanding to project the effects of your choices on different aspects of your financial reality and see the consequences of your decisions.

Ratio Analysis

Creating ratios is another way to see the numbers in relation to each other. Any ratio shows the relative size of the two items compared, just as a fraction compares the numerator to the denominator or a percentage compares a part to the whole. The percentages on the common-size statements are ratios, although they only compare items within a financial statement. Ratio analysis is used to make comparisons across statements. For example, you can see how much debt you have just by looking at your total liabilities, but how can you tell if you can afford the debt you have? That depends on the income you have to meet your interest and repayment obligations, or the assets you could use (sell) to meet those obligations. Ratio analysis can give you the answer.

The financial ratios you use depend on the perspective you need or the question(s) you need answered. Some of the more common ratios (and questions) are presented in the following chart (Figure 3.19 "Common Personal Financial Ratios").

Figure 3.19 Common Personal Financial Ratios

Ratio	Calculation	Question it helps to answer
Net income margin	Net income ÷ Total income	How much income is used up by expenses?
Return on assets	Net income ÷ Total assets	How big is the income supporting the assets?
Return on net worth	Net income ÷ Net worth	How big is income relative to net worth?
Debt to assets	Total debt ÷ Total assets	How much asset value is financed by debt? Or how much asset value is there to satisfy debt?
Total debt	Total debt ÷ Net worth	How large is debt relative to net worth?
Interest coverage	Income before interest ÷ Interest expense	How well does income cover interest expenses?
Cash flow to income	Net cash flow ÷ Net income	How much do payments for investments and financing take from income?
Cash flow to assets	Net cash flow ÷ Total assets	How much cash flow supports assets?
Free cash flow	Free cash flow ÷ Net cash flow	How much cash is left to invest after covering living expenses and debt repayments?

These ratios all get "better" or show improvement as they get bigger, with two exceptions: debt to assets and total debt. Those two ratios measure levels of debt, and the smaller the ratio, the less the debt. Ideally, the two debt ratios would be less than one. If your debt-to-assets ratio is greater than one, then debt is greater than assets, and you are bankrupt. If the total debt ratio is greater than one, then debt is greater than net worth, and you "own" less of your assets' value than your creditors do.

Some ratios will naturally be less than one, but the bigger they are, the better. For example, net income margin will always be less than one because net income will always be less than total income (net income = total income − expenses). The larger that ratio is and the fewer expenses that are taken away from the total income, the better.

Some ratios should be greater than one, and the bigger they are, the better. For example, the interest coverage ratio should be greater than one, because you should have more income to cover interest expenses than you have interest expenses, and the more you have, the better. Figure 3.20 "Results of Ratio Analysis" suggests what to look for in the results of your ratio analyses.

Figure 3.20 Results of Ratio Analysis

Ratio	Calculation	Question it helps to answer	Better as it gets...
Net income margin	Net income ÷ Total income	How much income is used up by expenses?	Bigger Will be <1
Return on assets	Net income ÷ Total assets	How big is the income supporting the assets?	Bigger
Return on net worth	Net income ÷ Net worth	How big is income relative to net worth?	Bigger
Debt to assets	Total debt ÷ Total assets	How much asset value is financed by debt? Or how much asset value is there to satisfy debt?	Smaller Should be <1
Total debt	Total debt ÷ Net worth	How large is debt relative to net worth?	Smaller Should be <1
Interest coverage	Income before interest ÷ Interest expense	How well does income cover interest expenses?	Bigger Should be >1
Cash flow to income	Net cash flow ÷ Net income	How much do payments for investments and financing take from income?	Bigger
Cash flow to assets	Net cash flow ÷ Total assets	How much cash flow supports assets?	Bigger
Free cash flow	Free cash flow ÷ Net cash flow	How much cash is left to invest after covering living expenses and debt repayments?	Bigger

While you may have a pretty good "feel" for your situation just by paying the bills and living your life, it so often helps to have the numbers in front of you. Here is Alice's ratio analysis for 2009 (Figure 3.21 "Alice's Ratio Analysis, 2009").

Figure 3.21 Alice's Ratio Analysis, 2009

Ratio	Calculation	Result
Net income margin	Net income ÷ Total assets	0.1353
Return on assets	Net income ÷ Net worth	1.1505
Return on net worth	Total debt ÷ Total assets	(0.1197)
Debt to assets	Total debt ÷ Net worth	10.6095
Interest coverage	Income before interest ÷ Interest expense	2.3482
Cash flow to income	Net cash flow ÷ Net income	0.0662
Cash flow to assets	Net cash flow ÷ Total assets	0.0762
Free cash flow	Free cash flow ÷ Net cash flow	1.0000

The ratios that involve net worth—return-on-net-worth and total debt—are negative for Alice, because she has negative net worth, as her debts are larger than her assets. She can see how much larger her debt is than her assets by looking at her debt-to-assets ratio. Although she has a lot of debt (relative to assets and to net worth), she can earn enough income to cover its cost or interest expense, as shown by the interest coverage ratio.

Alice is earning well. Her income is larger than her assets. She is able to live efficiently. Her net income is a healthy 13.53 percent of her total income (net income margin), which means that her expenses are only 86.47 percent of it, but her cash flows are much less (cash flow to income), meaning that a significant portion of earnings is used up in making investments or, in Alice's case, debt repayments. In fact, her debt repayments don't leave her with much free cash flow; that is, cash flow not used up on living expenses or debts.

Looking at the ratios, it is even more apparent how much—and how subtle—a burden Alice's debt is. In addition to giving her negative net worth, it keeps her from increasing her assets and creating positive net worth—and potentially more income—by obligating her to use up her cash flows. Debt repayment keeps her from being able to invest.

Currently, Alice can afford the interest and the repayments. Her debt does not keep her from living her life, but it does limit her choices, which in turn restricts her decisions and future possibilities.

Comparisons over Time

Another useful way to compare financial statements is to look at how the situation has changed over time. Comparisons over time provide insights into the effects of past financial decisions and changes in circumstance. That insight can guide you in making future financial decisions, particularly in foreseeing the potential costs or benefits of a choice. Looking backward can be very helpful in looking forward.

Fast-forward ten years: Alice is now in her early thirties. Her career has progressed, and her income has grown. She has paid off her student loan and has begun to save for retirement and perhaps a down payment on a house.

A comparison of Alice's financial statements shows the change over the decade, both in absolute dollar amounts and as a percentage (see Figure 3.22 “Alice’s Income Statements: Comparison Over Time”, Figure 3.23 “Alice’s Cash Flow Statements: Comparison Over Time”, and Figure 3.24 “Alice’s Balance Sheets: Comparison Over Time”). For the sake of simplicity, this example assumes that neither inflation nor deflation have significantly affected currency values during this period.

Figure 3.22 Alice’s Income Statements: Comparison Over Time

For the Year Ending	12/31/09	12/31/19	Change	% Change
Gross wages	**44,650**	**74,000**	**29,350**	**65.73%**
Income taxes and deductions	8,930	18,500	9,570	107.17%
Disposable income	35,720	55,500	19,780	55.38%
Rent expense	10,800	18,000	7,200	66.67%
Food	3,900	3,900	0	0.00%
Car expenses	3,600	3,600	0	0.00%
Clothing	1,800	1,800	0	0.00%
Cell phone	1,200	1,200	0	0.00%
Internet and cable TV	1,200	1,200	0	0.00%
Entertainment, travel, etc.	2,700	5,200	2,500	92.59%
Total living expenses	25,200	34,900	9,700	38.49%
Car loan interest	240	757	517	215.42%
Student loan interest	4,240	0	(4,240)	−100.00%
Total interest expenses	4,480	757	(3,723)	−83.10%
Net income	6,040	19,843	13,803	228.53%

Figure 3.23 Alice's Cash Flow Statements: Comparison Over Time

For the Year Ending	12/31/09	12/31/19	Change	% Change
Cash from gross wages	**44,650**	**74,000**	**29,350**	**65.73%**
Cash paid for:				
Income taxes and deductions	(8,930)	(18,500)	(9,570)	107.17%
Rent expense	(10,800)	(18,000)	(7,200)	66.67%
Food	(3,900)	(3,900)	0	0.00%
Car expenses	(3,600)	(3,600)	0	0.00%
Clothing	(1,800)	(1,800)	0	0.00%
Cell phone	(1,200)	(1,200)	0	0.00%
Internet and cable TV	(1,200)	(1,200)	0	0.00%
Entertainment, travel, etc.	(2,700)	(5,200)	(2,500)	92.59%
Car loan interest	(240)	(757)	(517)	215.42%
Student loan interest	(4,240)	0	4,240	−100.00%
Operating cash flows	6,040	19,843	13,803	228.53%
Cash invested in 401k	0	(3,000)	(3,000)	100.00%
Cash invested in car	0	(6,300)	(6,300)	100.00%
Investing cash flows	0	(9,300)	(9,300)	100.00%
Cash for repayment of car loan	(2,160)	(4,610)	(2,450)	113.43%
Cash for repayment of student loan	(3,480)	–		−100.00%
Financing cash flows	(5,640)	(4,610)	1,030	−18.26%
Net cash flow	400	5,933	5,533	1383.25%

Figure 3.24 Alice's Balance

Sheets: Comparison Over Time

As of	12/31/09	12/31/19	Change	% Change
Assets				
Cash/checking	0	5,000	5,000	100.00%
Savings	250	250	0	0.00%
Money market	0	2,600	2,600	100.00%
Retirement 401k	0	13,000	13,000	100.00%
Retirement IRA	0	7,400	7,400	100.00%
Car	5,000	15,000	10,000	200.00%
Total assets	5,250	43,250	38,000	723.81%
Liabilities				
Car loan	2,700	4,610	1,910	70.74%
Student loan	53,000	0	(53,000)	-100.00%
Total liabilities	55,700	4,610	(51,090)	-91.72%
Net worth	(50,450)	38,640	89,090	

Starting with the income statement, Alice's income has increased. Her income tax withholding and deductions have also increased, but she still has higher disposable income (take-home pay). Many of her living expenses have remained consistent; rent and entertainment have increased. Interest expense on her car loan has increased, but since she has paid off her student loan, that interest expense has been eliminated, so her total interest expense has decreased. Overall, her net income, or personal profit, what she clears after covering her living expenses, has almost doubled.

Her cash flows have also improved. Operating cash flows, like net income, have almost doubled—due primarily to eliminating the student loan interest payment. The improved cash flow allowed her to make a down payment on a new car, invest in her 401(k), make the payments on her car loan, and still increase her net cash flow by a factor of ten.

Alice's balance sheet is most telling about the changes in her life, especially her now positive net worth. She has more assets. She has begun saving for retirement and has more liquidity, distributed in her checking, savings, and money market accounts. Since she has less debt, having paid off her student loan, she now has positive net worth.

Comparing the relative results of the common-size statements provides an even deeper view of the relative changes in Alice's situation (Figure 3.25 "Comparing Alice's Common-Size Statements for 2009 and 2019: Income Statements", Figure 3.26 "Comparing Alice's Common-Size Statements for 2009 and 2019: Cash Flow Statements", and Figure 3.27 "Comparing Alice's Common-Size Statements for 2009 and 2019: Balance Sheets").

Figure 3.25 Comparing Alice's Common-Size Statements for 2009 and 2019: Income Statements

For the Year Ending	12/31/09	12/31/19
Gross wages	**100.00%**	**100.00%**
Income taxes and deductions	20.00%	25.00%
Disposable income	80.00%	75.00%
Rent expense	24.19%	24.32%
Food	8.73%	5.27%
Car expenses	8.06%	4.86%
Clothing	4.03%	2.43%
Cell phone	2.69%	1.62%
Internet and cable TV	2.69%	1.62%
Entertainment, travel, etc.	6.05%	7.03%
Total living expenses	56.44%	47.16%
Car loan interest	0.54%	1.02%
Student loan interest	9.50%	0.00%
Total interest expenses	10.03%	1.02%
Net income	13.53%	26.81%

Figure 3.26 Comparing Alice's Common-Size Statements for

2009 and 2019: Cash Flow Statements

For the Year Ending	12/31/09	12/31/19
Cash from gross wages	**100.00%**	**100.00%**
Cash paid for:		
Income taxes and deductions	−20.00%	−25.00%
Rent expense	−24.19%	−24.32%
Food	−8.73%	−5.27%
Car expenses	−8.06%	−4.86%
Clothing	−4.03%	−2.43%
Cell phone	−2.69%	−1.62%
Internet and cable TV	−2.69%	−1.62%
Entertainment, travel, etc.	−6.05%	−7.03%
Car loan interest	−0.54%	−1.02%
Student loan interest	−9.50%	0.00%
Operating cash flows	13.53%	26.81%
Cash invested in 401k	0.00%	−4.05%
Cash invested in car	0.00%	−8.51%
Investing cash flows	0.00%	−12.57%
Repayment of car loan	−4.84%	−6.23%
Repayment of student loan	−7.79%	0.00%
Financing cash flows	−12.63%	−6.23%
Net cash flow	0.90%	8.02%

Figure 3.27 Comparing Alice's Common-Size Statements for 2009 and 2019: Balance Sheets

As of	12/31/09	12/31/19
Assets		
Cash/checking	0.00%	11.56%
Savings	4.76%	0.58%
Money market	0.00%	6.01%
Retirement 401k	0.00%	30.06%
Retirement IRA	0.00%	17.11%
Car	95.24%	34.68%
Total Assets	100.00%	100.00%
Liabilities	0.00%	0.00%
Car loan	51.43%	10.66%
Student loan	1009.52%	0.00%
Total Liabilities	1060.95%	10.66%
Net worth	–960.95%	89.34%

Although income taxes and rent have increased as a percentage of income, living expenses have declined, showing real progress for Alice in raising her standard of living: it now costs her less of her income to sustain herself. Interest expense has decreased substantially as a portion of income, resulting in a net income or personal profit that is not only larger, but is larger relative to income. More of her income is profit, left for other discretionary uses.

The change in operating cash flows confirms this. Although her investing activities now represent a significant use of cash, her need to use cash in financing activities—debt repayment—is so much less that her net cash flow has increased substantially. The cash that used to have to go toward supporting debt obligations now goes toward building an asset base, some of which (the 401(k)) may provide income in the future.

Changes in the balance sheet show a much more diversified and therefore much less risky asset base. Although almost half of Alice's assets are restricted for a specific purpose, such as her 401(k) and Individual Retirement Account (IRA) accounts, she still has significantly more liquidity and more liquid assets. Debt has fallen from ten times the assets' value to one-tenth of it, creating some ownership for Alice.

Finally, Alice can compare her ratios over time (Figure 3.28 "Ratio Analysis Comparison").

Figure 3.28 Ratio Analysis Comparison

Ratio Analysis	12/31/09	12/31/19
Net income margin	0.1353	0.2681
Return on assets	1.1505	0.4588
Return on net worth	–0.1197	0.5135
Debt to assets	10.6095	0.1066
Interest coverage	1.3482	26.2127
Cash flow to income	0.0662	0.2990
Cash flow to assets	0.0762	0.1372
Free cash flow	1.0000	2.5675

Most immediately, her net worth is now positive, and so are the return-on-net-worth and the total debt ratios. As her debt has become less significant, her ability to afford it has improved (to pay for its interest and repayment). Both her interest coverage and free cash flow ratios show large increases. Since her net income margin (and income) has grown, the only reason her return-on-asset ratio has decreased is because her assets have grown even faster than her income.

By analyzing over time, you can spot trends that may be happening too slowly or too subtly for you to notice in daily living, but which may become significant over time. You would want to keep a closer eye on your finances than Alice does, however, and review your situation at least every year.

KEY TAKEAWAYS

- Each financial statement shows a piece of the larger picture. Financial statement analysis puts the financial statement information in context and so in sharper focus.
- Common-size statements show the size of each item relative to a common denominator.
- On the income statement, each income and expense is shown as a percentage of total income.
- On the cash flow statement, each cash flow is shown as a percentage of total positive cash flow.
- On the balance sheet, each asset, liability, and net worth is shown as a percentage of total assets.
- The income and cash flow statements explain the changes in the balance sheet over time.
- Ratio analysis is a way of creating a context by comparing items from different statements.
- Comparisons made over time can demonstrate the effects of past decisions to better understand the significance of future decisions.
- Financial statements should be compared at least annually.

EXERCISES

1. Prepare common-size statements for your income statement,

cash flow statement, and balance sheet. What do your common-size statements reveal about your financial situation? How will your common-size statements influence your personal financial planning?

2. Calculate your debt-to-income ratio and other ratios using the financial tools at Biztech (http://www.usnews.com/usnews/biztech/tools/modebtratio.htm). According to the calculation, are you carrying a healthy debt load? Why, or why not? If not, what can you do to improve your situation?
3. Read a PDF document of a 2006 article by Charles Farrell in the *Financial Planning Association Journal* on "Personal Financial Ratios: An Elegant Roadmap to Financial Health and Retirement" at http://www.slideshare.net/Ellena98/fpa-journal-personal-financial-ratios-an-elegant-road-map. Farrell focuses on three ratios: savings to income, debt to income, and savings rate to income. Where, how, and why might these ratios appear on the chart of Common Personal Financial Ratios in this chapter?
4. If you increased your income and assets and reduced your expenses and debt, your personal wealth and liquidity would grow. In My Notes or in your personal financial journal, outline a general plan for how you would use or allocate your growing wealth to further reduce your expenses and debt, to acquire more assets or improve your standard of living, and to further increase your real or potential income.

3.3 Accounting Software: An Overview

LEARNING OBJECTIVES

1. Identify the uses of personal finance software.
2. List the common features of personal financial software.
3. Demonstrate how actual financial calculations may be accomplished using personal financial software.
4. Discuss how personal financial software can assist in your personal financial decisions.

Many software products are available to help you organize your financial information to be more useful in making financial decisions. They are designed to make the record-keeping aspects of personal finance—the collection, classification, and sorting of financial data—as easy as possible. The programs also are designed to produce summary reports (e.g., income statements, cash flow statements, and balance sheets) as well as many calculations that may be useful for various aspects of financial planning. For example, financial planning software exists for managing education and retirement savings, debt and mortgage repayment, and income and expense budgeting.

Collecting the Data

Most programs have designed their data input to look like a checkbook, which is what most people use to keep personal financial records. This type of user interface is intended to be recognizable and familiar, similar to the manual record keeping that you already do.

When you input your checkbook data into the program, the software does the bookkeeping—creating the journals, ledgers, adjustments, and trial balances that generations of people have done, albeit more tediously, with parchment and quill or with ledger paper and pencil. Most personal financial transactions happen as cash flows through a checking account, so the checkbook becomes the primary source of data.

More and more, personal transactions are done by electronic transfer; that is, no paper changes hands, but cash still flows to and from an account, usually a checking account.

Data for other transactions, such as income from investments or changes in investment value, are usually received from periodic statements issued by investment managers, such as banks where you have savings accounts; brokers or mutual fund companies that manage investments; or employers' retirement account statements.

Most versions of personal financial software allow you to download account information directly from the source—your bank, broker, or employer—which saves you from manually entering the data into the program. Aside from providing convenience, downloading directly should eliminate human error in transferring the data.

Reporting Results and Planning Ahead

All personal financial software produces the essential summary reports—the income statement, cash flow statement, and balance sheet—that show the results of financial activity for the period. Most will also report more specific aspects of activities, such as listing all transactions for a particular income or expense.

Most will provide separate reports on activities that have some tax consequence, since users always need to be aware of tax obligations and the tax consequences of financial decisions. Some programs, especially those produced by companies that also sell tax software, allow you to export data from your financial software to your tax program, which makes tax preparation—or at least tax record keeping—easier. In some programs, you need to know which activities are taxable and flag them as such. Some programs recognize that information already, while others may still prompt you for tax information.

All programs allow you to play "what if": a marvelous feature of computing power and the virtual world in general and certainly helpful when it comes to making financial decisions. All programs include a budgeting feature that allows you to foresee or project possible scenarios and gauge your ability to live with them. This feature is particularly useful when budgeting for income and living expenses. (Budgeting is discussed more thoroughly in Chapter 5 "Financial Plans: Budgets".) Most programs have features that allow you to project the results of savings plans for education or retirement. None can dictate the future, or allow you to, but they can certainly help you to have a better view.

Security, Benefits, and Costs

All programs are designed to be installed on a personal computer or a handheld device such as a Personal Digital Assistant (PDA) or smart phone, but some can also be run from a Web site and therefore do not require a download. Product and service providers are very concerned with security.

As with all Internet transactions, you should be aware that the more your data is transferred, downloaded, or exported over the Internet, the more exposed it is to theft. Personal financial data theft is a serious and growing problem worldwide, and security systems are hard pressed to keep up with the ingenuity of hackers. The convenience gained by having your bank, brokerage, tax preparer, and so on accessible to you (and your data accessible to them) or your data accessible to you wherever you are must be weighed against the increased exposure to data theft. As always, the potential benefit should be considered against the costs.

Keeping digital records of your finances may be more secure than keeping them scattered in shoeboxes or files, exposed to risks such as fire, flood, and theft. Digital records are often easily retrievable because the software organizes them systematically for you. Space is not a practical issue with digital storage, so records may be kept longer. As with anything digital, however, you must be diligent about backing up your data, although many programs will do that automatically or regularly prompt you to do so. Hard copy records must be disposed of periodically, and judging how long to keep them is always difficult. Throwing them in the trash may be risky because of "dumpster diving," a well-known method of identity theft, so documents with financial information should always be shredded before disposal.

Personal financial software is usually quite reasonably priced, with many programs selling for less than $50, and most for less than $100. Buying the software usually costs less than buying an hour of accounting expertise from an accountant or financial planner. While software cannot replace financial planning professionals who provide valuable judgment, it can allow you to hire them only for their judgment and not have to pay them to collect, classify, sort, and report your financial data.

Software will not improve your financial situation, but it can improve the organization of your financial data monthly and yearly, allowing you a much clearer view and almost certainly a much better understanding of your situation.

Software References

About.com offers general information

http://financialsoft.about.com/od/softwaretitle1/u/Get_Started_Financial_Software.htm

Helpful software reviews

- http://financialsoft.about.com/od/reviewsfinancesoftware/2_Financial_Software_Reviews.htm
- http://personal-finance-software-review.toptenreviews.com/
- http://blogs.zdnet.com/gadgetreviews/?p=432
- http://linux.com/feature/49400
- http://financialsoft.about.com/b/2008/04/09/updated-top-personal-finance-software-for-mac-os.htm

Personal financial software favorites priced under $50 include

(as listed on http://personal-finance-software-review.toptenreviews.com/)

- Quicken
- Moneydance
- AceMoney
- BankTree Personal
- Rich Or Poor
- Budget Express
- Account Xpress
- iCash
- Homebookkeeping
- 3click Budget

KEY TAKEAWAYS

- Personal finance software provides convenience and skill for collecting, classifying, sorting, reporting, and securing financial data to better assess you current situation.

- To help you better evaluate your choices, personal finance software provides calculations for projecting information such as the following:
    - Education savings
    - Retirement savings
    - Debt repayment
    - Mortgage repayment
    - Income and expense budgeting

EXERCISES

1. Explore free online resources for developing and comparing baseline personal financial statements. One good resource is a blog from Money Musings called "It's Your Money" (http://www.mdmproofing.com/iym/networth.shtml). This site also explains how and where to find the figures you need for accurate and complete income statements and balance sheets.
2. Compare and contrast the features of popular personal financial planning software at the following Web sites: Mint.com, Quicken.intuit.com, Moneydance.com, and Microsoft.com/Money. In My Notes or your personal finance journal, record your findings. Which software, if any, would be your first choice, and why? Share your experience and views with others taking this course.

3. View these videos online and discuss with classmates your answers to the questions that follow.
    1. "Three Principles of Personal Finance" by the founder of Mint: http://video.google.com/videoplay?docid=6863995600686009715&ei=Ic1bSdyeF4rkqQLtzIzrBg&q=personal+finance. What are the three principles of personal finance described in this video? How is each principle relevant to you and your personal financial situation? What will be the outcome of observing the three principles?
    2. A financial planner explains what goes into a financial plan in "How to Create a Financial Plan": http://www.youtube.com/watch?v=Wmhif6hmPTQ. According to this video, what goes into a financial plan? What aspects of financial planning do you already have in place? What aspects of financial planning should you

consider next?

3. Certified Financial Planner (CFP) Board's Financial Planning Clinic, Washington, DC, October 2008: http://www.youtube.com/watch?v=eJS5FMF_CFA. Each year the Certified Financial Planner Board conducts a clinic in which people can get free advice about all areas of financial planning. This video is about the 2008 Financial Planning Clinic in Washington, DC. What reasons or benefits did people express about attending this event?

PART IV

MODULE 3: CREDIT REPORTS

8. Free Credit Reports

Visit annualcreditreport.com to get your free credit report.

One or more interactive elements has been excluded from this version of the text. You can view them online here: https://library.achievingthedream.org/lfccpersonalfinance/?p=31

The Fair Credit Reporting Act (FCRA) requires each of the nationwide credit reporting companies — Equifax, Experian, and TransUnion — to provide you with a free copy of your credit report, at your request, once every 12 months. The FCRA promotes the accuracy and privacy of information in the files of the nation's credit reporting companies. The Federal Trade Commission (FTC), the nation's consumer protection agency, enforces the FCRA with respect to credit reporting companies.

A credit report includes information on where you live, how you pay your bills, and whether you've been sued or have filed for bankruptcy. Nationwide credit reporting companies sell the information in your report to creditors, insurers, employers, and other businesses that use it to evaluate your applications for credit, insurance, employment, or renting a home.

Here are the details about your rights under the FCRA, which established the free annual credit report program.

Q: How do I order my free report?

The three nationwide credit reporting companies have set up a central website, a toll-free telephone number, and a mailing address through which you can order your free annual report.

To order, visit annualcreditreport.com, call 1-877-322-8228. Or complete the Annual Credit Report Request Form and mail it to: Annual Credit Report Request Service, P.O. Box 105281, Atlanta, GA 30348-5281. Do not contact the three nationwide credit reporting companies individually. They are providing free annual credit reports only through annualcreditreport.com, 1-877-322-8228 or mailing to Annual Credit Report Request Service.

You may order your reports from each of the three nationwide credit reporting companies at the same time, or you can order your report from each of the companies one at a time. The law allows you to order one free copy of your report from each of the nationwide credit reporting companies every 12 months.

A Warning About "Imposter" Websites

Only one website is authorized to fill orders for the free annual credit report you are entitled to under law — annualcreditreport.com. Other websites that claim to offer "free credit reports," "free credit scores," or "free credit monitoring" are not part of the legally mandated free annual credit report program. In some cases, the "free" product comes with strings attached. For example, some sites sign you up for a supposedly "free" service that converts to one you have to pay for after a trial period. If you don't cancel during the trial period, you may be unwittingly agreeing to let the company start charging fees to your credit card.

Some "imposter" sites use terms like "free report" in their names; others have URLs that purposely misspell annualcreditreport.com in the hope that you will mistype the name of the official site. Some of these "imposter" sites direct you to other sites that try to sell you something or collect your personal information.

Annualcreditreport.com and the nationwide credit reporting companies will not send you an email asking for your personal information. If you get an email, see a pop-up ad, or get a phone call from someone claiming to be from annualcreditreport.com or any of the three nationwide credit reporting companies, do not reply or click on any link in the message. It's probably a scam. Forward any such email to the FTC at spam@uce.gov.

Q: What information do I need to provide to get my free report?

A: You need to provide your name, address, Social Security number, and date of birth. If you have moved in the last two years, you may have to provide your previous address. To maintain the security of your file, each nationwide credit reporting company may ask you for some information that only you would know, like the amount of your monthly mortgage payment. Each company may ask you for different information because the information each has in your file may come from different sources.

Q: Why do I want a copy of my credit report?

A: Your credit report has information that affects whether you can get a loan — and how much you will have to pay to borrow money. You want a copy of your credit report to:

- make sure the information is accurate, complete, and up-to-date before you apply for a loan for a major purchase like a house or car, buy insurance, or apply for a job.
- help guard against identity theft. That's when someone uses your personal information — like your name, your Social Security number, or your credit card number — to commit

> fraud. Identity thieves may use your information to open a new credit card account in your name. Then, when they don't pay the bills, the delinquent account is reported on your credit report. Inaccurate information like that could affect your ability to get credit, insurance, or even a job.

Q: How long does it take to get my report after I order it?

A: If you request your report online at annualcreditreport.com, you should be able to access it immediately. If you order your report by calling toll-free 1-877-322-8228, your report will be processed and mailed to you within 15 days. If you order your report by mail using the Annual Credit Report Request Form, your request will be processed and mailed to you within 15 days of receipt.

Whether you order your report online, by phone, or by mail, it may take longer to receive your report if the nationwide credit reporting company needs more information to verify your identity.

Q: Are there any other situations where I might be eligible for a free report?

A: Under federal law, you're entitled to a free report if a company takes adverse action against you, such as denying your application for credit, insurance, or employment, and you ask for your report within 60 days of receiving notice of the action. The notice will give you the name, address, and phone number of the credit reporting company. You're also entitled to one free report a year if you're unemployed and plan to look for a job within 60 days; if you're on welfare; or if your report is inaccurate because of fraud, including identity theft. Otherwise, a credit reporting company may charge you a reasonable amount for another copy of your report within a 12-month period.

To buy a copy of your report, contact:

- Equifax:1-800-685-1111; equifax.com
- Experian: 1-888-397-3742; experian.com
- TransUnion: 1-800-916-8800; transunion.com

Q: Should I order a report from each of the three nationwide credit reporting companies?

A: It's up to you. Because nationwide credit reporting companies get their information from different sources, the information in your report from one company may not reflect all, or the same, information in your reports from the other two companies. That's not to say that the information in any of your reports is necessarily inaccurate; it just may be different.

Q: Should I order my reports from all three of the nationwide credit reporting companies at the same time?

A: You may order one, two, or all three reports at the same time, or you may stagger your requests. It's your choice. Some financial advisors say staggering your requests during a 12-month period may be a good way to keep an eye on the accuracy and completeness of the information in your reports.

Q: What if I find errors — either inaccuracies or

incomplete information — in my credit report?

A: Under the FCRA, both the credit reporting company and the information provider (that is, the person, company, or organization that provides information about you to a consumer reporting company) are responsible for correcting inaccurate or incomplete information in your report. To take full advantage of your rights under this law, contact the credit reporting company and the information provider.

1. Tell the credit reporting company, in writing, what information you think is inaccurate.

Credit reporting companies must investigate the items in question — usually within 30 days — unless they consider your dispute frivolous. They also must forward all the relevant data you provide about the inaccuracy to the organization that provided the information. After the information provider receives notice of a dispute from the credit reporting company, it must investigate, review the relevant information, and report the results back to the credit reporting company. If the information provider finds the disputed information is inaccurate, it must notify all three nationwide credit reporting companies so they can correct the information in your file.

When the investigation is complete, the credit reporting company must give you the written results and a free copy of your report if the dispute results in a change. (This free report does not count as your annual free report.) If an item is changed or deleted, the credit reporting company cannot put the disputed information back in your file unless the information provider verifies that it is accurate and complete. The credit reporting company also must send you written notice that includes the name, address, and phone number of the information provider.

2. Tell the creditor or other information provider in writing that you dispute an item. Many providers specify an address for disputes. If the provider reports the item to a credit reporting company, it

must include a notice of your dispute. And if you are correct — that is, if the information is found to be inaccurate — the information provider may not report it again.

Q: What can I do if the credit reporting company or information provider won't correct the information I dispute?

A: If an investigation doesn't resolve your dispute with the credit reporting company, you can ask that a statement of the dispute be included in your file and in future reports. You also can ask the credit reporting company to provide your statement to anyone who received a copy of your report in the recent past. You can expect to pay a fee for this service.

If you tell the information provider that you dispute an item, a notice of your dispute must be included any time the information provider reports the item to a credit reporting company.

Q: How long can a credit reporting company report negative information?

A: A credit reporting company can report most accurate negative information for seven years and bankruptcy information for 10 years. There is no time limit on reporting information about criminal convictions; information reported in response to your application for a job that pays more than $75,000 a year; and information reported because you've applied for more than $150,000 worth of credit or life insurance. Information about a lawsuit or an unpaid judgment against you can be reported for seven years or until the statute of limitations runs out, whichever is longer.

Q: Can anyone else get a copy of my credit report?

A: The FCRA specifies who can access your credit report. Creditors, insurers, employers, and other businesses that use the information in your report to evaluate your applications for credit, insurance, employment, or renting a home are among those that have a legal right to access your report.

Q: Can my employer get my credit report?

A: Your employer can get a copy of your credit report only if you agree. A credit reporting company may not provide information about you to your employer, or to a prospective employer, without your written consent.

For More Information

The FTC works for the consumer to prevent fraudulent, deceptive, and unfair business practices in the marketplace and to provide information to help consumers spot, stop, and avoid them. To file a complaint, visit ftc.gov/complaint or call 1-877-FTC-HELP (1-877-382-4357). The FTC enters Internet, telemarketing, identity theft, and other fraud-related complaints into Consumer Sentinel, a secure online database available to hundreds of civil and criminal law enforcement agencies in the U.S. and abroad.

Report Scams

If you believe you've responded to a scam, file a complaint with:

- the FTC
- your state Attorney General

9. Building a Better Credit Report

What is a credit report?

A credit report includes information on where you live, how you pay your bills, and whether you've been sued or have filed for bankruptcy. Nationwide credit reporting companies sell the information in your report to creditors, insurers, employers, and other businesses that, in turn, use it to evaluate your applications for credit, insurance, employment, or renting a place to live.

Why should I check my credit report?

Some financial advisors and consumer advocates suggest that you review your credit report several times a year. Why?

- The information in it affects whether you can get a loan — and how much you will have to pay to borrow money.

- To make sure the information is accurate, complete, and up-to-date before you apply for a loan for a major purchase like a house or car, buy insurance, or apply for a job.

- To help repair possible identity theft. Identity thieves may use your information to open new credit accounts in your name. Then, when they don't pay the bills, the delinquent account is reported on your credit report. Inaccurate information like that could affect your ability to get credit, insurance, or even a job.

How do I get my credit report?

By law, you're entitled to a free copy of your credit report from each of the nationwide credit reporting companies — Equifax, Experian, and TransUnion — once every 12 months. To order, visit **annualcreditreport.com** or call 1-877-322-8228.

You may order reports from one, two, or all three of the companies at the same time, or you may stagger your requests. Some financial advisors say staggering your requests during a 12-month period may be a good way to keep an eye on the accuracy and completeness of the information in your reports. If you're getting ready to apply for a loan or job, you might want to check all three reports at the same time.

To learn more, read **Free Credit Reports** at **consumer.ftc.gov**.

How do I correct errors on my credit report?

Both the credit reporting company and the information provider (that is, the person, company, or organization that provides information about you to a credit reporting company) are responsible for correcting inaccurate or incomplete information in your report once you bring it to their attention. Letting them know involves two steps:

Step One

Tell the **credit reporting company,** in writing, what information you think is inaccurate.

A sample dispute letter is at **consumer.ftc.gov**. Your letter should identify each item in your report you dispute, explain why you dispute the information, and ask that it be removed or corrected. Include copies (NOT originals) of documents that support your position. You may want to enclose a copy of your report with the items in question circled. Send your letter by certified mail, "return receipt requested," so you can document what the credit reporting company received. Keep copies of your dispute letter and enclosures.

Credit reporting companies must investigate the items in question usually within 30 days, unless they consider your dispute frivolous. They also must forward all the relevant data you provide about the inaccuracy to the information provider, which reviews the relevant information, investigates, and reports the results back to the credit reporting company. If the information provider finds the disputed information is inaccurate, it must notify all three nationwide credit reporting companies so they can correct the information in your file.

What happens after the investigation?

When the investigation is complete, the credit reporting company must give you the results in writing and a free copy of your report if the dispute results in a change. If an item is changed or deleted, the credit reporting company cannot put the disputed information back in your file unless the information provider verifies that it is accurate and complete. The credit reporting company also must send you written notice that includes the name, address, and phone number of the information provider.

If you ask, the credit reporting company must send notices of any corrections to anyone who received your report in the past six months. You can have a corrected copy of your report sent to anyone who received a copy during the past two years for employment purposes.

What if the investigation doesn't resolve my dispute?

Ask that a statement of the dispute be included in your file and in future reports. You also can ask the credit reporting company to provide your statement to anyone who received a copy of your report in the recent past. Expect to pay a fee for this service.

Step Two

Tell the i**nformation provider,** in writing, that you dispute an item in your credit report.

A sample dispute letter is at **consumer.ftc.gov**. Include copies (NOT originals) of documents that support your position. If the provider listed an address on your credit report, send your letter to that address. If no address is listed, contact the provider and ask for the correct address to send your letter. If the information provider does not give you an address, you can send your letter to any business address for that provider.

What if the provider continues to report the disputed item to a credit reporting company?

The provider must let the credit reporting company know about your dispute. And if you are correct — that is, if the information you dispute is found to be inaccurate or incomplete — the information provider must tell the credit reporting company to update or delete the item.

To learn more, read **Disputing Errors on Credit Reports** at **consumer.ftc.gov**.

How long can negative information stay on my credit report?

A credit reporting company can report most accurate negative information for seven years and bankruptcy information for 10 years. There is no time limit on reporting information about criminal convictions; information reported in response to your application for a job that pays more than $75,000 a year; and information reported because you've applied for more than $150,000 worth of credit or life insurance. Information about a lawsuit or an unpaid judgment against you can be reported for seven years or until the statute of limitations runs out, whichever is longer. The standard method for calculating the seven-year reporting period starts with the date that the event took place.

How can my credit report affect my job application?

When you apply for a job, employers look at the application you complete and the resume you prepare. Some employers also check into your background before they hire you. Depending on the employer and the job, that background information might include your employment history, your driving record, criminal records, and your credit report.

An employer must get your permission before asking for a report about you from a credit reporting company or any other company that provides background information. If you don't give your okay, your application for employment may not get a second look. That's up to you. But if you don't get the job because of information in your report, the employer has some legal obligations: First, the employer must show you the report; second, the employer must tell you how to get your own copy. The report is free if you ask for it within 60 days of learning the bad news.

To learn more about your rights, read **Employment Background Checks** at **consumer.ftc.gov**.

What is a credit freeze?

A credit freeze, also known as a security freeze, lets you restrict access to your credit report, which in turn makes it more difficult for identity thieves to open new accounts in your name. That's because most creditors need to look at your credit report before approving a new account. If they can't see your file, they may not extend the credit.

You may want to place a credit freeze on your credit reports if you're concerned about the potential consequences of data breaches.

To place a freeze on your credit reports, contact each of the nationwide credit reporting companies:

Equifax — 1-800-525-6285; equifax.com
Experian —1-888-397-3742; experian.com
TransUnion — 1-800-680-7289; transunion.com

You'll need to supply your name, address, date of birth, Social Security number and other personal information. Fees vary based on where you live; they commonly range from $5 to $10.

A credit freeze does not:

- affect your credit score
- prevent you from getting your free annual credit report
- keep you from opening a new account, applying for a job,

renting an apartment, or buying insurance. If you're doing any of these, you'll need to lift the freeze temporarily, either for a specific time, or for a specific party, say, a potential landlord or employer. The cost and lead times to lift a freeze vary, so it's best to check with the credit reporting company in advance.

- prevent a thief from incurring charges on your existing accounts. You still need to monitor all bank, credit card and insurance statements for fraudulent transactions.

What is a fraud alert?

Unlike a credit freeze that locks down your credit, a fraud alert allows creditors to get a copy of your credit report as long as they take steps to verify your identity. For example, if you provide a telephone number, the business must call you to verify whether you are the person making the credit request. Fraud alerts may be effective at stopping someone from opening new credit accounts in your name, but they may not prevent the misuse of your existing accounts. You still need to monitor all bank, credit card and insurance statements for fraudulent transactions.

There are three types of fraud alerts:

Initial Fraud Alert

If you're concerned about identity theft, but haven't yet become a victim, this fraud alert protects your credit from unverified access for at least 90 days. You may want to place a fraud alert on your file if your wallet, Social Security card, or other personal, financial or account information are ever lost or stolen.

Extended Fraud Alert

For victims of identity theft, an extended fraud alert protects your credit for seven years.

Active Duty Military Alert

For those in the military who want to protect their credit while deployed, this type of fraud alert lasts for one year.

To place a fraud alert on your credit reports, contact one of the nationwide credit reporting companies. A fraud alert is free. You must provide proof of your identity. The company you call must tell the other companies; they, in turn, will place an alert on their versions of your report.

To learn more, visit **ftc.gov/idtheft**.

What is a credit score?

Credit scoring is a system creditors use to help determine whether to give you credit. It also may be used to help decide the credit terms you are offered or the rate you will pay for the loan.

Information about you and your credit experiences, like your bill-paying history, the number and type of accounts you have, whether you pay your bills by the date they're due, collection actions, outstanding debt, and the age of your accounts, is collected from your credit report. Using a statistical program, creditors compare this information to the loan repayment history of consumers with similar profiles. For example, a credit scoring system awards points for each factor that helps predict who is most likely to repay a debt. The total number of points — a credit score — helps predict how creditworthy you are: how likely it is that you will repay a loan and make the payments when they're due. A higher credit score is taken to mean you are less of a risk, which, in turn, means you are more likely to get credit or insurance — or pay less for it.

What factors affect my credit score?

Credit scoring systems are complex and vary among creditors or insurance companies and for different types of credit or insurance. If one factor changes, your score may change — but improvement generally depends on how that factor relates to others the system considers. Only the business using the system knows what might improve your score under the particular model they use to evaluate your application.

Nevertheless, scoring models usually consider the following types of information in your credit report to help compute your credit score:

Have you paid your bills on time?

You can count on payment history to be a significant factor. If your credit report indicates that you have paid bills late, had an account referred to collections, or declared bankruptcy, it is likely to have a negative effect on your score.

Are you maxed out?

Many scoring systems evaluate the amount of debt you have compared to your credit limits. If the amount you owe is close to your credit limit, it's likely to have a negative effect on your score.

How long have you had credit?

Generally, scoring systems consider your credit track record. An insufficient credit history may affect your score negatively, but factors like timely payments and low balances can offset that.

Have you applied for new credit lately?

Many scoring systems consider whether you have applied for credit recently by looking at "inquiries" on your credit report. If you have applied for too many new accounts recently, it could have a negative effect on your score. Every inquiry isn't counted: for example, inquiries by creditors who are monitoring your account or looking at credit reports to make "prescreened" credit offers are not considered liabilities.

How many credit accounts do you have and what kinds of accounts are they?

Although it is generally considered a plus to have established credit accounts, too many credit card accounts may have a negative effect on your score. In addition, many scoring systems consider the type of credit accounts you have. For example, under some scoring models, loans from finance companies may have a negative effect on your credit score.

Scoring models may be based on more than the information in your credit report. When you are applying for a mortgage loan, for example, the system may consider the amount of your down payment, your total debt, and your income, among other factors.

Improving your score significantly is likely to take some time, but it can be done. To improve your credit score under most systems, focus on paying your bills in a timely way, paying down any outstanding balances, and staying away from new debt.

To learn more, read **How Credit Scores Affect the Price of Credit and Insurance** at **consumer.ftc.gov**.

What are my options for dealing with debt?

Many people face a financial crisis at some point in their lives. Whether the crisis is caused by illness, the loss of a job, or overspending, it can seem overwhelming. But often, it can be overcome. Your financial situation doesn't have to go from bad to worse.

If you get into financial hot water, there are options: credit counseling from a reputable organization, debt consolidation, or bankruptcy. Which path works best for you depends on your level of debt, your level of discipline, and your prospects for the future.

Contact your creditors immediately if you ever have trouble making ends meet. Tell them why it's difficult for you to pay your bills, and try to work out a modified payment plan that reduces your payments to a manageable level. Don't wait until your accounts have been turned over to a debt collector. At that point, your creditors have given up on you.

To learn more, read **Coping with Debt** at **consumer.ftc.gov**.

Got bad credit?

Steer clear of credit repair scams

You see the ads in newspapers, on TV, and online. You hear them on the radio. You get fliers in the mail, email messages, and maybe even calls offering credit repair services. They all make the same claims:

Credit problems? No problem!

We can remove bankruptcies, judgments, liens, and bad loans from your credit file forever!

We can erase your bad credit — 100% guaranteed.

Create a new credit identity — legally.

Do yourself a favor and save some money, too. Don't believe these claims: they're very likely signs of a scam. Indeed, attorneys at the

Federal Trade Commission, the nation's consumer protection agency, say they've never seen a legitimate credit repair operation making those claims. The fact is there's no quick fix for creditworthiness. No one can legally remove accurate and timely negative information from a credit report. You can improve your credit report legitimately, but it takes time, a conscious effort, and sticking to a personal debt repayment plan.

To learn more read, **Credit Repair Scams** at **consumer.ftc.gov**.

For more information

The FTC works to prevent fraudulent, deceptive and unfair business practices in the marketplace and to provide information to help consumers spot, stop and avoid them. To file a complaint or get free information on consumer issues, visit **ftc.gov** or call toll-free, 1-877-FTC-HELP (1-877-382-4357); TTY: 1-866-653-4261.

Watch a video, **How to File a Complaint,** at **consumer.ftc.gov/media** to learn more. The FTC enters consumer complaints into the Consumer Sentinel Network, a secure online database and investigative tool used by hundreds of civil and criminal law enforcement agencies in the U.S. and abroad.

PART V

MODULE 4: TAXES

10. After You've Filed Your Federal Taxes

Find tax information for after you’ve filed your federal taxes.

What’s on This Page

- Check Your Federal Tax Refund Status
- Get Copies and Transcripts of Your Tax Returns
- Pay Federal Taxes and Resolve Tax Disputes
- Tax Liens
- Tax Refund Reductions – Treasury Offset Program
- Undelivered and Unclaimed Federal Tax Refund Checks
- Taxpayer ID Theft: Use IRS.gov to Verify Your Identity

Check Your Federal Tax Refund Status

If you have filed your federal income taxes and expect to receive a refund, you may be eager to find out when you will receive it. You can track the status of your refund using the Internal Revenue Service’s Where’s My Refund tool or the mobile app, IRS2Go. These systems are updated once every 24 hours. If you prefer, you can call the IRS refund hotline to check on the status of your refund. Refunds are generally issued within 21 days of when you electronically filed your tax return or 42 days of when you filed paper returns.

Get Copies and Transcripts of Your Tax Returns

Do you need a copy of your prior year tax return? If you need an exact copy of a previously filed tax return and attachments, you can get it by mailing the following items:

- A completed Form 4506.
- $50 fee for each tax return requested. The check or money order should be made payable to the United States Treasury.

A transcript, which is a computer printout of your return information, may be an acceptable substitute for an exact copy of your tax return. Instead of paying for a copy of your tax return, you can request a transcript online to get the information you need quickly. Transcripts are often used to validate income and tax filing status for mortgage applications, student and small business loan applications, and during tax preparation. Contact the IRS to obtain a free transcript. If you need federal tax returns from earlier than 3 years ago, call 1-800-908-9946 or submit a completed form 4506-T.

Contact your state's Department of Revenue to find out how to get copies of prior years' state returns.

Pay Federal Taxes and Resolve Tax Disputes

There are several ways to pay your federal taxes: direct pay, debit or credit card, electronic federal tax payment system, and check or money order. Find out how to make a tax payment.

Payment Options for Back Taxes

The IRS provides these options to help you pay your tax debt:

- Call the phone number listed on any letters or documents you received from the IRS for help with tax payments.
- Get information on alternative payment plans and hardship information.
- Learn about the IRS Fresh Start Program to help you pay back taxes and avoid tax liens.

Resolve Tax Disputes

Get help resolving your tax disputes with the IRS and understanding your rights and responsibilities as a taxpayer:

- Taxpayer Advocate Service (TAS) – Find out if you are eligible for this free service by contacting TAS at 1-877-777-4778 (TTY: 1-800-829-4059) or by checking with a local taxpayer advocate.
- Low-Income Taxpayer Clinics (LITCs) – Contact a local LITC for free or low-cost services. This resource is also available to taxpayers who speak English as a second language (ESL).
- Office of Appeals – This independent organization within the IRS helps resolve your tax disputes without going to tax court. Learn whether an appeal is right for you.

Tax Liens

A tax lien is the government's legal claim against your property when you neglect, or fail, to pay a tax debt. As a tax lien can affect you in many ways, it's helpful to know the steps you can take to find a solution.

How a Tax Lien Affects You

- **Assets** – A lien attaches to all of your assets (property, securities, vehicles) and to future assets acquired during the period of the lien.
- **Credit –** Tax liens can show up on your credit report, making it more difficult for you to get a loan, or buy and sell property.
- **Business** – A lien is tied to all business property and to all rights to business property, including accounts receivable.
- **Bankruptcy –** If you file for bankruptcy, your tax debt, lien, and all public documents alerting creditors that the government has a right to your property may continue after the bankruptcy.

How to Get Rid of a Tax Lien

Paying your tax debt in full is the best way to get rid of a tax lien. The Internal Revenue Service (IRS) will release a federal tax lien within 30 days after you have paid your tax debt. However, there are other options to reduce the impact of a tax lien:

- **Discharge of property –** A "discharge" removes the lien from selected property, but there are several Internal Revenue Code (IRC) conditions. For more information, refer to Publication 783, Instructions on How to Apply for Certificate of Discharge From Federal Tax Lien.
- **Subordination –** While "subordination" does not remove the lien, it allows other creditors to move ahead of the IRS, which may make it easier to get a loan or mortgage. To learn more, read Publication 784, Instructions on How to Apply for a Certificate of Subordination of Federal Tax Lien.
- **Withdrawal –** A "withdrawal" removes the public Notice of Federal Tax Lien and assures that the IRS is not competing

with other creditors for your property. But you are still liable for the amount due. For eligibility, refer to Form 12277, Application for the Withdrawal of Filed Form 668(Y), Notice of Federal Tax Lien, Internal Revenue Code Section 6323j.

For assistance removing a state tax lien, contact your state revenue department. To help release a local government tax lien, contact your local government tax entity.

IRS Resources

Centralized Lien Operation

To resolve basic and routine lien issues, such as verifying a lien, requesting a lien payoff amount, or releasing a lien, call or write to:

Phone: 1-800-913-6050

Internal Revenue Service
Lien Processing Unit
PO Box 145595
Stop 8420G
Cincinnati OH 45250-5595

IRS Video Portal

Watch informational videos on various tax lien issues, including lien notice withdrawal, selling or refinancing when there is an IRS lien, and applying to the IRS for a lean discharge or subordination.

Tax Refund Reductions – Treasury Offset

Program

If you owe money to a federal or state agency (including past-due child support), the federal government may deduct your debts from your federal tax refund. Known as the Treasury Offset Program (TOP), the Bureau of Fiscal Service (BFS) collects such delinquent debts (typically more than 90 days overdue) on behalf of other federal and state government agencies.

BFS will cross check your name and taxpayer information against its delinquent debtor database. If there is a match, BFS will notify you that it is deducting the amount you owe from the payment you were going to receive. BFS will send the outstanding amount to the federal or state government agency to which you owed the money. If you owe more money than the payment you were going to receive, then BFS will send the entire amount to the other government agency. If you owe less, BFS will send the agency the amount you owed, and then send you the remaining balance.

For example, if you were going to receive a $1,500 federal tax refund, but you have been delinquent on a student loan and have $1,000 outstanding, BFS will deduct $1,000 from your tax refund and send it to the U.S. Department of Education. It will also send you a notice of its action, along with the remaining $500 that was due to you as a tax refund.

The Internal Revenue Service (IRS) provides helpful tips to help you understand tax refund offsets. If you believe that a deduction was made in error, you should contact the agency that said you owed money, not the IRS. Call the TOP call center at 1-800-304-3107 if you need help locating the agency you need to contact. If you have questions about this program, check out the frequently asked questions or contact the Bureau of Fiscal Service.

Undelivered and Unclaimed Federal Tax Refund

Checks

Every year, the Internal Revenue Service (IRS) has millions of dollars in tax refunds that go undelivered or unclaimed.

Undelivered Federal Tax Refund Checks

Refund checks are mailed to your last known address. If you move without notifying the IRS or the U.S. Postal Service, your refund check may be returned to the IRS.

If you were expecting a federal tax refund and did not receive it, check the IRS' Refund Status. You'll need to enter your Social Security number, filing status, and the exact whole dollar amount of your refund. You may be prompted to change your address online. You can also call the IRS' Refund Hotline.

If you move, submit a Change of Address – Form 8822 to the IRS; you should also submit a Change of Address to the U.S. Postal Service.

Unclaimed Federal Tax Refunds

If you are eligible for a federal tax refund and do not file a return, then your refund will go unclaimed. Even if you aren't required to file a return, it might benefit you to file if:

- Federal taxes were withheld from your pay

and/or

- You qualify for the Earned Income Tax Credit (EITC)

If you didn't file a tax return because your wages were below the filing requirement, you can still file a return within three years of the filing deadline in order to get your refund.

State Refund Checks

For information about your state tax refund check, contact your state revenue department.

Contact the IRS

For more information, contact the Internal Revenue Service.

Taxpayer ID Theft: Use IRS.gov to Verify Your Identity

The IRS stops and flags suspicious or duplicate federal tax returns that falsely represent your identity, such as your name or social security number. If the IRS suspects tax ID theft, the agency will send a 5071C letter to your home address. If you receive this letter, verify your identity at idverify.irs.gov or call the toll free number listed in the letter.

If you are a victim of state tax ID theft, contact your state's taxation department or comptroller's office about the next steps you need to take.

The IRS provides more information about IDVerifyIRs.gov and your 5071C letter.

11. Filing Your Federal Taxes

Find out how to file your federal taxes, get an extension, and more.

What's on This Page

- Key Tax Tips
- File a Federal Income Tax Return
- Extension to File Your Tax Return
- IRS Imposter Scams
- 1099 Income Statements
- Federal Tax Filing Season
- Get Tax Forms and Publications
- Get Your W-2 Before Tax Time
- IRS Mailing Addresses
- Taxpayer Identification Numbers (TINs)

Key Tax Tips

Find out the important factors to consider when doing your taxes. This infographic explains the important factors to consider when doing your taxes.

This infographic explains the important factors to consider when doing your taxes.

View a larger version of the infographic.

Show Description of Infographic

File a Federal Income Tax Return

The government collects taxes to pay its bills and provide public goods and services. The Internal Revenue Service (IRS) is the nation's tax collection agency.

The taxes you owe to the government are generally paid through withholding (money taken out of your paycheck), estimated tax payments, and payments made when you file your taxes each year.

You may not have to file a federal income tax return if your income is below a certain amount. However, you must file a tax return to claim a refundable tax credit or a refund on income tax withheld.

- Find out if you have to file a tax return.

If you have to file a tax return:

- Determine your filing status.
- See if you qualify for free tax return preparation.
- Choose the simplest form for your tax situation.
- Figure your taxes and credits.
- Claim your dependents and exemptions.
- Determine if you need to pay quarterly estimated taxes.
- File your taxes online or mail your paper tax return.

Tax Payment Information

There are several ways to pay your federal taxes: direct pay, debit or credit card, electronic federal tax payment system, or check or money order. Find out how to make a tax payment.

Tax Refund Information

If you are expecting a refund, you can check your federal tax refund status online or call the Refund Hotline. If you have questions about the status of your refund within the first 21 days after filing electronically, the IRS will direct you to the online Where's My Refund? tool.

You can choose to receive your tax refund by direct deposit, U.S. Series I Savings Bonds, or paper check.

Contact the IRS

For more information, contact the IRS.

Extension to File Your Tax Return

Do you need more time to prepare your tax return?

If you are unable to file your federal income tax return by the due date, you may be able to get an extension from the Internal Revenue Service (IRS). But this does not grant you more time to pay your taxes.

You may be able to get an automatic six-month extension to file your return. To do so, you must file IRS Form 4868, Application for Automatic Extension of Time To File U.S. Individual Income Tax Return by the due date for filing your calendar year return (usually April 15) or fiscal year return. For a Spanish version of this form, download IRS Form 4868sp.

Special rules may apply if you are:

- Living outside the United States.
- Out of the country when your six-month extension expires.
- Living in a combat zone or a qualified hazardous area.

Get filing information about your tax return, including guidelines on extensions of time to file.

IRS Imposter Scams

You may get a call from someone pretending to be from the IRS who claims you owe taxes. This caller will typically demand immediate payment and threaten you with arrest or lawsuits for not paying.

Individuals carrying out this fraud will also make the caller ID appear as if the IRS is calling. Learn the signs to watch out for and how to report IRS imposter scams.

Signs of an IRS Imposter Scam

The IRS will always contact you by mail before calling you about unpaid taxes and will never:

- Demand immediate payment
- Ask for a specific payment method, such as a prepaid debit card, gift card, or wire transfer
- Threaten you with arrest or deportation for not paying your taxes
- Request personal or financial information by email, texting, or any social media

Report an IRS Imposter Scam

Follow these steps if you get a call from someone claiming to be from the IRS asking for a payment and have not first been contacted by the IRS by mail:

- If you owe federal taxes or think you might owe taxes, hang up and get helpful online tools from the IRS. You can also call the IRS about payment questions at 1-800-829-1040 or 1-800-829-4059 (TTY).
- If you don't owe taxes, report the scam to the Treasury Inspector General for Tax Administration (TIGTA) by calling 1-800-366-4484.
- You can also file a complaint with the Federal Trade

Commission (FTC) or call 1-877-FTC-HELP (1-877-382-4357). Please add “IRS Telephone Scam” to your complaint description.
- Help keep others safe by reporting all unsolicited online messages claiming to be from the IRS (or related to their work) to phishing@irs.gov.
- Learn how to protect yourself from and report other scams and fraud.

1099 Income Statements

Businesses and government agencies use Form 1099 to report various types of income other than wages, salaries, and tips to the Internal Revenue Service (IRS).

Every business or agency must:

- Complete a Form 1099 for each transaction.
- Retain a copy for its records.
- Send a copy to you and to the IRS. You should receive your copy by early February (or mid-to-late February for Form 1099-B).

You must include this income on your federal tax return.

Incorrect or Missing Form 1099

If you do not agree with the information contained in your Form 1099, contact the business or agency that issued it.

If you did not receive your Form 1099, contact the business or agency that should have issued it.

Contact the IRS

If you requested Form 1099 from a business or agency and did not receive it, contact the IRS.

Federal Tax Filing Season

The Internal Revenue Service (IRS) began accepting and processing federal tax returns for tax year 2016 on January 23, 2017. You have until April 18, 2017 to file your tax return unless you file for an extension.

Help and Resources

- To help you prepare and file your return, the IRS offers free online tools and special programs for qualifying taxpayers.
- If you owe the IRS money, learn about your payment options. If the IRS owes you money, you can choose to receive your tax refund by direct deposit, U.S. Series I Savings Bonds, or paper check.
- File your federal tax return online or find out the address for mailing your paper return.
- For more information, contact the IRS.

Get Tax Forms and Publications

Federal Tax Forms

You can get free tax forms and publications you need directly from the Internal Revenue Service (IRS) by downloading them from IRS.gov or ordering by phone at 1-800-829-3676. You can also get them from locations in your community, such as taxpayer assistance centers and libraries.

Many forms and publications are available in multiple years and file formats, including Section 508 accessible PDFs and Braille or text formats.

State Tax Forms

Download your state's tax forms and instructions and instructions for free

Get Your W-2 Before Tax Time

The Wage and Tax Statement, commonly known as a W-2 form, is an important document to have at tax time. This form shows the income you earned for the year and the taxes withheld from those earnings. If you have had several jobs over the year, you may have several W-2 forms to file your tax return. Employers must send you your W-2 by January 31 for the earnings from the previous calendar year of work.

If you were an employee and haven't received your W-2 by January 31 or the information is incorrect, the Internal Revenue Service (IRS) offers some tips on what you can do. Employers that have questions about filing W-2 forms for your employees can check these resources on where, when, and how to file from the IRS.

For more information, contact the Internal Revenue Service.

IRS Mailing Addresses

The Internal Revenue Service (IRS) provides mailing addresses for tax returns, non-return forms, applications, and payments. There are several mailing addresses; the correct one to use depends on the purpose of contact and the region of the country you are in:

- Paper Tax Returns (with or without a payment)
- Non-Return Forms (applications and payments)

You can also check a form's corresponding instructions for a mailing address.

Contact the IRS

For more information, contact the IRS.

Taxpayer Identification Numbers (TINs)

A Taxpayer Identification Number (TIN) is an identification number that you need to include on returns, statements, and other tax-related documents.

There are many types of TINs for a variety of tax situations:

- Employer Identification Number (EIN) – This is also known as a federal tax identification number, and is used to identify a business.

    - Learn how to apply for an EIN.
    - If your business structure or ownership has changed, you may need a new EIN.
    - Learn about business taxes, the forms you need to file, and more.
- Social Security Number (SSN) – You need this nine-digit number to get a job, receive Social Security benefits, and other government services.
    - Find out how to get a new, replacement, or corrected card.
- Individual Taxpayer Identification Number (ITIN) – This tax processing number is only available for certain nonresident and resident aliens, their spouses, and dependents who cannot get a SSN.
    - To obtain an ITIN, you must complete IRS Form W-7, IRS Application for Individual Taxpayer Identification Number. Note: You must renew your ITIN if it has not been used on a federal income tax return in the last three years or if it was issued before 2013.
- Adoption Taxpayer Identification Number (ATIN) – A temporary nine-digit number issued by the IRS to individuals who are in the process of legally adopting a U.S. citizen or resident child, but who cannot get an SSN for that child in time to file their tax return.
    - To apply for an ATIN, you must complete Form W-7A, Application for Taxpayer Identification Number for Pending U.S. Adoptions.
- Preparer Tax Identification Number (PTIN) – If you are a paid tax preparer you must use a valid Preparer Tax Identification Number (PTIN) on returns you prepare.
    - To get a PTIN, use the IRS sign-up system.

The Social Security Administration (SSA) issues a SSN and the Internal Revenue Service (IRS) issues all other TINs.

12. Business Tax Information

Learn about business taxes and incentives.

What's on This Page

- Business Taxes
- Energy Tax Incentives
- Estimated Taxes

Business Taxes

As a business owner, it's important to understand your federal, state, and local tax requirements. This will help you file your taxes accurately and make payments on time. The business structureyou choose when starting a business will determine what taxes you must pay and how you pay them.

Business taxes cover a wide range of categories:

Income Tax

All businesses, except partnerships, must file and pay taxes on any income earned or received during the year. Partnerships file an annual information return to report income, gains, losses, and other important tax information. Almost every state imposes a business or corporate income tax, though each state and locality has its own tax laws. Find out the business income tax requirements in your state or territory.

Employment Taxes

If you have employees, there are federal tax requirements for what you must pay and the forms you have to file. These employment taxes include Social Security and Medicare taxes, federal income tax withholding, and federal unemployment (FUTA) tax. In all states, businesses must pay state workers' compensation insurance and unemployment insurance taxes.

Excise Tax

The federal government taxes businesses that manufacture or sell certain products. You may also have to pay this tax in other situations, including if your business uses various types of equipment, facilities, or other products. Learn about federal excise tax requirements and the forms you must file.

Property Tax

Each of the 50 states have different definitions of what property is taxable. Some states collect property tax from businesses in commercial real estate locations. Certain states also collect property tax for business assets, such as vehicles, computer equipment, and peripherals. The amount of tax you pay is calculated by the total value of the property or on a certain percentage of the value. Search for property tax requirements in your state.

Sales and Use Tax

States may impose a tax on the sale of goods and services. Check whether your business has to register to pay and/or collect sales tax in your state. Exclusions in sales tax often include food, clothing, medicine, newspapers, and utilities.

States may also tax your business on the use of goods and services when sales tax has not been collected. This typically applies to goods and services purchased outside of the state where you conduct business.

Estimated Tax

You must pay federal tax on income that is not subject to withholding or when the amount of your federal income tax being withheld is not enough. Find out if your business has to pay estimated taxes and the steps to follow.

Self-Employment Tax

When conducting your own business, you must pay Social Security and Medicare taxes to be covered under the Social Security system. Learn about who must pay self-employment tax and how to pay it.

Energy Tax Incentives

Purchasing energy efficient appliances or making energy saving improvements to your home or business can save money, in the form of tax incentives (tax credits and rebates) or sales tax holidays. Tax credits can help reduce the amount of tax you owe, while rebates can lead to cash back from your purchase.

Find out if you qualify for state, local, utility, and federal incentives:

- Database of State Incentives for Renewables and Efficiency (DSIRE) – Explore incentives and policies in your state that support renewable energy and energy efficiency.
- Department of Energy (DOE): Tax Credits, Rebates, and Savings – Select your state to find savings that may be available for you or your business in your state.
- Offers and Rebates from Energy Star Partners – Search for rebates on certified energy-efficient products and other special offers in your area.
- Residential Renewal Energy Tax Credit – Qualify for tax credits for buying a solar-electric or solar water-heating property for your home.
- Sales tax holidays– Find out if your state offers a sales tax holiday for buying energy efficient appliances.

Estimated Taxes

Estimated tax is the method used to pay taxes on income that is not subject to withholding. This includes income from self-employment, interest, and dividends. You may also have to pay estimated tax if the amount of income tax being withheld from your salary, pension, or other income is not enough.

Who Has to Pay Estimated Taxes?

Individuals who conduct their own business typically have to make estimated tax payments. You may be charged a penalty if you do not pay enough through withholding or estimated tax payments.

Find out if you have to make estimated tax payments and how to pay.

When Are Estimated Taxes Due?

The year is divided into four periods to pay estimated tax. Each period has a specific payment deadline.

These are the 2017 Estimated Federal Tax due dates:

- April 18
- June 15
- Sept. 15
- Jan. 16 of the next year

13. Frequently Requested Tax Benefits

Learn about tax relief, benefits, and incentives.

What's on This Page

- Earned Income Tax Credit
- Tax Benefits for Education
- Energy Tax Incentives
- Federal Tax Deductions for Charitable Donations
- Mortgage Debt Forgiveness
- Tax Relief in Disaster Situations

Earned Income Tax Credit

If you earn a low to moderate income, the Earned Income Tax Credit (EITC) can help you by reducing the amount of tax you owe. To qualify, you must meet certain requirements and file a tax return, even if you do not owe any tax or are not required to file. If EITC reduces your tax to less than zero, you may get a refund.

Who Qualifies for EITC?

You qualify for EITC if:

- You have earned income and adjusted gross income within

certain limits; AND
- You meet certain basic rules; AND

You either:

- Meet the rules for those without a qualifying child; OR
- Have a child who meets all the qualifying rules for you, or your spouse if you file a joint return.

EITC has special rules for members of the military, members of the clergy and taxpayers with certain types of disability income or children with disabilities.

EITC Resources

The Internal Revenue Service (IRS) provides resources covering the Earned Income Tax Credit (EITC):

- Use the EITC Assistant to find out your filing status, if your child qualifies, if you are eligible, and the amount of credit you may receive.
- If you or your spouse is a nonresident alien, refer to Publication 519, U.S. Tax Guide for Aliensto find out if you qualify for EITC.

Tax Benefits for Education

Paying for college or graduate school is a big financial responsibility. To help with your expenses for higher education, there are various tax benefits available:

Credits

An education credit helps by reducing the amount of tax owed on your tax return. If the credit reduces your tax to less than zero, you may get a refund.

There are two education credits available:

- **American Opportunity Tax Credit –** This is a credit for qualified education expenses paid for an eligible student for the first four years of higher education. You can get a maximum annual credit of $2,500 per eligible student.
- **Lifetime Learning Credit** – This credit is for qualified tuition and related expenses paid for eligible students enrolled in an eligible educational institution. It can help pay for undergraduate, graduate, and professional degree courses—including courses to acquire or improve job skills. There is no limit on the number of years you can claim the credit.

Deductions

A deduction reduces the amount of your income that is subject to tax, thus reducing the amount of tax you may have to pay.

There are several types of deductions for education:

- Tuition and fees deduction
- Student loan interest deduction
- Qualified student loan
- Qualified education expenses

Savings Plans

Some savings plans allow the accumulated earnings to grow tax-free until money is taken out (known as a distribution), or allow the distribution to be tax-free. Other savings plans allow both tax-free accumulated earnings and distribution.

There are two types of savings plans available:

- **529 Plans –** States, colleges, and groups of colleges sponsor these qualified tuition programs—authorized under section 529 of the Internal Revenue Code—to either prepay or contribute to an account for paying a student's qualified higher education expenses.
- **Coverdell Education Savings Account –** This account was created as an incentive to help parents and students save for education expenses. Unlike a 529 plan, a Coverdell ESA can be used to pay a student's eligible K-12 expenses as well as post-secondary expenses.

Scholarships and Fellowships

A **scholarship** generally represents an amount paid for the benefit of a student at an educational institution to aid in the pursuit of studies. The student may be either an undergraduate or a graduate. A **fellowship** is generally an amount paid for the benefit of an individual to aid in the pursuit of study or research.

- Whether the scholarship or fellowship is tax-free or taxable depends on the expense paid with the scholarship or fellowship amount, and whether you are a degree candidate.

Exclusions from Income

You may exclude certain educational assistance benefits from your income. That means that you won't have to pay any tax on them. However, it also means that you can't use any of the tax-free education expenses as the basis for any other deduction or credit, including the lifetime learning credit.

Help and Resources

The IRS provides comprehensive information and resources covering tax benefits for education:

- Refer to Tax Benefits for Education to compare the various benefits.
- Use the Interactive Tax Assistant to help determine if you're eligible for educational credits or deductions, including the American opportunity credit, the lifetime learning credit, and the tuition and fees deduction.

Energy Tax Incentives

Purchasing energy efficient appliances or making energy saving improvements to your home or business can save money, in the form of tax incentives (tax credits and rebates) or sales tax holidays. Tax credits can help reduce the amount of tax you owe, while rebates can lead to cash back from your purchase.

Find out if you qualify for state, local, utility, and federal incentives:

- Database of State Incentives for Renewables and Efficiency

(DSIRE) – Explore incentives and policies in your state that support renewable energy and energy efficiency.

- Department of Energy (DOE): Tax Credits, Rebates, and Savings – Select your state to find savings that may be available for you or your business in your state.
- Offers and Rebates from Energy Star Partners – Search for rebates on certified energy-efficient products and other special offers in your area.
- Residential Renewal Energy Tax Credit – Qualify for tax credits for buying a solar-electric or solar water-heating property for your home.
- Sales tax holidays– FInd out if your state offers a sales tax holiday for buying energy efficient appliances.

Federal Tax Deductions for Charitable Donations

You may be able to claim a deduction on your federal taxes if you donated to a 501(c)3 organization. In order to deduct your donations you must file an itemized federal tax return, along with Schedule A and a form 8283 for your non-cash donations.

The amount of money that you can deduct on your taxes may not be equal to the total amount of your donations. If you donate non-cash items, you can claim the fair market value of the items on your taxes.

If you donated a vehicle, the amount of your deduction depends on if the car is used by the organization or sold at an auction. The IRS's publication "A Donor's Guide to Vehicle Donation" explains how your deduction is determined and the documents you must have to claim a deduction.

If you donated money to the charity and you received a gift in exchange, or if part of your contribution paid for a dinner, event entrance, or registration in a race, the entire amount is not tax deductible. Rather, the only part of your donation that you can deduct on your federal income taxes is the amount that is in excess of the value of the gift, dinner, or race.

Recordkeeping

Keep records of your donations to charities. You may not have to send these documents with your tax returns, but these documents are good to include with your other tax records. Some common documents include:

- Canceled check to the organization
- Credit card statement showing a payment to the organization
- Receipt from the organization
- Annual giving statement from the charity or non-profit
- Email confirmation from the organization
- Written acknowledgment for vehicle donations
- Itemized list of the items you donated
- Vehicle identification number for vehicle donations
- Signed over vehicle title
- Phone bill, if you gave a donation through a text message
- Valuations of stocks, real estate, art, or jewelry donated to a charity

There are some pieces of information that may be included in receipts and giving statements:

- Name of the organization
- Date of the donation
- Amount of the donation
- Statement that no goods or services were provided by the charity in return for your donation (if that was the case)
- Vehicle identification number (VIN) for vehicle donations

Mortgage Debt Forgiveness

Canceled debt is normally taxable to you. But homeowners whose mortgage debt was partly or entirely forgiven during tax years 2007 through 2014 may qualify as an exception. The Mortgage Forgiveness Debt Relief Act of 2007 covers key points about mortgage debt forgiveness:

- Homeowners whose mortgage debt was partly or entirely forgiven from tax years 2007 through 2014 may be able to exclude up to $2 million.
- The limit is $1 million for a married person filing a separate return.
- You may exclude debt reduced through mortgage restructuring as well as mortgage debt forgiven in a foreclosure.
- To qualify, the debt must have been used to buy, build, or substantially improve your principal residence and be secured by that residence.
- Refinanced debt proceeds used to substantially improve your principal residence also qualify for the exclusion.
- Proceeds of refinanced debt used for other purposes (to pay off credit card debt, etc.) do not qualify for the exclusion.

Eligibility

To determine if your canceled mortgage debt is taxable, use the Interactive Tax Assistant (ITA) from the IRS.

- If you qualify for the special exclusion, fill out Form 982, Reduction of Tax Attributes Due to Discharge of Indebtedness, and attach the completed form to your federal income tax return for the tax year in which the qualified debt was forgiven.

Tax Relief in Disaster Situations

Major disasters and emergencies in your area affect families and businesses. The Internal Revenue Service (IRS) offers special tax law provisions to help individuals and businesses recover financially from the impact of a disaster. In a federally-declared disaster area, you can get a faster refund by filing an amended return and claiming disaster-related losses on your tax return for the previous year.

The IRS provides guidance for those affected by disasters, such as how to amend tax returns or file an extension.

You may also contact the IRS for more information on tax relief in disaster situations.

14. Get Help with Your Taxes

Learn if you're eligible for free help with your tax returns.

What's on This Page

- Free Income Tax Return Preparation Help
- Free Federal Tax Resources for Seniors and Retirees
- Tax Help for Individuals with Disabilities

Free Income Tax Return Preparation Help

The Internal Revenue Service (IRS) provides free publications, forms, and tools to help all taxpayers fulfill their tax obligation:

- Forms and Publications – Get the most popular forms and instructions, or search for specific titles or product numbers. The IRS also offers forms and publications for taxpayers with visual impairments.
- Tools – Find interactive forms, calculators, and other helpful tools.
- Help and Resource Center – Learn about the many free services and resources that the IRS offers to taxpayers.
- Choose a Tax Preparer – Get tips for finding a tax preparer with the credentials and experience to handle your tax needs. Learn how to file a complaint if your preparer has acted improperly.

Special Programs for Eligible Taxpayers

If you qualify, the following free tax return preparation programs are available:

- Volunteer Income Tax Assistance (VITA) – VITA offers free tax help to people who generally make $54,000 or less; persons with disabilities; the elderly; and taxpayers with limited English. IRS-certified volunteers provide information about tax credits and prepare a basic tax return with electronic filing.
- Tax Counseling for the Elderly (TCE) – TCE offers free tax help to all taxpayers. They offer specialized help to those who are 60 years and older, and have pension or retirement questions. IRS-certified volunteers specialize in questions about pensions and retirement-related issues unique to seniors.

Contact the IRS

For more information, contact the Internal Revenue Service.

Free Federal Tax Resources for Seniors and Retirees

The Internal Revenue Service (IRS) offers resources to answer your federal tax questions and address topics that matter to you.

- Seniors and Retirees Page—Find answers to federal tax related issues such as tax preparation and tax counseling, along with information to help you avoid common mistakes or tax related scams.
- Tax Guide for Seniors—Review the federal tax preparation

guide for seniors.

- Credits for the Elderly or Disabled—Find out if you qualify for federal tax credits for the elderly.
- Free Tax Preparation Services—See if you qualify for the IRS's Volunteer Income Tax Assistance (VITA) program, which offers free federal tax return preparation for seniors. You can also locate the VITA center near you.
- Frequently Asked Questions—Visit the FAQs for seniors or retirees for answers to your federal tax questions.

For more information about federal tax resources, contact the Internal Revenue Service. Contact your state's tax department to get information about state tax laws and resources.

Tax Help for Individuals with Disabilities

The Internal Revenue Service (IRS) offers tax assistance and resources for individuals with disabilities:

- Contact your local IRS office for more information on services available to people with disabilities.
- Sponsored by the IRS, the Volunteer Income Tax Assistance (VITA) program offers free tax help to persons with disabilities. Find a VITA site near you.
- Find tax forms and publications for people with disabilities at IRS.gov Accessibility. This resource contains a current list of accessible tax products available by download. If you prefer hardcopy Braille or large print, please call the IRS at 1-800-TAX-FORM (1-800-829-3676).

PART VI

MODULE 5: HOUSING

15. Buying a Home

Thinking about buying a home? We have information that can help! Got questions? Talk to one of our housing counselors!

1. Figure out how much you can afford

What you can afford depends on your income, credit rating, current monthly expenses, downpayment and the interest rate.

- Home Economics
- Homebuying programs in your state

2. Know your rights

- Fair Housing: Equal Opportunity for All – brochure
- Real Estate Settlement Procedures Act (RESPA)
- Borrower's rights
- Predatory lending

3. Shop for a loan

- Looking for the best mortgage: shop, compare, negotiate – brochure
- Let FHA help you
- Learn about interest only loans

4. Learn about homebuying programs

- Homebuying programs in your state
- Let FHA help you (FHA loan programs offer lower downpayments and are a good option for first-time homebuyers!)
- HUD's special homebuying programs
    - Good Neighbor Next Door (formerly known as Teacher/Officer/Firefighter Next Door)

- Homeownership for public housing residents
- Indian Home Loan Guarantee Program (Section 184)

5. Shop for a home

- Wish list – what features do you want?
- Home-shopping checklist? take this list with you when comparing homes
- Homes for sale (including HUD homes)
- “Fixer-Uppers – home purchase and repair programs
- Manufactured (mobile) homes
- Shopping for a Home FAQ’s

6. Make an offer

- Making an offer

7. Get a home inspection

- For Your Protection Get a Home Inspection

8. Shop for homeowners insurance

- Homeowners insurance
- 12 ways to lower your homeowners insurance costs

9. Sign papers
You’re finally ready to go to “settlement” or “closing.” Be sure to read everything before you sign!

- Getting ready to close

16. Mortgages

Learn some of the basics about mortgages.

What's on This Page

- Mortgage Refinancing
- Predatory Loans
- Reverse Mortgages

Mortgage Refinancing

Refinancing refers to satisfying a debt by making another loan on new terms. The most common consumer refinancing is for a home mortgage, which generally involves paying off your existing mortgage and taking out a new mortgage.

The following resources provide further information:

- A Consumer's Guide to Mortgage Refinancings
- Buying Your Home: Settlement Costs Booklet (PDF, Download Adobe Reader)
- Interest Rate Reduction Refinancing Loans (IRRRL) – For Veterans

Making Home Affordable Program

The Making Home Affordable Program offers opportunities to modify or refinance your mortgage to make your monthly payments more affordable. It also includes the Home Affordable Foreclosure Alternatives Program for homeowners who are interested in a short sale or deed-in-lieu of foreclosure. Call 1-888-995-4673 for more information.

Please note: New Federal Reserve rules require mortgage companies to notify homeowners when their loans are transferred to another company. The company that takes over your loan must send you a notice within 30 days of acquiring it. Even with a new loan owner, the company that "services" or handles your loan might not change and you might continue to send your payments to the same address. If that loan servicer changes, you will receive a separate notice.

For more information about servicing companies, read the Federal Trade Commission's publication "Mortgage Servicing: Making Sure Your Payments Count."

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Predatory Loans

Most mortgage professionals are trustworthy and provide a valuable service, helping you to buy or refinance your home. But dishonest or "predatory" lenders do exist and engage in practices that increase the chances of borrowers losing their homes to foreclosure. To avoid becoming a victim of predatory lending, you need to understand the process to buy a home and be a smart consumer.

What Is Predatory Lending?

Predatory lenders, appraisers, mortgage brokers and home improvement contractors could use any of these tactics to take away your home or investments:

- Sell properties for much more than they are worth using false appraisals
- Encourage borrowers to lie about their income, expenses, or cash available for down payments in order to get a loan
- Knowingly lend more money than a borrower can afford to repay
- Charge high interest rates to borrowers based on their race or national origin and not on their credit history
- Charge fees for unnecessary or nonexistent products and services

Avoid Predatory Loans by Being a Smart Consumer

Follow these guidelines to avoid becoming a victim of predatory lending:

- Before you buy a home, attend a homeownership education course offered by a U.S. Department of Housing and Urban Development (HUD)-approved, non-profit counseling agency.
- Interview several real estate professionals (agents), and ask for and check references before you select one to help you buy or sell a home.
- Get information about the prices of other homes in the neighborhood. Don't be fooled into paying too much.
- Hire a qualified and licensed home inspector to carefully inspect the property before you are obligated to buy. Determine whether you or the seller will be responsible for paying for the repairs.
- Shop for a lender and compare costs. Be suspicious if anyone tries to steer you to just one lender.

The HUD Office of Housing Counseling has a list of federal, state, and local resources to protect you from predatory lending.

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Reverse Mortgages

A reverse mortgage is a home loan that you do not have to pay back for as long as you live in your home. You only repay the loan when you die, sell your home, or permanently move away. Homeowners who are at least 62 years old are eligible. These mortgages allow older homeowners to convert part of the equity in their homes into cash without having to sell their homes or take on additional monthly bills.

Read more information about reverse mortgages.

Types of reverse mortgages include:

- Federally insured Reverse Mortgages – Known as Home Equity Conversion Mortgages (HECM)
- Proprietary Reverse Mortgages
- Single Purpose Reverse Mortgages

Be sure to watch for aggressive lending practices, advertisements that refer to the loan as "free money," or those that fail to disclose fees or terms of the loan. To be a savvy consumer and help protect yourself, remember:

- Do not respond to unsolicited advertisements
- Be suspicious of anyone claiming that you can own a home with no down payment
- Seek out your own reverse mortgage counselor
- Never sign anything you do not fully understand
- Make sure the loan is federally insured

Reporting Fraud or Abuse

If you suspect fraud or abuse, let the counselor, lender, or loan servicer know. You may also file a complaint:

- Federal Trade Commission (FTC)
- State Attorney General's office
- State banking authority

If you have questions, contact your local Homeownership Center for advice.

17. Housing-Related Complaints

Find out what to do if you have one of these complaints when buying or renting a home.

What's on This Page

- Complaints About Mortgage Companies
- Identify and Complain about Housing Discrimination
- Landlord and Tenant Disputes

Complaints About Mortgage Companies

If you feel that you have been the victim of a discriminatory lending transaction, you can contact the Federal Trade Commission (FTC) or file a complaint using their Online Complaint Assistant. The FTC has enforcement authority in the case of mortgage companies for the following laws:

- Equal Credit Opportunity Act (ECOA)
- Truth in Lending Act
- Fair Credit Reporting Act

You may also file consumer complaints using the following resources:

- Consumer Financial Protection Bureau (CFPB)
- State/local consumer protection agencies

Foreclosure Scams

If you feel you are the victim of a foreclosure scam, you may contact the HOPE NOW Alliance at 1-888-995-HOPE (1-888-995-4673) or (TTY 1-877-304-9709), for more information on how to lodge your complaint.

Predatory Lending

Getting the right mortgage can be difficult. For instance, consumers can become victims of predatory lending, which is the practice of convincing borrowers to agree to unfair and/or unprincipled loan terms. Federal and state governments enact many laws to prevent predatory lending. Find information on predatory lending, including resources to help protect you against it.

Please note: You are legally obligated to make your mortgage payments by the date specified each month, whether or not you are provided with a bill, the mortgage company or loan service agency has properly credited your previous payments, and/or the escrow has been properly handled. Never withhold your mortgage payments for any reason.

Identify and Complain about Housing Discrimination

Housing discrimination happens when a housing provider acts in a way that blocks someone from renting or buying housing because of their

- Race or color

- Religion
- Sex
- National origin
- Familial status (such as having children)
- Disability

A housing provider that discriminates against someone could be a landlord or a real estate management company. It could also be a lending institution like a bank or other organization that is an important part of acquiring a home.

Housing discrimination is prohibited by the Fair Housing Act. Discrimination covered by the Act can take many different forms beyond just raising prices or lying about availability. For example, the Act addresses wheelchair access in some newer properties. Learn what the Fair Housing Act covers, how to complain, and how the investigation process works.

File a Housing Discrimination Complaint

If you think you are a victim of housing discrimination,

- Complete and submit a Housing Discrimination Complaint Form or
- Contact your regional HUD office

Discrimination Against LGBT People

The Fair Housing Act does not specifically prohibit discrimination based on sexual orientation or gender identity. But discrimination against someone who is lesbian, gay, bisexual, or transgender (LGBT) may still be in violation of the Act or other state or local regulations. If you think you've been discriminated against for these reasons, file a complaint as described above, or email HUD at LGBTFairhousing@hud.gov with general questions about LGBT housing issues.

Landlord and Tenant Disputes

If you are someone who pays to rent a home or an apartment (a tenant), you may at some point have a dispute with the person who owns the building or management company that represents the owner (the landlord). Often disputes are about the conditions of the building, essential services, rent increases, or your right to stay. It is best to come to an agreement directly with the landlord or manager. Make sure that you get everything in writing. If a landlord and tenant cannot come to an agreement, a tenant might turn to outside help.

Getting Help for a Dispute with a Landlord

Laws about the rights of tenants and landlords are almost always handled at the state level. Find help from your state in a directory of state-level agencies and resources of interest to tenants. Results differ for each state, but you may find:

- State agencies that address tenant rights.
- Agencies that handle complaints.
- Resources for legal assistance.

You may eventually decide that you need help from a lawyer. People with very low-income might qualify for free legal aid from a non-profit organization.

Complaints about housing discrimination or landlords who receive assistance from the federal government should be directed to the U.S. Department of Housing and Urban Development.

Before There's a Problem

Of course, it's best to avoid a dispute in the first place if possible.

- Understand your lease completely.
- Keep all correspondence between you and your landlord.
- Communicate problems early on and in writing, noting date and time of phone calls.
- Keep proof of rent and deposits paid.
- Know the landlord-tenant laws in your state.

PART VII

MODULE 6: VEHICLES

18. Buying a Car

Learn what to do before buying, leasing, or renting a car.

What's on This Page

Buy a New Car

Whether you are buying or leasing a new car, consider these tips to get the best deal and avoid problems:

- Compare car makes and models. Visit the websites of car manufacturers to review the models that interest you.
- Research the dealer's price (or wholesale price) for the car and options. This information can help you negotiating the final price.
- Find out if the manufacturer is offering rebates that will lower the cost.
- Read car advertisements closely. Ads may over promise on the deals, or only apply to a small group of buyers.
- Get price quotes from several dealers. Find out if the amounts quoted are the prices before or after rebates are deducted.
- Research financing options. Be mindful of "loan packing.",

where a lender presses you to add features and services to your car to increase the amount of your loan.
- Avoid low-value extras such as credit insurance, auto club memberships, extended warranties, rust proofing, and upholstery finishes.
- Get estimates for how much your auto insurance would cost for each model you are considering.

Buy a Used Car

Consider these factor If you are buying a used car from a dealership.

- Contact your state or local consumer protection office to learn your rights when buying a used car.
- Find out from your state motor vehicle department what paperwork you will need to register a vehicle.
- Check prices of similar models with used car guides that you can find online or at your local library.
- Research the vehicle's history. Ask the seller for details concerning past owners, use, and maintenance. You can also find out whether the car has been damaged in a flood, involved in a crash, had its odometer rolled back, or been labeled a "lemon." Get the car's unique vehicle information number (VIN), usually found on the car's lower left dashboard.
- Research the car's title history with your state motor vehicle department.
- Find out if the car has any recalls, investigations or complaints searchable online database.
- Verify that mileage disclosures match the car's odometer reading.
- Check with the manufacturer to verify if the manufacturer's warranty is still in effect.
- Get and read the seller's return policy in writing.

- Have the car inspected by your mechanic. Talk to the seller and agree in advance that you'll pay for the examination if the car passes inspection, but the seller will pay if the mechanic discovers significant problems. A qualified mechanic should check the vehicle's frame, tires, air bags, and undercarriage, as well as the engine.
- Examine dealer documents carefully. Make sure you are buying—not leasing—the vehicle. Leases use terms such as "balloon payment" and "base mileage" disclosures.

Buying a Car from a Private Owner

You may choose to buy a car directly from an individual, instead of a dealer. The purchase price is often lower and easier to negotiate if you buy a car from a private owner. You should still take the same steps as if you bought the car from a dealership. There are more factors to consider if you buy from a private owner.

A private owner sells the car "as is." If the car has defects when you buy it, the seller isn't required to repair them before you purchase it. Also, federal protections and rules, such as FTC's Buyer's Guide don't apply. If the seller is fraudulent, it can be more difficult to resolve the problem. You can't complain to your local consumer protection office about the seller.

If you choose to purchase a car from a private seller:

- Ask to get service records from the owner.
- Verify that the seller actually owns the car and that the title and registration are in their name.
- Verify that there are no liens against the car, or if it is still under a finance agreement.
- Contact the manufacturer to determine if the manufacturer warranty, or other warranty protection, transfer to you.
- Meet the seller in a public place or busy area, especially if the

seller is a someone you don't know.

Vehicle Financing

Learn about the options available for paying for a vehicle.

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Lease a Car

When you lease, you pay to drive a vehicle owned by a automobile dealership or leasing company. Monthly lease payments may be lower than loan payments, but at the end of the lease you have no ownership or equity in the car. To get the best deal, follow the advice below.

- Compare leasing versus owning. The Consumer Leasing Act requires leasing companies to give you information so that you can compare monthly payments and other charges.
- Compare lease offers from multiple dealers. Consider buying from an independent agent rather than a car dealership
- Find out what the down payment, or capitalized cost reduction, is for the lease.
- Calculate the total cost over the life of the lease, and include the down payment. A lease with a higher down payment and low monthly payments may be a better deal for you.

- Ask for details on wear and tear limits. Damages that you regard as normal wear and tear could be billed as significant damage at the end of your lease.
- Find out how many miles you can drive in a year. Most leases allow 12,000 to 15,000 miles a year. Expect a charge of 10 to 25 cents for each additional mile driven.
- Check the manufacturer's warranty. It should cover the entire lease term and the number of miles you are likely to drive.
- Ask the dealer what happens if you give up the car before the end of your lease. You could be responsible for termination fees if you end the lease early.
- Ask what happens if the car is involved in an accident.
- Get all the terms in writing. Everything included with the car should be listed on the lease to avoid being charged for "missing" equipment later.

Get more tips to help you understand the differences between a buying or leasing a car.

Car Safety Information

Car Safety Tests

These organizations conduct automobile safety crash tests:

- The National Highway Traffic Safety Administration (NHTSA):
    - Conducts new vehicle crash tests to determine the protection level for drivers and passengers during front and side-impact crashes.
    - Evaluates vehicle restraints such as air bags and safety belts.
    - Determines the likelihood of a vehicle rolling over if

    involved in a single-vehicle crash.
- The Insurance Institute for Highway Safety performs a different test that uses offset-frontal car crashes to assess the protection provided by a vehicle's structure.

Safety Performance Reporting

These organizations report on or provide automobile safety information:

- SaferCar.gov:
    - Provides information on how to file a complaint about child safety seats, tires, equipment, and vehicles
    - Lists vehicle and equipment defects and recalls – If a vehicle has been recalled, ask your car dealer for proof that the defect has been repaired. Used vehicles should also have a current safety inspection sticker if your state requires one.
    - Lists vehicles equipped with Electronic Stability Control (ESC)
- The National Motor Vehicle Title Information System provides information about a vehicle's history and condition, including information about its title, odometer reading, and, in some cases, theft.
- Consumer Reports' car issue rates vehicles in terms of overall safety. Its safety score combines crash test results with a vehicle's accident avoidance factors, such as emergency handling, braking, acceleration, and driver comfort.

Car Rental and Car Sharing Services

Even if you don't own a car, there are times when you may need one. When you rent a car, you're using a company's vehicle for a short period of time. Use these tips before signing the rental agreement to help you avoid unexpected problems and charges:

- **Fees:** What is the total cost, after all fees are included? Will there be an airport surcharge or fees for car drop-off, insurance, fuel, mileage, taxes, additional drivers, an underage driver, or equipment rental (for items such as ski racks and car seats)?
- **Driving record:** Ask whether the rental company checks customers' driving records when they arrive at the service counter. If there are problems with your driving record, the rental company could turn you away, even if you have a confirmed reservation.
- **Insurance:** Be sure that you aren't duplicating coverage. You might have coverage through your personal auto insurance policy, a motor club membership, the credit card you used to reserve the rental, or your employer, if you're traveling on business.
- **Damages:** Before driving off, inspect the vehicle for dents, scratches, and marks and check the tires. Report any pre-existing problems and ask the company to note them on your rental agreement. Try to return the car during regular business hours so you and the rental staff can look at the car together to verify that you didn't damage it.
- **Fuel:** Some rental companies, particularly at airports, may require you to refuel within a 10 mile radius of the airport or show a fuel receipt when you return the car.
- **Payment method:** Pay with a credit card rather than a debit card to avoid holds on other funds in your checking account.
- **Rental deposit:** Does the rental company require a deposit? If

so, ask for a clear explanation of the deposit refund procedures.

Some state laws cover short-term car and truck rentals. Contact your state or local consumer protection office for information or to file a complaint.

Car Sharing

If you'd rather rent a car on an hourly basis and have greater flexibility in where and when you can pick up a vehicle, you can join a car sharing service. You get the convenience of a car when you need one, without the costs of ownership.

- **Fees:** What fees does the company charge (annual fees, application fee)? Are they refundable, even if you cancel or are denied membership?
- **Availability of cars:** Are there cars available at times that you need one? How far in advance do you need to reserve a vehicle?
- **Attendants:** Are there on-site staff present when you check out your car and return it? This can be very helpful when you need to verify that the car is returned in the same condition as when you borrowed it.
- **Fuel:** Do you have to pay for gas out of your own pocket or does the company pay for it?
- **Extension of time:** How easy is it to extend the length of your rental? Is it done through an app or is there a dedicated customer service hotline?
- **Cancellation:** How far in advance must you give notice to cancel a reservation or your membership? And can the company cancel your membership without notification?
- **Damages:** Are you responsible for damages, even if they were

not your fault or they happened after you returned the car? This is especially important if you return the car to a lot that does not have on-site staff.

- **Insurance:** Is insurance included? You may be insured by a personal policy or the credit card that you use to pay for this service.

19. Buying a New Car

A new car is second only to a home as the most expensive purchase many consumers make. According to the National Automobile Dealers Association, the average price of a new car sold in the United States is about $30,000. That's why it's important to know how to make a smart deal.

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- Buying Your New Car
- Learning the Terms
- Financing Your New Car
- Trading in Your Old Car
- Considering a Service Contract

Buying Your New Car

Think about what car model and options you want and how much you're willing to spend. Do some research. You'll be less likely to feel pressured into making a hasty or expensive decision at the showroom and more likely to get a better deal.

Consider these suggestions:

- Check publications and websites that discuss new car features and prices. These may provide information on the dealer's costs for specific models and options.
- Shop around to get the best possible price by comparing models and prices in ads and at dealer showrooms. You also may want to contact car-buying services and broker-buying services to make comparisons.
- Plan to negotiate on price. Dealers may be willing to bargain on their profit margin, often between 10 and 20 percent. Usually, this is the difference between the manufacturer's suggested retail price (MSRP) and the invoice price.
- Because the price is a factor in the dealer's calculations regardless of whether you pay cash or finance your car — and also affects your monthly payments — negotiating the price can save you money.
- Consider ordering your new car if you don't see what you want on the dealer's lot. This may involve a delay, but cars on the lot may have options you don't want — and that can raise the price. However, dealers often want to sell their current inventory quickly, so you may be able to negotiate a good deal if an in-stock car meets your needs.

Learning the Terms

Negotiations often have a vocabulary of their own. Here are some terms you may hear when you're talking price.

- Invoice Price is the manufacturer's initial charge to the dealer. This usually is higher than the dealer's final cost because dealers receive rebates, allowances, discounts, and incentive awards. Generally, the invoice price should include freight (also known as destination and delivery). If you're buying a car based on the invoice price (for example, "at invoice," "$100 below invoice," "two percent above invoice") and if freight is already included, make sure freight isn't added again to the sales contract.

- Base Price is the cost of the car without options, but includes standard equipment and factory warranty. This price is printed on the Monroney sticker.
- Monroney Sticker Price (MSRP) shows the base price, the manufacturer's installed options with the manufacturer's suggested retail price, the manufac-turer's transportation charge, and the fuel economy (mileage). Affixed to the car window, this label is required by federal law, and may be removed only by the purchaser.
- Dealer Sticker Price, usually on a supplemental sticker, is the Monroney sticker price plus the suggested retail price of dealer-installed options, such as additional dealer markup (ADM) or additional dealer profit (ADP), dealer preparation, and undercoating.

Financing Your New Car

If you decide to finance your car, be aware that the financing obtained by the dealer, even if the dealer contacts lenders on your behalf, may not be the best deal you can get. Contact lenders directly. Compare the financing they offer you with the financing the dealer offers you. Because offers vary, shop around for the best deal, comparing the annual percentage rate (APR) and the length of the loan. When negotiating to finance a car, be wary of focusing only on the monthly payment. The total amount you will pay depends on the price of the car you negotiate, the APR, and the length of the loan.

Sometimes, dealers offer very low financing rates for specific cars or models, but may not be willing to negotiate on the price of these cars. To qualify for the special rates, you may be required to make a large down payment. With these conditions, you may find that it's sometimes more affordable to pay higher financing charges on a car that is lower in price or to buy a car that requires a smaller down payment.

Before you sign a contract to purchase or finance the car, consider the terms of the financing and evaluate whether it is affordable. Before you drive off the lot, be sure to have a copy of the contract that both you and the dealer have signed and be sure that all blanks are filled in.

Some dealers and lenders may ask you to buy credit insurance to pay off your loan if you should die or become disabled. Before you buy credit insurance, consider the cost, and whether it's worthwhile. Check your existing policies to avoid duplicating benefits. Credit insurance is not required by federal law. If your dealer requires you to buy credit insurance for car financing, it must be included in the cost of credit. That is, it must be reflected in the APR. Your state Attorney General also may have requirements about credit insurance. Check with your state Insurance Commissioner or state consumer protection agency.

Before you negotiate the price of your next new car, use this worksheet to establish the bargaining room. *You can get the invoice price by looking at the dealer's invoice or reviewing car publications.

Trading in Your Old Car

Discuss the possibility of a trade-in only after you've negotiated the best possible price for your new car and after you've researched the value of your old car. Find out what your current vehicle is worth before you negotiate the purchase of a new car. Check the National Automobile Dealers Association's (NADA) Guides, Edmunds, and Kelley Blue Book. This information may help you get a better price from the dealer. Though it may take longer to sell your car yourself, you generally will get more money than if you trade it in.

Considering a Service Contract

Service contracts that you may buy with a new car provide for the repair of certain parts or problems. These contracts are offered by manufacturers, dealers, or independent companies and may or may not provide coverage beyond the manufacturer's warranty. Remember that a warranty is included in the price of the car while a service contract costs extra.

Before deciding to purchase a service contract, read it carefully and consider these questions:

- What's the difference between the coverage under the warranty and the coverage under the service contract?
- What repairs are covered?
- Is routine maintenance covered?
- Who pays for the labor? The parts?
- Who performs the repairs? Can repairs be made elsewhere?
- How long does the service contract last?
- What are the cancellation and refund policies?

PART VIII

MODULE 7: INSURANCE

20. Understanding Your Health Coverage

Health coverage pays for provider services, medications, hospital care, and special equipment when you're sick. It's also important when you're not sick. Marketplace coverage includes preventive health services like immunizations for children and adults, annual doctor visits for women and seniors, screening and counseling for people of all ages, and more. The best news – it's free. Here are 4 things to know about your health coverage:

1. All Marketplace health plans must provide you with a Summary of Benefits and Coverage, which includes coverage examples showing how the plan might help pay for services.
2. The actual costs and care will vary by your health care needs and your coverage.
3. You can use our glossary to understand key terms like copayment, deductible, network, and premium.
4. If you have questions about your coverage, you can contact

your health plan, state Medicaid program, or Children's Health Insurance Program (CHIP) to get more information.

See why it's so important to have health coverage and share what you learn with your family and friends.

Watch the video: "Understand the Plan" – from Coverage to Care

Watch the video: "Words to Know" – from Coverage to Care

Print your own booklet: Step 2 – Understand Your Health Coverage

Sample Insurance Card

21. Buying Insurance

Learn how to find a trustworthy and affordable insurance company.

What's on This Page

- Types of Insurance
- Shop for Insurance

Types of Insurance

Insurance protects you from financial loss in the event of a disaster or other hardship. By purchasing insurance policies, you can receive reimbursement for losses due to car accidents, property theft, natural disasters, medical expenses, disability, or death.

- **Health insurance**—helps pay your doctor's visits and other health care expenses
- **Disability insurance**—replaces some of your income if an injury or illness prevents you from working
- **Life insurance**—helps pay bills and your family's future financial needs after you die
- **Auto insurance**—protects you against financial loss if you have a car accident
- **Homeowner's insurance**—pays you if there is damage to your home, or for loss of personal property due to damage or theft
- **Flood insurance**—protects you against property loss from flooding
- **Renter's insurance**—pays claims for damage or loss of your personal property as a renter

- **Pet insurance**—helps pay veterinary bills for your pet
- **Crop and livestock insurance**—protects your farm from loss due to natural disasters or declining prices
- **Catastrophic health care insurance**—covers certain types of expensive medical care, like hospitalizations
- **College tuition insurance**—refunds college tuition if you must withdraw because of a serious injury or illness
- **Dental and vision insurance**—helps pay your dental or vision care expenses
- **Identity theft insurance**—reimburses you for the cost of restoring your identity and repairing credit reports if you're a victim of identity theft. This insurance may be part of your homeowner's insurance policy or a stand-alone policy.
- **International health care insurance**—provides health coverage no matter where you are in the world. The policy term is flexible, so you can purchase it only for the time you will be out of the country.
- **Liability insurance**—pays if you are sued for negligence or injury to another person
- **Host protection insurance**—protects you if you rent your home out or use your car to drive others for a fee
- **Travel insurance**—protects against losses during travel. There are four kinds of travel insurance: travel cancelation insurance, baggage or personal effects coverage, emergency medical coverage, and accidental death.
- **Umbrella insurance**—supplements the insurance you already have for home, auto, and other personal property. Umbrella insurance can help cover costs that exceed the limits of other policies.

Shop for Insurance

Before you buy insurance, do your homework. Research the insurance company to be sure that the company is financially sound and provides good service. Also find out what factors matter so that you can get the coverage you need at the best price.

Check Out the Insurance Company

- Find out whether your state insurance department offers any information concerning insurance companies and rates.
- Make sure the insurance company is licensed and covered by the state's guaranty fund. The fund pays claims in case the company defaults. Your state insurance department can provide this information.
- Check the financial stability and soundness of the insurance company with credit rating agencies.
- Research the company's complaint record.
- Find out what others think about the company's customer service by reading online reviews from current customers.
- Make sure you receive a written policy. This tells you that the agent forwarded your premium to the insurance company. If you don't receive a policy within 60 days, contact your agent and the insurance company.

Find the Best Rates

- Compare quotes from several companies to get the best better deal.
- Ask your insurance agent about discounts. You may be able to get a lower premium if you have safety features in your home, such as deadbolt locks, smoke detectors, an alarm system, storm shutters, or fire-retardant roofing material. Similarly, you may save on car insurance based on your vehicle's safety

features, the number of miles you drive, your age, good grades if you're a student, and your driving record. You might also be able to get discounts if you're a member of civic or alumni associations, or have multiple policies with the same company.
- Consider a higher deductible. Increasing your deductible by just a few hundred dollars can make a big difference in your premiums.

22. Personal Insurance

Learn about different types of personal insurance.

What's on This Page

- Disability Insurance
- Health Insurance Plans
- Life Insurance
- Life Insurance for Military Personnel and Veterans

Disability Insurance

Disability insurance protects individuals and their families from financial hardship when illness or injury prevents them from earning a living. Many employers offer some form of disability coverage to employees, or you can buy an individual disability insurance policy.

Types of Disability Policies

There are two types of disability policies:

- **Short-term** disability policies have a maximum benefit of two years.
- **Long-term** disability policies have benefits that can last the rest of your life.

Employers may offer short-term disability coverage, long-term disability coverage, or integrate both of these as part of a competitive employee benefits package. When purchasing individual disability insurance coverage, you should ask:

- How is disability defined?
- When do benefits begin?
- How long do benefits last?
- What dollar amount is promised?

Social Security Disability and Supplemental Security Income Programs

Both programs are administered by the Social Security Administration (SSA), and they serve as the largest of several federal programs that offer assistance to people with disabilities.

- The Social Security disability insurance program pays benefits to you and certain members of your family if you are "insured," meaning that you have worked long enough and paid Social Security taxes.
- The Supplemental Security Income (SSI) program pays benefits based on financial need.

Health Insurance Plans

Learn About Health Coverage

Health insurance helps you pay for medical services and sometimes prescription drugs. Once you purchase insurance coverage, you and your health insurer each agree to pay a part of your medical expenses–usually a certain dollar amount or percentage of the expenses.

How to get Health Coverage

You can get health care coverage through:

- A group coverage plan at your job or your spouse or partner's job
- Your parents' insurance plan, if you are under 26 years old
- A plan you purchase on your own directly from a health insurance company or through the Health Insurance Marketplace
- Government programs such as Medicare, Medicaid, or Children's Health Insurance Program (CHIP)
- The Veterans Administration or TRICARE for military personnel
- Your state, if it provides a health insurance plan
- Continuing employer coverage from your former employer, on a temporary basis under the Consolidated Omnibus Budget Reconciliation Act (COBRA)

Types of Health Insurance Plans

When purchasing health insurance, your choices typically fall into one of three categories:

- Traditional fee-for-service health insurance plans are usually the most expensive choice, but they offer you the most flexibility in choosing health care providers.
- Health maintenance organizations (HMOs) offer lower co-

payments and cover the costs of more preventive care, but your choice of health care providers is limited to those who are part of the plan.
- Preferred provider organizations (PPOs) offer lower co-payments like HMOs but give you more flexibility in selecting a provider.

Choosing a Health Insurance Plan

Read the fine print when choosing among different health care plans. Also ask a lot of questions, such as:

- Do I have the right to go to any doctor, hospital, clinic, or pharmacy I choose?
- Are specialists, such as eye doctors and dentists, covered?
- Does the plan cover special conditions or treatments such as pregnancy, psychiatric care, and physical therapy?
- Does the plan cover home care or nursing home care?
- Will the plan cover all medications my physician may prescribe?
- What are the deductibles? Are there any co-payments? Deductibles are the amount you must pay before your insurance company will pay a claim. These differ from co-payments, which are the amount of money you pay when you receive medical services or a prescription.
- What is the most I will have to pay out of my own pocket to cover expenses?
- If there is a dispute about a bill or service, how is it handled?

Life Insurance

A life insurance policy states that you will pay premiums to an insurance company over time, and, in exchange, the company will pay a lump sum amount to a designated beneficiary upon your death. The money from your life insurance policy can help pay bills and help support your surviving family members' living expenses. You may need to adjust the amount of your life insurance policy related to major life events, like buying a home, getting married, or having a child.

There is no set amount of life insurance you need. If you have dependents you want to provide for, or leave an inheritance to charities, you may need more life insurance than someone without dependents or charitable causes to support. Consider potential future expenses that your loved ones may need.The life insurance payout could be used to replace the money you would have earned to pay for their college education, moving expenses, or retirement. You can buy an individual life insurance policy from an insurance agent. You may also be part of a group life insurance policy through your employer or civic organization. If you are a veteran, you may be eligible for the VA's life insurance benefits.

Use these tips when you are shopping for insurance.

There are two main types of life insurance policies:

- **Whole (or universal) life insurance policies** are considered permanent. As long as you pay the premium, the policy is in effect. In addition to paying a benefit upon your death, whole life insurance policies also have an investment or savings component. This means that you accumulate cash value over the life of the policy, so you can borrow money from these types of policies if you need to.
- **Term life insurance policies** are in effect for a certain period of time, or term. If you have this type of policy and pass away during the term that the policy is in effect, the insurance

company will pay a benefit. If you live past the time that the policy is in effect, the insurance company won't pay a benefit or give you a refund.

Term life insurance policies are usually less expensive than whole life insurance policies. This is because term life insurance policies only cover a set amount of time, while whole life insurance policies are intended to be permanent and because part of the money you pay is put away for savings.

Lost Life Insurance Policies

If you have misplaced a life insurance policy, your state's insurance commission may be able to help you locate a copy of it. A policy locator service can search for it for a fee. If the insurance company knows that an insured person has died but can't locate the beneficiary, the company must turn the benefits over to the state's unclaimed property office.

Life Insurance for Military Personnel and Veterans

The Department of Veterans Affairs (VA) offers life insurance programs for veterans, servicemembers and their families.

There are also voluntary programs that ensure the survivors of retirees (and, in some situations, active duty members) continue to receive income throughout their lives. View more information about military/veteran survivor benefits.

23. Property Insurance

Learn about the different types of insurance for your property.

What's on This Page

- Auto Insurance
- Homeowners and Renters Insurance
- Flood Insurance
- Pet Insurance

Auto Insurance

Auto insurance protects you from paying the full cost for vehicle repairs and medical expenses due to a collision. A number of things affect the premiums you pay for this protection, including your:

- Gender
- Age
- Marital status
- Credit history
- Car's make and model
- City and neighborhood

Types of Auto Insurance

Every state requires drivers to carry minimum levels of auto insurance coverage, or the equivalent in financial responsibility waivers. These requirements ensure that you can pay for property damages or medical expenses. There are several components that can make up your insurance policy:

- **Liability coverage** protects you if you are at fault for a collision. It pays for medical expenses and vehicle damage for the other driver and passengers.
- **Uninsured motorist coverage** pays for damages to your car and medical expenses if an uninsured driver hits your car.
- **Collision coverage** pays to repair your vehicle, if you were at fault for the collision.
- **Underinsured motorist coverage** pays damages for your car if someone hits it, but doesn't have enough insurance to cover your medical expenses and car damages.
- **Comprehensive coverage** pays for damages to your car due to theft, fire, or falling objects.

Auto insurance requirements vary from state to state, but liability coverage is mandatory in most states. You may choose to opt out of certain types of coverage, depending on your budget and car's age. Check with your state insurance regulator to learn more about its requirements and to research potential insurers.

Be sure to read the declarations page of your auto insurance policy. This summary includes your policy's important details: the duration of coverage, annual premium, the maximum amount your insurance company will pay out for each type of claim, and how your premium payment is split between each part of your coverage.

Homeowners and Renters Insurance

Homeowners and renters insurance protect your home and personal property against damage or loss, and insures you in case someone gets hurt while on your property. You may already have insurance on your home if you have a mortgage on the property, because most lenders make insurance a condition of the loan.

Renters insurance, or tenant insurance, offers renters coverage similar to homeowners insurance. If you are a renter, do not assume your landlord carries insurance on your personal belongings; you may wish to purchase a separate policy.

What Can Homeowners or Renters Insurance Cover?

Homeowners or renters insurance may pay claims for:

- damage to your home, garage, and other outbuildings
- loss of furniture and other personal property due to damage or theft, both at home and away
- additional living expenses if you rent temporary quarters while your house is being repaired

Homeowners or renters insurance may also:

- include liability for bodily injury and property damage that you cause to others through negligence
- include liability for accidents happening in and around your home, as well as away from home, for which you are responsible
- pay for injuries occurring in and around your home to anyone other than you or your family
- provide limited coverage for money, gold, jewelry, and stamp and coin collections
- cover personal property in storage

In addition to general shopping for insurance tips, keep these points in mind when shopping for homeowners insurance:

- Insure your house, not the land under it. If you don't subtract the value of the land when deciding how much homeowner's insurance to buy, you will pay more than you should.
- Purchase enough coverage to replace what is insured. "Replacement Cost Coverage" gives you the money to rebuild your home and replace its contents. An "Actual Cash Value" policy is cheaper but pays the difference between your property's worth at the time of loss minus the depreciation for age and wear.
- Ask about special coverage you might need. You may have to pay extra for computers, cameras, jewelry, art, antiques, musical instruments, stamp collections, etc.
- Flood and earthquake damage are not covered by a standard homeowners policy. The cost of a separate earthquake policy will depend on the likelihood of earthquakes in your area. Homeowners who live in areas prone to flooding should take advantage of the National Flood Insurance Program (NFIP).
- If you are a renter, do not assume your landlord carries insurance on your personal belongings. Purchase a separate policy for renters.

For help in deciding how much insurance coverage to buy, contact your state insurance regulator.

Flood Insurance

Since standard homeowners insurance doesn't cover flooding, it's important to have protection against flood damage. If you live in an area prone to flooding, you should take advantage of the National Flood Insurance Program.

National Flood Insurance Program (NFIP)

Administered by the Federal Emergency Management Agency (FEMA), the NFIP offers flood insurance to homeowners, renters, and business owners if their community participates in the program. The program works closely with more than 80 private insurance companies.

- Homes and businesses with mortgages from federally regulated or insured lenders in high-risk flood areas are required to have flood insurance. While flood insurance is not federally required if you live in a moderate-to-low risk flood area, it is still available and strongly recommended.
    - To find out if your home or business is in a community that participates in the NFIP, refer to the Community Status Book section on FEMA.gov.
- Flood insurance protects two types of insurable property: building and contents. The first covers your building; the latter covers your possessions; and neither covers the land they occupy. Flood insurance only covers damage that is a direct result of flooding.
- Rates are set nationally and do not differ from company to company or agent to agent. These rates depend on many factors, such as the 1) date and 2) type of construction of your home, and 3) your building's level of risk.
- Flood insurance can only be purchased through an insurance agent; you cannot purchase it directly from the federal government. Typically, there's a 30-day waiting period from the date of purchase before your policy goes into effect.
    - If your local insurance agent is unfamiliar with the NFIP, you can find an agent serving your area.

File a Complaint

If you have a problem with an insurance company or agent regarding flood insurance, contact your state insurance regulator.

More Information

Complete the One-Step Flood Risk Profile to rate your risk of flooding, estimate your premiums, and find an agent.

Pet Insurance

Health insurance for pets may help you pay veterinary bills if your pet is injured, gets sick, or needs routine preventive care. Most plans cover dogs and cats, and some plans cover other types of animals.

What to Consider Before Buying Pet Health Insurance

- Shop and compare: Ask your vet to recommend some pet insurers. Be aware that policies and premiums vary widely. Compare monthly or annual costs, and the differences in deductibles, co-pays, and coverage limits. These may limit payouts by incident, annually, or your animal's lifetime.
- Read policies carefully: Read the clauses on deductibles, co-pays, coverage limits, and exclusions before you buy a pet insurance policy. Insurance policies normally exclude pre-existing problems and hereditary conditions.

- Do the math: Add up the total costs of the policy for the anticipated life expectancy of your pet. Be aware that the age of your pet affects the premium. The older your pet is, the higher the premium you'll pay.

Questions to Ask Insurers

As you consider possible insurance providers, it's helpful to have standard questions you ask to each company, that make it easy to compare between policies. Some important questions to ask include:

- Can I choose my vet?
- Is there a waiting period?
- Do you cover routine wellness exams?
- Do you cover neutering or spaying?
- Does the plan include prescription drug coverage?
- Do you cover claims annually or by incident?
- If the coverage is by incident, is there a time limit?
- Is there a dollar limit for vet office fees?
- If my pet has a pre-existing or hereditary condition, will this plan cover it?
- Does this plan cover chronic or recurring conditions?
- How long do you take to pay claims?
- Does the plan cover the costs of vaccinations and required shots?
- Do you give discounts for insuring multiple pets?
- Does this plan cover advertising costs and rewards if my pet is lost or stolen?
- Does this plan make payouts if my pet dies during treatment?

For more information about pet insurance and to research regulations in your state, contact your state insurance regulator.

PART IX

MODULE 8: INVESTMENT

24. Bonds

What Are Bonds?

A bond is a debt security, similar to an IOU. Borrowers issue bonds to raise money from investors willing to lend them money for a certain amount of time.

When you buy a bond, you are lending to the issuer, which may be a government, municipality, or corporation. In return, the issuer promises to pay you a specified rate of interest during the life of the bond and to repay the principal, also known as face value or par value of the bond, when it "matures," or comes due after a set period of time.

Why do people buy bonds?
What types of bonds are there?
What are the benefits and risks of bonds?
How to buy and sell bonds
Understanding fees
Avoiding fraud
Additional information

Why Do People Buy Bonds?

Investors buy bonds because:

- They provide a predictable income stream. Typically, bonds pay interest twice a year.
- If the bonds are held to maturity, bondholders get back the entire principal, so bonds are a way to preserve capital while investing.

- Bonds can help offset exposure to more volatile stock holdings.

Companies, governments and municipalities issue bonds to get money for various things, which may include:

- Providing operating cash flow
- Financing debt
- Funding capital investments in schools, highways, hospitals, and other projects

What Types Of Bonds Are There?

There are three main types of bonds:

- **Corporate bonds** are debt securities issued by private and public corporations.
- **Investment-grade.** These bonds have a higher credit rating, implying less credit risk, than high-yield corporate bonds.
- **High-yield**. These bonds have a lower credit rating, implying higher credit risk, than investment-grade bonds and, therefore, offer higher interest rates in return for the increased risk.
- **Municipal bonds**, called "munis," are debt securities issued by states, cities, counties and other government entities. Types of "munis" include:

- **General obligation bonds**. These bonds are not secured by any assets; instead, they are backed by the "full faith and credit" of the issuer, which has the power to tax residents to pay bondholders.
- **Revenue bonds.** Instead of taxes, these bonds are backed by revenues from a specific project or source, such as highway tolls or lease fees. Some revenue bonds are "non-recourse," meaning that if the revenue stream dries up, the bondholders

do not have a claim on the underlying revenue source.

- **Conduit bonds.** Governments sometimes issue municipal bonds on behalf of private entities such as non-profit colleges or hospitals. These "conduit" borrowers typically agree to repay the issuer, who pays the interest and principal on the bonds. If the conduit borrower fails to make a payment, the issuer usually is not required to pay the bondholders.

- **U.S. Treasuries** are issued by the U.S. Department of the Treasury on behalf of the federal government. They carry the full faith and credit of the U.S. government, making them a safe and popular investment. Types of U.S. Treasury debt include:

- **Treasury Bills**. Short-term securities maturing in a few days to 52 weeks
- **Notes.** Longer-term securities maturing within ten years
- **Bonds.** Long-term securities that typically mature in 30 years and pay interest every six months
- **TIPS.** Treasury Inflation-Protected Securities are notes and bonds whose principal is adjusted based on changes in the Consumer Price Index. TIPS pay interest every six months and are issued with maturities of five, ten, and 30 years.

What Are The Benefits And Risks Of Bonds?

Bonds can provide a means of preserving capital and earning a predictable return. Bond investments provide steady streams of income from interest payments prior to maturity.

The interest from municipal bonds generally is exempt from federal income tax and also may be exempt from state and local taxes for residents in the states where the bond is issued.

As with any investment, bonds have risks. These riskes include:

Credit risk. The issuer may fail to timely make interest or principal payments and thus default on its bonds.

Interest rate risk. Interest rate changes can affect a bond's value. If bonds are held to maturity the investor will receive the face value, plus interest. If sold before maturity, the bond may be worth more or less than the face value. Rising interest rates will make newly issued bonds more appealing to investors because the newer bonds will have a higher rate of interest than older ones. To sell an older bond with a lower interest rate, you might have to sell it at a discount.

Inflation risk. Inflation is a general upward movement in prices. Inflation reduces purchasing power, which is a risk for investors receiving a fixed rate of interest.

Liquidity risk. This refers to the risk that investors won't find a market for the bond, potentially preventing them from buying or selling when they want.

Call risk. The possibility that a bond issuer retires a bond before its maturity date, something an issuer might do if interest rates decline, much like a homeowner might refinance a mortgage to benefit from lower interest rates.

Avoiding Fraud

Corporate bonds are securities and, if publicly offered, must be registered with the SEC. The registration of these securities can be verified using the SEC's EDGAR system. Be wary of any person who attempts to sell non-registered bonds.

Most municipal securities issued after July 3, 1995 are required to file annual financial information, operating data, and notices of certain events with the Municipal Securities Rulemaking Board (MSRB). This information is available free of charge online at www.emma.msrb.org. If the municipal bond is not filed with MSRB, this could be a red flag.

Additional Information

Investor Bulletin: What are Corporate Bonds
Investor Bulletin: What are High-yield Corporate Bonds
Investor Bulletin: Interest Rate Risk
MSRB Investor Guide 2012
Bond Funds and Income Funds
Callable or Redeemable Bonds
Financial Industry Regulatory Authority (FINRA)
Information on CUSIP numbers
Late Payment of Interest on Bonds
Municipal Securities Rulemaking Board (MSRB)
MSRB Electronic Municipal Market Access (EMMA)
The Securities Industry and Financial Markets Association (SIFMA)

25. Saving and Investing

Find popular topics about saving and investing.

What's on This Page

- Manage Finances and Save Money
- Steps to Make a Budget
- Saving for Retirement
- Savings Bonds
- Treasury Securities
- Trusts
- Things to Consider Before You Invest
- Tools to Research Investments
- Choose a Financial Professional
- Pyramid Schemes

Manage Finances and Save Money

To help you manage your money and reach your saving goals:

Create a Budget

A budget is your plan for how you will spend money over a set period of time. It shows how much money you make and how you spend your money. Creating a budget can help you:

- Pay your bills on time.

- Save for unplanned expenses in the future.
- Prepare for retirement.

Download a budget spreadsheet that you can use to create your own to manage your monthly income and expenses.

Consider Ways to Save

Saving money involves looking for deals and buying the quality items you need at the best price. You can save money by comparison shopping, comparing the prices and quality of products you plan to buy. MyMoney.gov offers ways to manage your spending and build your savings accounts to achieve your saving goals.

Invest in Long Term Goals

Investing is a way to make money grow, by buying shares of stocks, mutual funds, bonds, or real estate. When you invest, there is risk that you could lose the money you invest; in general the greater the earnings you can make, the greater the risk. You can save for long term goals, such as retirement (PDF, Download Adobe Reader) and college education, by investing. Learn how to savefor emergencies, short term and long term goals, and become an informed investor.

Steps to Make a Budget

See this video to learn how to make a budget and plan your finances.

One or more interactive elements has been excluded from this version of the text. You can view them online here: https://library.achievingthedream.org/lfccpersonalfinance/?p=53

Saving for Retirement

As you approach retirement, there are many things to think about. Experts advise that you will need about 80 percent of your pre-retirement income to continue your current quality of life. The exact amount depends on your individual needs. Some important factors to consider include:

- At what age do you plan to retire?
- Can you participate in an employer's retirement savings plan, such as a 401(k) plan, or a traditional pension plan?
- Will your spouse or partner retire when you do?
- Where do you plan to live when you retire? Will you downsize, rent, or own your home?
- Do you expect to work part-time?
- Will you have the same medical insurance you had while working? Will your coverage change?
- Do you want to travel or pursue a new hobby that might be costly?

Resources to Help You Prepare for Retirement

To help you plan for retirement:

- Find practical tips for building retirement savings in the Top 10 Ways to Prepare for Retirement(PDF, Download Adobe Reader).
- Use a retirement calculator to find out the best age to claim your Social Security benefits.
- myRA can help you start saving for retirement when you don't have access to an employer-sponsored plan or lack other options to save.
- Find out the trade-offs between taking your pension in a monthly payment or in a lump sum(PDF, Download Adobe Reader).
- Social Security pays benefits that are on average equal to about 40 percent of your pre-retirement earnings. You may be able to estimate your benefits.
- Learn how you can boost your retirement savings at Investor.gov.
- If you have a financial advisor, talk to him or her about your plans.

Savings Bonds

U.S. savings bonds are one of the safest types of investments because they are endorsed by the federal government and, therefore, are virtually risk free.

Visit TreasuryDirect, a website from the U.S. Department of the Treasury, to learn about savings bonds, treasury bonds, and securities: how to buy and redeem your investments, what to do in the event of the death of an owner, and much more. TreasuryDirect is your one-stop shopping site for government securities where you can find information about the wide range of savings options, including EE/E, HH/H, and I savings bonds.

Manage and determine the value of savings bonds using these tools:

- Savings Bond Calculator
- Savings Bond Wizard
- Redemption Tables

You can give savings bonds for many occasions, such as birthdays, weddings, and graduations. Learn how to give savings bonds as gifts.

Treasury Securities

Treasury securities are debts issued by the federal government's Bureau of Fiscal Service. When you buy a treasury security, you are lending money to the federal government for a set amount of time. In return the government promises to pay you back the entire amount, also known as the face value, when the security matures.

There are several types of treasury securities:

- Treasury Bills—Short term securities that mature between a few days and 52 weeks.
- Treasury Notes—Medium term securities that mature between one and 10 years.
- Treasury Bonds—Long term securities, with a 30 year term that pays interest every six months, until the bond matures.
- Treasury Inflation-Protected Securities (TIPS)—Securities with principle values that adjust based on inflation, but with fixed interest rates for five, 10, or 30 year maturities.
- Savings Bonds—Securities that offer a fixed interest rate over a fixed period of time.
- Floating Rate Notes (FRNs)—Securities with variable interest rates, so that as bank interest rates increase or decrease, the interest rates on the FRNs change in the same direction.

You can purchase treasury securities for yourself or as gifts. You can purchase them in several ways:

- Banks, brokers, and other financial institutions through the Commercial Book-Entry System.
- Online through Treasury Direct
- Payroll savings plans
- Public auctions

Trusts

A trust (or trust fund) is a legal entity that allows a person (the grantor, donor, or settlor) to transfer assets to another person or organization (the trustee). Once the grantor establishes the trust, the trustee controls and manages the assets for the grantor or for another beneficiary—someone who will ultimately benefit from the trust. To help you decide if a trust is right for you, first consult a licensed attorney experienced with estate planning and trust matters.

Reasons to Set Up a Trust

Some common reasons for setting up a trust include:

- Providing for minor children or family members who are inexperienced or unable to handle financial matters
- Arranging for management of personal assets, if you become unable to handle them yourself
- Avoiding probate and immediately transferring assets to beneficiaries upon death
- Reducing estate taxes and providing liquid assets to help pay

for them

- The terms of a will are public while the terms of a trust are not, so privacy makes a trust an appealing option.

Types of Trusts

Trusts can be living (inter vivos) or after-death (testamentary). A living trust is one that a grantor sets up while still alive and an after-death trust is usually established by a will after one's death. Living trusts can be irrevocable (can't be changed) or revocable (can be changed), although revocable trusts don't get the same tax shelter benefits as irrevocable ones do.

The most common type of trust is the revocable living trust. If there's a specific purpose in mind for the trust, dozens of different options exist (charitable trusts, bypass trusts, spendthrift trusts, and life insurance trusts). Two types of trusts can help pay for long-term care services:

- **Charitable Remainder Trusts** – This trust allows you to use your own assets to pay for long-term care services while contributing to a charity of your choice and reducing your tax burden at the same time. You can set up the trust so that you receive payments from the trust to pay for long-term care services while you are alive.
- **Medicaid Disability Trusts** – These trusts are limited to persons with disabilities who are under age 65 and qualify for public benefits. Parents, grandparents, and legal guardians often set up these trusts to benefit people with disabilities and a non-profit organization manages the assets. This is the only kind of trust that is exempt from rules regarding trusts and Medicaid eligibility.

Trust Scams and Fraud

If someone approaches you to set up a trust, be careful. Before signing any papers to create a living trust, will, or other kind of trust, make sure to explore all options and shop around to compare services. Some other tips to avoid trust scams and fraud include:

- Avoid high-pressure sales tactics and high-speed sales pitches.
- Stay away from salespeople who give the impression that specific organizations and recognized brands back or sell the trust.
- Research and get information about local probate laws from the Clerk or Register of Wills.
- If someone tries to sell a living trust to you, ask if they are an attorney. Some states restrict the sale of living trusts to licensed attorneys.
- If you buy a trust in your home or in another location that is not the seller's permanent place of business, remember you have the right to take advantage of the Cooling Off Rule and cancel the transaction within three business days.

Things to Consider Before You Invest

Do you have a financial goal in mind, such as saving for retirement, paying for college, or buying a new house? If so, then you may decide to invest your money to earn enough to fund your goals. Before you invest, make sure you have answers to all of these questions:

- **How quickly can you get your money back?** Stocks, bonds, and shares in mutual funds usually can be sold at any time, but there is no guarantee that you will get back all the money you invested. Other investments, such as limited partnerships, certificates of deposit (CDs), or IRAs, often restrict your ability to cash out your holdings.

- **What can you expect to earn on your money?** While bonds generally promise a fixed return, earnings on most other securities go up and down with market changes. Keep in mind, just because an investment has done well in the past, there is no guarantee it will do well in the future.
- **What type of earnings can you expect?** Will you get income in the form of interest, dividends, or rent? Some investments, such as stocks and real estate, have the potential for earnings and growth in value. What is the potential for earnings over time?
- **How much risk is involved?** With any investment, there is always the risk that you will not get your money back or the earnings promised. There is usually a trade-off between risk and reward–the higher the potential return, the greater the risk. While the U.S. government backs U.S. Treasury securities, it does not protect against loss on any other investments.
- **Are your investments diversified?** Some investments perform better than others in certain situations. For example, when interest rates go up, bond prices tend to go down. One industry may struggle while another prospers. Putting your money in a variety of investment options can reduce your risk.
- **Are there any tax advantages to a particular investment?** U.S. savings bonds are exempt from state and local taxes. Municipal bonds are exempt from federal income tax and, sometimes, state income tax as well. Tax-deferred investments for special goals, such as paying for college and retirement, are available that let you postpone or even avoid paying income taxes.

More Information on Investing

To learn more about investing, refer to these resources:

- You can find useful tips on investing at Investor.gov, a website from the Securities and Exchange Commission (SEC).
- For all of your investment-related questions, contact the SEC's Office of Investor Education and Advocacy.
- To get help preparing to invest, consult the Financial Industry Regulatory Authority (FINRA).

Tools to Research Investments

To help you make informed decisions when investing and avoid investment fraud, there are a variety of research tools available:

- Find investor news and alerts and a guide to investment products at Investor.gov, a website from the Securities and Exchange Commission (SEC).
- The SEC requires public companies to disclose financial and other information to help you make sound decisions. You can view the text of these files on EDGAR.
- The Financial Industry Regulatory Authority (FINRA) has up-to-date market data and information for a wide range of stocks, bonds, mutual funds, and other securities.
- If you are considering investing in collectible coins, refer to the U.S. Mint. Before you purchase coins or coin-related products, research the seller with a government agency, such as your state consumer protection office or the Federal Trade Commission (FTC).

Choose a Financial Professional

A financial professional can have multiple titles and be authorized to provide various services, including investment, financial planning, and insurance products. When researching a financial professional, find out what the titles and licenses mean, as well as the educational, work experience, and ethical requirements. Keep in mind that a professional title is not the same as a license. The Securities and Exchange Commission (SEC), the Financial Industry Regulatory Authority (FINRA), and state regulators do not grant or endorse any professional titles.

When choosing a broker or investment adviser, research the person's education and professional history as well as the firm the person works for. Make sure you have answers to all of these questions:

- **Has the person worked with others who have circumstances similar to yours?**
- **Is the person licensed in your state?** Your state securities regulator lists individuals and firms that are registered in your state. Ask whether the regulatory office has any other background information. To find out how to contact your state securities regulator, consult the North American Securities Administrators Association (NASAA).
- **Has the person had any run-ins with regulators or received serious complaints from investors?** Contact your state securities regulator or the SEC. To review licensing, employment, and disciplinary information, use FINRA's BrokerCheck tool.
- **How is the person paid?** Is it an hourly rate, a flat fee, or a commission that depends on the investments you make? Does the person get a bonus from their firm for selling you a particular product?
- **What are the fees for setting up and servicing your account?**

Resources to Help You Choose a Financial Professional

For more information on choosing a financial professional, refer to these resources:

- The Commodity Futures Trading Commission's (CFTC's) SmartCheck allows you to check the background of financial professionals and stay informed on the latest fraud schemes.
    - To ask a question, report information, or file a complaint, contact the CFTC.
- The Financial Industry Regulatory Authority (FINRA) has information on the professional designations of financial professionals and the organizations that offer them.
- Both the North American Securities Administrators Association (NASAA) and the National Futures Association can offer helpful information on saving and investing.

Pyramid Schemes

A pyramid scheme, also known as Ponzi scheme, is an illegal form of multilevel marketing. In these scams, your ability to earn profits is based on the number of new participants you recruit, instead of the amount of products or services you sell. Sometimes there actually aren't any real products that are being sold. These types of schemes are common with investment and independent direct selling opportunities.

These schemes rely on the income from new participants in order to pay fake "profits" to people that have been part of the scheme for longer amounts of time. However, the scheme falls apart when there aren't enough new recruits to pay into the system, so the earlier participants no longer receive earnings.

Tips to Avoid Being a Victim

Take steps to protect yourself from being a victim of a pyramid scheme:

- Be wary of "opportunities" to invest your money in franchises or investments that require you to bring in more investors to increase your profit, or recoup your initial investment.
- Be wary if the company sells non-tangible products or technical services, rather than physical items.
- Independently verify the legitimacy of any franchise or investment with the Better Business Bureau, your state Attorney General, or any licensing agencies.
- Be skeptical of success stories and testimonials of fantastic earnings.

File a Complaint

If you are aware of a pyramid scheme or have been the victim of one, file a complaint with your state consumer protection office, state Attorney General, or the Better Business Bureau (BBB). If the pyramid scheme involved securities, you should also file a complaint with your state's securities administrator, or the Securities and Exchange Commission.

26. Stocks

What Are Stocks?

Stocks are a type of security that gives stockholders a share of ownership in a company. Stocks also are called "equities."

Why do people buy stocks?
Why do companies issue stock?
What kinds of stock are there?
What are the benefits and risks of stocks?
How to buy and sell stocks
Understanding fees
Avoiding fraud
Additional information

Why Do People Buy Stocks?

Investors buy stocks for various reasons. Here are some of them:

- Capital appreciation, which occurs when a stock rises in price
- Dividend payments, which come when the company distributes some of its earnings to stockholders
- Ability to vote shares and influence the company

Why Do Companies Issue Stock?

Companies issue stock to get money for various things, which may include:

- Paying off debt
- Launching new products
- Expanding into new markets or regions
- Enlarging facilities or building new ones

What Kinds Of Stocks Are There?

There are two main kinds of stocks, common stock and preferred stock.

Common stock entitles owners to vote at shareholder meetings and receive dividends.

Preferred stockholders usually don't have voting rights but they receive dividend payments before common stockholders do, and have priority over common stockholders if the company goes bankrupt and its assets are liquidated.

Common and preferred stocks may fall into one or more of the following categories:

- **Growth stocks** have earnings growing at a faster rate than the market average. They rarely pay dividends and investors buy them in the hope of capital appreciation. A start-up technology company is likely to be a growth stock.
- **Income stocks** pay dividends consistently. Investors buy them for the income they generate. An established utility company is likely to be an income stock.
- **Value stocks** have a low price-to-earnings (PE) ratio, meaning they are cheaper to buy than stocks with a higher PE. Value stocks may be growth or income stocks, and their low PE ratio

may reflect the fact that they have fallen out of favor with investors for some reason. People buy value stocks in the hope that the market has overreacted and that the stock's price will rebound.

- **Blue-chip stocks** are shares in large, well-known companies with a solid history of growth. They generally pay dividends.

Another way to categorize stocks is by the size of the company, as shown in its market capitalization. There are large-cap, mid-cap, and small-cap stocks. Shares in very small companies are sometimes called "microcap" stocks. The very lowest priced stocks are known as "penny stocks." These companies may have little or no earnings. Penny stocks do not pay dividends and are highly speculative.

What Are The Benefits And Risks Of Stocks?

Stocks offer investors the greatest potential for growth (capital appreciation) over the long haul. Investors willing to stick with stocks over long periods of time, say 15 years, generally have been rewarded with strong, positive returns.

But stock prices move down as well as up. There's no guarantee that the company whose stock you hold will grow and do well, so you can lose money you invest in stocks.

If a company goes bankrupt and its assets are liquidated, common stockholders are the last in line to share in the proceeds. The company's bondholders will be paid first, then holders of preferred stock. If you are a common stockholder, you get whatever is left, which may be nothing.

Even when companies aren't in danger of failing, their stock price may fluctuate up or down. Large company stocks as a group, for example, have lost money on average about one out of every three years. If you have to sell shares on a day when the stock price is below the price you paid for the shares, you will lose money on the sale.

Market fluctuations can be unnerving to some investors. A stock's price can be affected by factors inside the company, such as a faulty product, or by events the company has no control over, such as political or market events.

Stocks usually are one part of an investor's holdings. If you are young and saving for a long-term goal such as retirement, you may want to hold more stocks than bonds. Investors nearing or in retirement may want to hold more bonds than stocks.

The risks of stock holdings can be offset in part by investing in a number of different stocks. Investing in other kinds of assets that are not stocks, such as bonds, is another way to offset some of the risks of owning stocks.

How To Buy And Sell Stocks

You can buy and sell stocks through:

- A direct stock plan
- A dividend reinvestment plan
- A discount or full-service broker
- A stock fund

Direct stock plans. Some companies allow you to buy or sell their stock directly through them without using a broker. This saves on commissions, but you may have to pay other fees to the plan, including if you transfer shares to a broker to sell them. Some companies limit direct stock plans to employees of the company or existing shareholders. Some require minimum amounts for purchases or account levels.

Direct stock plans usually will not allow you to buy or sell shares at a specific market price or at a specific time. Instead, the company will buy or sell shares for the plan at set times — such as daily, weekly, or monthly — and at an average market price. Depending on the plan, you may be able to automate your purchases and have the cost deducted automatically from your savings account.

Dividend reinvestment plans. These plans allow you to buy more shares of a stock you already own by reinvesting dividend payments into the company. You must sign an agreement with the company to have this done. Check with the company or your brokerage firm to see if you will be charged for this service.

Discount or full-service broker. Brokers buy and sell shares for customers for a fee, known as a commission.

Stock funds are another way to buy stocks. These are a type of mutual fund that invests primarily in stocks. Depending on its investment objective and policies, a stock fund may concentrate on a particular type of stock, such as blue chips, large-cap value stocks, or mid-cap growth stocks. Stock funds are offered by investment companies and can be purchased directly from them or through a broker or adviser.

Understanding Fees

Buying and selling stocks entails fees. A direct stock plan or a dividend reinvestment plan may charge you a fee for that service. Brokers who buy and sell stocks for you charge a commission. A discount brokerage charges lower commissions than what you would pay at a full-service brokerage. But generally you have to research and choose investments by yourself. A full-service brokerage costs more, but the higher commissions pay for investment advice based on that firm's research.

Avoiding Fraud

Stocks in public companies are registered with the SEC and in most cases, public companies are required to file reports to the SEC quarterly and annually. Annual reports include financial statements that have been audited by an independent audit firm. Information on public companies can be found on the SEC's EDGAR system.

Additional Information

Accounts, Opening a Brokerage Account
- Brokerage Orders
- Buying and Selling Stock: Market Centers
- Holding Your Securities
- Microcap Stock
- Stock Splits
- Reverse Stock Splits
- Stocks Held in Street Name
- Trade Execution: Rules Your Brokerage Firm Must Follow
- Voting Rights-Exercise Your Voting Rights in Corporate Elections
- Investor Bulletin: American Depositary Receipts
- Investor Bulletin: After-Hours Trading

27. Mutual Funds

What Are Mutual Funds?

A mutual fund is a company that pools money from many investors and invests the money in securities such as stocks, bonds, and short-term debt. The combined holdings of the mutual fund are known as its portfolio. Investors buy shares in mutual funds. Each share represents an investor's part ownership in the fund and the income it generates.

Order our free Mutual Funds publication

Why do people buy mutual funds?
What types of mutual funds are there?
What are the benefits and risks of mutual funds?
How to buy and sell mutual funds
Understanding fees
Avoiding fraud
Additional information

Why Do People Buy Mutual Funds?

Mutual funds are a popular choice among investors because they generally offer the following features:

- **Professional Management.** The fund managers do the research for you. They select the securities and monitor the performance.
- **Diversification** or "Don't put all your eggs in one basket." Mutual funds typically invest in a range of companies and industries. This helps to lower your risk if one company fails.

- **Affordability.** Most mutual funds set a relatively low dollar amount for initial investment and subsequent purchases.
- **Liquidity.** Mutual fund investors can easily redeem their shares at any time, for the current net asset value (NAV) plus any redemption fees.

What Types Of Mutual Funds Are There?

Most mutual funds fall into one of four main categories – money market funds, bond funds, stock funds, and target date funds. Each type has different features, risks, and rewards.

- **Money market funds** have relatively low risks. By law, they can invest only in certain high-quality, short-term investments issued by U.S. corporations, and federal, state and local governments.
- **Bond funds** have higher risks than money market funds because they typically aim to produce higher returns. Because there are many different types of bonds, the risks and rewards of bond funds can vary dramatically.
- **Stock funds** invest in corporate stocks. Not all stock funds are the same. Some examples are:
    - Growth funds focus on stocks that may not pay a regular dividend but have potential for above-average financial gains.
    - Income funds invest in stocks that pay regular dividends.
    - Index funds track a particular market index such as the Standard & Poor's 500 Index.
    - Sector funds specialize in a particular industry segment.
- **Target date funds** hold a mix of stocks, bonds, and other investments. Over time, the mix gradually shifts according to the fund's strategy. Target date funds, sometimes known as lifecycle funds, are designed for individuals with particular

retirement dates in mind.

What Are The Benefits And Risks Of Mutual Funds?

Mutual funds offer professional investment management and potential diversification. They also offer three ways to earn money:

- **Dividend Payments.** A fund may earn income from dividends on stock or interest on bonds. The fund then pays the shareholders nearly all the income, less expenses.
- **Capital Gains Distributions.** The price of the securities in a fund may increase. When a fund sells a security that has increased in price, the fund has a capital gain. At the end of the year, the fund distributes these capital gains, minus any capital losses, to investors.
- **Increased NAV.** If the market value of a fund's portfolio increases, after deducting expenses, then the value of the fund and its shares increases. The higher NAV reflects the higher value of your investment.

All funds carry some level of risk. With mutual funds, you may lose some or all of the money you invest because the securities held by a fund can go down in value. Dividends or interest payments may also change as market conditions change.

A fund's past performance is not as important as you might think because past performance does not predict future returns. But past performance can tell you how volatile or stable a fund has been over a period of time. The more volatile the fund, the higher the investment risk.

How To Buy And Sell Mutual Funds

Investors buy mutual fund shares from the fund itself or through a broker for the fund, rather than from other investors. The price that investors pay for the mutual fund is the fund's per share net asset value plus any fees charged at the time of purchase, such as sales loads.

Mutual fund shares are "redeemable," meaning investors can sell the shares back to the fund at any time. The fund usually must send you the payment within seven days.

Before buying shares in a mutual fund, read the prospectus carefully. The prospectus contains information about the mutual fund's investment objectives, risks, performance, and expenses. See How to Read a Mutual Fund Prospectus Part 1, Part 2, and Part 3 to learn more about key information in a prospectus.

Understanding Fees

As with any business, running a mutual fund involves costs. Funds pass along these costs to investors by charging fees and expenses. Fees and expenses vary from fund to fund. A fund with high costs must perform better than a low-cost fund to generate the same returns for you.

Even small differences in fees can mean large differences in returns over time. For example, if you invested $10,000 in a fund with a 10% annual return, and annual operating expenses of 1.5%, after 20 years you would have roughly $49,725. If you invested in a fund with the same performance and expenses of 0.5%, after 20 years you would end up with $60,858.

It takes only minutes to use a mutual fund cost calculator to compute how the costs of different mutual funds add up over time and eat into your returns. See the Mutual Fund Glossary for types of fees.

Avoiding Fraud

By law, each mutual fund is required to file a prospectus and regular shareholder reports with the SEC. Before you invest, be sure to read the prospectus and the required shareholder reports. Additionally, the investment portfolios of mutual funds are managed by separate entities know as "investment advisers" that are registered with the SEC. Always check that the investment adviser is registered before investing.

Additional Information

Mutual Funds – A Guide for Investors
  Closed-End Funds
  Index Funds
  Interval Funds
  Mutual Fund Proxy Voting Records and Policies
  Mutual Fund Investing: Look at More Than a Fund's Past Performance

BASICS

Save and InvestExpand
  How Stock Markets WorkExpand
  Investment Products
  529 Plans

Annuities
Auction Rate Securities
Bonds
Certificates of Deposit (CDs)
Commodities
Corporate Bonds
Exchange-Traded Funds (ETFs)
Hedge Funds
High-yield Corporate Bonds
International Investing
Money Market Funds
Municipal Bonds
Mutual Funds
myRA
Options
Private Equity Funds
Real Estate Investment Trusts (REITs)
Savings Bonds
Stocks
Structured Notes with Principal Protection
Target Date Funds
Variable Annuities
Expand
What is Risk?
Role of the SECExpand

PART X

MODULE 9: BANKING

28. Choose a Bank Account

A bank account provides a safe place to put your money; can be less costly, over the long term, than using a check casher or other non-bank service; and can help you save money. When it comes to choosing an account, there are many options, such as:

- **Savings** – This is a deposit account that earns interest known as an annual percentage rate or APR.
- **Checking** – These accounts allow you to deposit money, withdraw money, and write checks to pay for purchases and bills. Most banks will also provide a debit or ATM card and a checkbook to allow you to withdraw cash, transfer funds between accounts, and make deposits at your bank's ATM machines.
- **Certificate of deposit (CD)** – This is a deposit-only account that offers a guaranteed interest rate for a specified term usually ranging from 6 months to 5 years–if you promise not to touch the money for the agreed upon term. Most banks charge a penalty for early withdrawal.
- **Money market** – These are deposit accounts that pay interest. Money market accounts provide a higher interest rate than traditional savings accounts and usually come with high minimum balance requirements.

Each has different rules and benefits that fit different needs. The bank or credit union must provide you with the account terms and conditions when you open your account.

Important Things to Consider

When choosing an account that is right for you, think about these factors:

- **Minimum deposit requirements** – Do you have to keep a minimum dollar amount in your account to earn interest or avoid account maintenance fees?
- **Limits on withdrawals** – Can you take money out whenever you want? Are there any penalties for doing so?
- **Interest** – Can you earn interest on your accounts? How frequently is it paid (monthly, quarterly)? Check with banks or credit unions to compare their current published rates.
- **Online bill pay** – Can you pay your bills directly from your bank or credit union's website?
- **Deposit insurance** – Make sure that the bank is a member of the Federal Deposit Insurance Corporation (FDIC) or that a credit union is insured by the National Credit Union Share Insurance Fund (NCUSIF).
- **Mobile banking** – Can you access your accounts and make deposits from your mobile phone or tablet? Does the bank charge fees for this access?
- **Convenience** – Are there branches or ATMs close to where you work and live? Can you bank by phone or Internet?

If you are considering a checking account or another type of account with check-writing privileges, add these items to your list of things to think about:

- **Number of checks** – Is there a maximum number of checks you can write per month without incurring a charge?
- **Check fees** – Is there a monthly fee for the account or a charge for each check you write?
- **Holds on checks** – Is there a waiting period for checks to clear before you can withdraw money from your account?

- **Overdraft protection** – Many banks and credit unions offer overdraft protection, but you must opt-in to get the service. This prevents you from cashing a check, withdrawing money, or using your debit card for an amount greater than the amount of money in your checking account. Banks can't impose overdraft fees if you haven't opted in.
- **Debit card fees** – Are there fees for using your debit card?
- **Account fees** – Does the bank charge fees on your checking or savings accounts to cover things like maintenance, withdrawals, or minimum balance rules?

29. How Are My Deposit Accounts Insured by the FDIC?

Use this tool to learn the basics about FDIC-insured deposit accounts and deposit insurance coverage guidelines. For more detailed information about your specific situation, you can use the Electronic Deposit Insurance Estimator (EDIE).

Single Account

Coverage Limit: **$250,000 per owner**

A deposit account owned by one person, without named beneficiaries

Certain Retirement Account

Coverage Limit: **$250,000 per owner**

A retirement account in which plan participants have the right to direct how the money is invested

Joint Account

Coverage Limit: **$250,000 per co-owner**

A deposit account owned by two or more people, without named beneficiaries

Revocable Trust Account

Coverage Limit: **Owner insured $250,000 for each unique beneficiary designated**

A deposit account owned by one or more people that identifies one or more beneficiaries who will receive the deposits upon the death of the owner(s). This includes both formal "Living" Trusts and informal ITF/POD accounts

Irrevocable Trust Account

Coverage Limit: **$250,000 for the trust – more coverage available if requirements are met**

A deposit account held in connection with an irrevocable trust established by statute or a written trust agreement

Account Type	Coverage Limit
Employee Benefit Plan Account A deposit of a pension plan, defined benefit plan or other employee benefit plan that is not self-directed	Coverage Limit: **$250,000 for the noncontingent interest of each plan participant**
Corporation, Partnership, or Unincorporated Association Account Deposits owned by corporations, partnerships, and unincorporated associations – including for-profit and not-for-profit organizations	Coverage Limit: **$250,000 per corporation, partnership or unincorporated association**
Government Account	Coverage Limit: **$250,000 per official custodian**

30. Deposit Insurance FAQs

Q: What is the FDIC?

A: The FDIC (Federal Deposit Insurance Corporation) is an independent agency of the United States government that protects you against the loss of your insured deposits if an FDIC-insured bank or savings association fails. FDIC insurance is backed by the full faith and credit of the United States government.

Q: What is deposit insurance?

A: FDIC deposit insurance covers the depositors of a failed FDIC-insured depository institution dollar-for-dollar, principal plus any interest accrued or due to the depositor, through the date of default, up to at least $250,000. For example, if a person had a CD account in her name alone with a principal balance of $195,000 and $3,000 in accrued interest, the full $198,000 would be insured, since principal plus interest did not exceed the $250,000 insurance limit for single ownership accounts.

Q: What happens when a bank fails?

A: Though unlikely, bank failures do occur and the FDIC responds in two capacities. First, as the insurer of the bank's deposits, the FDIC pays insurance to depositors up to the insurance limit. Historically, the FDIC pays insurance within a few days after a bank closing, usually the next business day, by either (1) providing each depositor with a new account at another insured bank in an amount equal to the insured balance of their account at the failed bank, or (2) by issuing a check to each depositor for the insured balance of their account at the failed bank.

Some deposits that exceed $250,000 and are linked to trust documents or deposits established by a third party broker may have a short wait so that their accounts can be reviewed to determine the amount of deposit insurance coverage available to them. The amount of time involved depends on how long it takes for the depositor to provide supplemental information to the FDIC so that we can complete the insurance determination.

Second, as the receiver of the failed bank, the FDIC assumes the task of selling/collecting the assets of the failed bank and settling its debts, including claims for deposits in excess of the insured limit. If a depositor has uninsured funds they receive the insured portion of their funds quickly, as described above. They may also, however, recover some portion of their uninsured funds (their remaining claim on the failed bank) from the proceeds from the sale of failed bank assets. It can take several years to sell off the assets of a failed bank. As assets are sold, however, depositors who had uninsured funds usually receive periodic payments (on a pro-rata "cents on the dollar" basis) on their remaining claim.

Q: How can I get deposit insurance?

A: Depositors do not need to apply for FDIC insurance. Coverage is automatic whenever a deposit account is opened at an FDIC-insured bank. If you want your funds insured by the FDIC, simply make sure you are placing your funds in a deposit account at an FDIC-insured bank and that your deposit does not exceed the insurance limit for that ownership category.

Q: How do I find out if a bank is FDIC-insured?

A: To determine if a bank is FDIC-insured, you can ask a bank representative, look for the FDIC sign at your bank, call the FDIC at 877-275-3342, or you can use the FDIC's BankFind tool. BankFind allows you to access detailed information about all FDIC-insured institutions, including branch locations, the bank's official website address, the current operating status of your bank, and the regulator to contact for additional information and assistance.

Coverage

Q: How much deposit insurance coverage do I qualify for?

A: The standard deposit insurance amount is $250,000 per depositor, per FDIC-insured bank, per ownership category. For a basic category-by-category overview of FDIC deposit insurance coverage, you can use the Account Categories tool.

The "Your Insured Deposits" brochure also includes more comprehensive information and examples of deposit insurance coverage for various ownership categories. You can also access the FDIC's Electronic Deposit Insurance Estimator (EDIE) to get details about your specific situation.

Q: Is every financial product at a bank covered by the FDIC?

A: No, FDIC deposit insurance coverage depends on whether your chosen financial product is a deposit product. The FDIC covers the traditional types of bank deposit accounts – including checking and savings accounts, money market deposit accounts (MMDAs), and certificates of deposit (CDs). Investment products that are not deposits, such as mutual funds, annuities, life insurance policies and stocks and bonds are not covered by FDIC deposit insurance.

For a more comprehensive list of financial products that are insured by the FDIC and financial products that are not insured by the FDIC, visit Accounts Covered by the FDIC

Q: Can I have more than $250,000 of deposit insurance coverage at one FDIC-insured bank?

A: Yes. The FDIC insures deposits according to the ownership category in which the funds are insured and how the accounts are titled. The standard deposit insurance coverage limit is $250,000 per depositor, per FDIC-insured bank, per ownership category. Deposits held in different ownership categories are separately insured, up to at least $250,000, even if held at the same bank. For example, a revocable trust account (including living trusts and informal revocable trusts commonly referred to as payable on death (POD) accounts) with one owner naming three unique beneficiaries can be insured up to $750,000. See the Your Insured Deposit brochure for details.

Q: Can I check to see if my accounts are fully covered?

A: Yes, you can get detailed information about your specific deposit insurance coverage by accessing the FDIC's Electronic

Deposit Insurance Estimator (EDIE) and entering information about your accounts. You can also call the FDIC at 1-877-ASK-FDIC (1-877-275-3342) and ask to speak to an FDIC deposit insurance specialist.

31. Failed Bank List

The FDIC is often appointed as receiver for failed banks. This page contains useful information for the customers and vendors of these banks. This includes information on the acquiring bank (if applicable), how your accounts and loans are affected, and how vendors can file claims against the receivership. Failed Financial Institution Contact Search displays point of contact information related to failed banks.

This list includes banks which have failed since October 1, 2000. To search for banks that failed prior to those on this page, visit this link: Failures and Assistance Transactions

https://www.fdic.gov/bank/individual/failed/banklist.htmlFi

32. Learning Bank - Checking & Savings Accounts

People generally use checking accounts to store money in the short term until it is needed for day to day expenses – like gas or groceries – or to pay bills, and they can usually deposit or withdraw any amount of money in their account as many times as they like. Checking accounts also come with convenient ways to deposit and withdraw money from the account, such as checks and ATM cards. However, people with checking accounts must be careful when using them, since some banks charge fees for certain actions, such as using another bank's ATM, withdrawing more money from your account than the amount in it, or not maintaining a minimum balance.

On the other hand, a savings account is used to set money aside for use in the future and allow the money to collect interest. Many people regularly place some of their money into savings accounts rather than spending it in order to achieve financial goals, such as buying the latest gadget or game, without having to go into debt to do it.

Savings can really add up

Compound interest is interest paid on both the money you put into your account *and* the interest already earned. For example, if you put $100 into an account that earns 10% interest, you will initially earn $10, which will result in a total account balance of $110. The next time your account earns 10% it will be based on $110 instead of just $100, giving you a total account balance of $121.

You can earn even more in compound interest if you stretch to put as much money as you can into your account and leave it untouched. See the chart below, which is based on a savings account started with $50 and earning interest at a rate of 3.5% each month. If you add just $10 each month, the account can grow nicely to $714 after five years. If you instead put in a slightly higher amount—$15 each month—you'd have a balance of $1,042 after five years. But if you had increased your deposits to $50 a month, those extra dollars plus the compounding of interest would give you a balance of $3,333 after five years.

There are many banks that offer special accounts for kids and teens, so talk to your parents if you'd like to open an account of your own and start learning how to manage money. But you don't need a bank account to start the habit of saving – a simple piggy bank will do!

33. Frauds & Scams

While the Internet, social networking sites like Facebook and Twitter, and texting are all fun ways to connect with friends, play games, and do research for school, you must be careful about the information you share because kids and teens are often targeted for scams. These scams often lure young people to web sites by offering items for free to get them to provide personal information that the scammers can use to charge money to credit cards and phone bills or sell to marketers.

picture of a bank vault c. 1930

How can you protect yourself?

1. ***Be Aware*** – The most important thing you can do is be aware that scams and scammers are out there, so if you see anything that looks suspicious or too good to be true, you should try to avoid it.
2. ***Limit the Personal Information You Give Out*** – You should never provide personal information, such as your name, address, and telephone number, to anyone you don't know. You also should never give out your social security number or parents' bank account or credit card numbers without talking to your parents first about it.
3. ***Check Your Privacy Settings*** – The best way to avoid being scammed is to take advantage of the privacy settings on your online accounts, like Facebook, e-mail, and Twitter. Make sure your privacy settings are customized so that as little personal information as possible is available for strangers to see.
4. ***Ignore* SPAM** – SPAM is a message that is usually an advertisement for questionable products or information that is sent to many people through e-mail and text messages. SPAM messages are often very enticing because they contain information about celebrities or how to get an expensive item

for free. Although it may be tempting to click on the SPAM message and read it, you should ignore it and delete it.

5. ***Tell Your Parents*** – If you get a text, e-mail, or Facebook message and you're not sure whether it's legitimate, ask your parents about it. Also be sure to ask your parents to take a look at all web sites offering anything for free so long as you "sign-up"; or fill out an application.

34. Complaints About Banks and Lenders

Learn how to complain about a problem with a bank or a lending company, such as a mortgage provider.

What's on This Page

- Bank and Credit Product Complaints
- Complaints About Mortgage Companies
- Mandatory Arbitration Clauses

Bank and Credit Product Complaints

If you have a problem with your bank, financial institution, lender, broker, or any other financial service provider, you should report it. To guide you through the process of filing these types of complaints, the Federal Reserve offers consumer help and the following tips:

- First, try to resolve it with the manager at the branch location, the customer service hotline, or the institution's website.
- When filing your complaint, clearly explain your problem and how you would like it to be resolved. Use this sample complaint letter for tips on what information to include in your complaint.
- Be sure to have copies of receipts, checks, or other proof of the transaction.

If you don't get your problem resolved using these steps, you have the right to get help from the correct regulatory agency.

Complaints About Deposit Accounts

Financial institutions are regulated by different government agencies, depending on how the institution was chartered.

Use the Federal Reserve System's financial institution search tool to find out which agency accepts complaints about the financial institution you need to file a complaint against. The Federal Deposit Insurance Corporation offers the contact information for the primary federal agencies that regulate financial institutions.

- To file a complaint about a national bank (those with National in their names, or N.A. after their name), contact the Office of the Comptroller of the Currency.
- Contact the Office of the Comptroller of the Currency for complaints about federal savings and loans and federal savings banks.
- For a problem with a state-chartered bank and trust company, contact either the Federal Deposit Insurance Corporation or state banking authority.
- To file a complaint about a federally chartered credit union, contact the National Credit Union Administration.
- For a problem with a state-chartered bank that is a member of the Federal Reserve System, contact the Federal Reserve System.

Complaints About Other Financial Services

The Consumer Financial Protection Bureau accepts complaints involving loan products, such as mortgage companies, car loans and leases, student loans, payday loans, and any other consumer loans. This agency also accepts complaints about other financial services, such as credit cards, prepaid cards, money transfers, and debt collection.

File a complaint about investments to the Securities and Exchange Commission or your state's securities regulator. These agencies accept complaints about investment fraud, pyramid schemes, or other violations of federal and state securities laws.

Complaints About Mortgage Companies

If you feel that you have been the victim of a discriminatory lending transaction, you can contact the Federal Trade Commission (FTC) or file a complaint using their Online Complaint Assistant. The FTC has enforcement authority in the case of mortgage companies for the following laws:

- Equal Credit Opportunity Act (ECOA)
- Truth in Lending Act
- Fair Credit Reporting Act

You may also file consumer complaints using the following resources:

- Consumer Financial Protection Bureau (CFPB)
- State/local consumer protection agencies

Foreclosure Scams

If you feel you are the victim of a foreclosure scam, you may contact the HOPE NOW Alliance at 1-888-995-HOPE (1-888-995-4673) or

(TTY 1-877-304-9709), for more information on how to lodge your complaint.

Predatory Lending

Getting the right mortgage can be difficult. For instance, consumers can become victims of predatory lending, which is the practice of convincing borrowers to agree to unfair and/or unprincipled loan terms. Federal and state governments enact many laws to prevent predatory lending. Find information on predatory lending, including resources to help protect you against it.

Please note: You are legally obligated to make your mortgage payments by the date specified each month, whether or not you are provided with a bill, the mortgage company or loan service agency has properly credited your previous payments, and/or the escrow has been properly handled. Never withhold your mortgage payments for any reason.

Mandatory Arbitration Clauses

Mandatory arbitration clauses are phrases written into contracts that state that if you have a dispute with a company, you must resolve it through arbitration. These clauses can prevent you from filing a lawsuit against a company. Arbitration clauses are fairly common in automotive, credit card, and cell phone contracts. But now, they are appearing in website terms and conditions statements, coupons, or corporate social media profiles. While arbitration can be less expensive, it is sometimes seen as unfair to make arbitration a requirement before a negative incident has happened or knowing how serious the problem is. Also, the decisions are binding, so you can't appeal the decision, even if the company was severely negligent.

Before you sign a contract or even use a website, read the contract or terms of service for mentions of "arbitration", "binding arbitration" or "resolution programs"; this language is often in the fine print of the contract and can be easily missed. Also, note that some companies may let you opt-out of these clauses, if you do so within 30 days.

PART XI

MODULE 10: RETIREMENT

35. Retirement

Learn some of the basics about retirement and pension benefits.

What's on This Page

Saving for Retirement

As you approach retirement, there are many things to think about. Experts advise that you will need about 80 percent of your pre-retirement income to continue your current quality of life. The exact amount depends on your individual needs. Some important factors to consider include:

- At what age do you plan to retire?
- Can you participate in an employer's retirement savings plan, such as a 401(k) plan, or a traditional pension plan?
- Will your spouse or partner retire when you do?
- Where do you plan to live when you retire? Will you downsize, rent, or own your home?
- Do you expect to work part-time?
- Will you have the same medical insurance you had while working? Will your coverage change?

- Do you want to travel or pursue a new hobby that might be costly?

Resources to Help You Prepare for Retirement

To help you plan for retirement:

- Find practical tips for building retirement savings in the Top 10 Ways to Prepare for Retirement(PDF, Download Adobe Reader).
- Use a retirement calculator to find out the best age to claim your Social Security benefits.
- myRA can help you start saving for retirement when you don't have access to an employer-sponsored plan or lack other options to save.
- Find out the trade-offs between taking your pension in a monthly payment or in a lump sum(PDF, Download Adobe Reader).
- Social Security pays benefits that are on average equal to about 40 percent of your pre-retirement earnings. You may be able to estimate your benefits.
- Learn how you can boost your retirement savings at Investor.gov.
- If you have a financial advisor, talk to him or her about your plans.

Back to Top

Determining a Target Retirement Saving Rate

Make a plan with the Retirement Saving worksheet. Learn more at Savings Fitness.

One or more interactive elements has been excluded from this version of the text. You can view them online here: https://library.achievingthedream.org/lfccpersonalfinance/?p=65

Social Security Retirement Benefits

Infographic showing the ways people save for retirement in the U.S. If you're like most Americans, Social Security is a key piece of your retirement savings. But how much you will get depends on your earnings over your lifetime, the age at which you'll begin receiving benefits, and whether you'll be eligible to receive a spouse's benefit instead of your own.

You can use Social Security's retirement planning tools to:

- Estimate your benefits at each age, from 62 (the earliest you can receive them) to 70 (when you hit your maximum amount)
- Apply for retirement benefits
- Manage your account

Finding More Social Security Information

Social Security also administers disability and survivor benefits. Get the answers to many of the top Social Security questions.

Protecting Your Private Pension Benefits

Avoiding Errors and Getting Help

If your job is covered by a traditional pension plan, make sure you get the pension amount you're owed.

- Find ways to protect yourself by reading these 10 common causes of errors in pension calculation.
- Get free legal help if you're experiencing a problem with your pension plan.
- Find out whether your pension or annuity income is taxable.
- If you have questions or complaints about your employer-sponsored pension plan, contact your human resources office or locate the Employee Benefits Security Administration (EBSA) regional office near you.

Federal Insurance for Private Pensions

If you've earned a traditional pension, you're likely to receive it even if your company runs into financial problems.

The Pension Benefit Guaranty Corporation (PBGC):

- Insures most private-sector defined-benefit pensions that typically pay a certain amount each month after you retire
- Covers most cash-balance plans, a type of defined-benefit pension that allows you to take a lump-sum distribution
- **Does not** cover government and military pensions, 401k plans, IRAs, and certain other plans.

Is Your Pension Insured?

- To see if your pension is insured, search PBGC's list of single-employer and multi-employer plans.
- If your plan is insured and it ends without enough money to pay all benefits, PBGC will pay you the money you're owed, up to legal limits.
- To learn more about PBGC-insured pensions, view these frequently asked questions.

Find an Unclaimed Pension

More than 38 million people in the U.S. haven't claimed pension benefits they have earned. Find out if you, or someone you know, is owed a pension.

Civil Service Retirement

Federal Employee Retirement Planning and Management

If you are a federal employee planning to retire or a federal retiree looking for information about your benefits, the U.S. Office of Personnel Management (OPM)'s Retirement page can help you:

- Research and learn about retirement options.
- Manage your benefits online.
- Find options for signing up for direct deposit. If you receive

paper checks now, you'll soon be required to switch to direct deposit or Direct Express debit card.
- Find answers to frequently asked questions about retirement.

If you are the survivor of a deceased federal employee or federal retiree, you may be eligible for death and survivor benefits. Visit the OPM website to report the death and apply for death benefits.

Thrift Savings Plan

In addition to the defined or basic benefits provided by your CSRS or FERS plan, if you are a current federal employee, you can boost your retirement savings by participating in the Thrift Savings Plan (TSP). The TSP offers the same types of savings and tax benefits as a 401(k) plan.

Credit for Military Service

Military service does not automatically count toward civil service retirement.

- To receive credit for military service performed after 1956, you must pay a deposit.
- If you are a military retiree, you generally cannot receive military service credit towards your civilian retirement unless you waive your military retired pay.

Pension Taxes

The Internal Revenue Service (IRS) offers an online tool and an online publication to help you determine whether or not your pension or annuity payment is taxable.

Contact OPM's Retirement Operations Center

For benefits information or help with a transaction, contact OPM's Retirement Operations Center.

State and Local Government Employees

If you are a state or local government employee and have questions about your pension plan, contact your agency's personnel department. You can also contact the Employee Benefits Security Administration (ESBA) for help.

Public Service and Volunteerism

Many federal organizations offer volunteer opportunities:

- Serve.gov – Sign up for volunteer opportunities and create projects. Tool kits are available to help develop your ideas into projects.
- JoiningForces.gov – Start a volunteer project, send a message of thanks or give service hours to support our service members and their families.
- PeaceCorps.gov – Find volunteer programs where you serve abroad and make a difference by working directly within communities to build capacity in education, health, environment and more.
- CitizenCorps.gov – Get training in first aid and emergency

skills. Volunteer to support local emergency responders and disaster relief efforts.

- NationalService.gov – Offers grants for service and volunteering; programs include the AmeriCorps, Senior Corps and Social Innovation Fund.
- Volunteer.gov – Volunteer opportunities in America's natural and cultural resources, including national parks.
- Volunteer.VA.gov – Volunteer at a Veterans Affairs (VA) facility in your area.
- Federal Election Volunteers – Become a Poll Worker – Assist election officials in your state.
- Natural Resources Conservation Earth Team Volunteers – Work with private landowners to improve soil quality, conserve water, improve air quality and enhance wildlife habitat.
- National Oceanic and Atmospheric Administration (NOAA) – Volunteers take part in research, observation and educational roles that benefit science and the planet.

36. Types of Retirement Plans

Individual Retirement Arrangements (IRAs)
Roth IRAs
401(k) Plans
403(b) Plans
SIMPLE IRA Plans (Savings Incentive Match Plans for Employees)
SEP Plans (Simplified Employee Pension)
SARSEP Plans (Salary Reduction Simplified Employee Pension)
Payroll Deduction IRAs
Profit-Sharing Plans
Defined Benefit Plans
Money Purchase Plans
Employee Stock Ownership Plans (ESOPs)
” href=”https://www.irs.gov/retirement-plans/governmental-plans-under-internal-revenue-code-section-401-a”>Governmental Plans

457 Plans
409A Nonqualified Deferred Compensation Plans
Help with Choosing a Retirement Plan

PART XII

MODULE 11: ESTATE PLANNING

37. Getting Your Affairs in Order

Ben has been married for 47 years. He always managed the family's money. But since his stroke, Ben is not able to walk or talk. His wife, Shirley, feels overwhelmed. Of course, she's worried about Ben's health. But, on top of that, she has no idea what bills should be paid or when they are due.

Across town, 80-year-old Louise lives alone. One night, she fell in the kitchen and broke her hip. She spent a week in the hospital and 2 months in a rehabilitation nursing home. Even though her son lives across the country, he was able to pay her bills and handle her Medicare questions right away. That's because, several years ago, Louise and her son made a plan about what he should do in case Louise had a medical emergency.

Plan for the Future

No one ever plans to be sick or disabled. Yet, it's this kind of planning that can make all the difference in an emergency.

Long before she fell, Louise put all her important papers in one place and told her son where to find them. She gave him the name of her lawyer, as well as a list of people he could contact at her bank, doctor's office, insurance company, and investment firm. She made sure he had copies of her Medicare and other health insurance cards. She added her son's name to her checking account and safe deposit box at the bank. Louise made sure Medicare and her doctor had written permission to talk with her son about her health and insurance claims.

On the other hand, Ben always took care of family money matters, and he never talked about the details with Shirley. No one but Ben knew that his life insurance policy was in a box in the closet or that the car title and deed to the house were filed in his desk drawer. Ben never expected that his wife would have to take over. His lack of planning has made a tough job even tougher for Shirley.

What Exactly Is an "Important Paper"?

The answer to this question may be different for every family. Remember, this is a starting place. You may have other information to add. For example, if you have a pet, you will want to include the name and address of your veterinarian. Include complete information about:

Personal Records

- Full legal name
- Social Security number
- Legal residence
- Date and place of birth
- Names and addresses of spouse and children
- Location of birth and death certificates and certificates of marriage, divorce, citizenship, and adoption
- Employers and dates of employment
- Education and military records
- Names and phone numbers of religious contacts
- Memberships in groups and awards received
- Names and phone numbers of close friends, relatives, doctors, lawyers, and financial advisors
- Medications taken regularly (be sure to update this regularly)
- Location of living will and other legal documents

Financial Records

- Sources of income and assets (pension from your employer, IRAs, 401(k)s, interest, etc.)
- Social Security and Medicare/Medicaid information
- Insurance information (life, health, long-term care, home, car) with policy numbers and agents' names and phone numbers
- Names of your banks and account numbers (checking, savings, credit union)
- Investment income (stocks, bonds, property) and stockbrokers' names and phone numbers
- Copy of most recent income tax return
- Location of most up-to-date will with an original signature
- Liabilities, including property tax— what is owed, to whom, and when payments are due
- Mortgages and debts—how and when they are paid
- Location of original deed of trust for home
- Car title and registration
- Credit and debit card names and numbers
- Location of safe deposit box and key

Steps for Getting Your Affairs in Order

- **Put your important papers and copies of legal documents in one place.** You can set up a file, put everything in a desk or dresser drawer, or list the information and location of papers in a notebook. If your papers are in a bank safe deposit box, keep copies in a file at home. Check each year to see if there's anything new to add.

- **Tell a trusted family member or friend where you put all your important papers.** You don't need to tell this friend or family member about your personal affairs, but someone should know where you keep your papers in case of an emergency. If you don't have a relative or friend you trust, ask a lawyer to help.
- **Give permission in advance for your doctor or lawyer to talk with your caregiver as needed.** There may be questions about your care, a bill, or a health insurance claim. Without your consent, your caregiver may not be able to get needed information. You can give your okay in advance to Medicare, a credit card company, your bank, or your doctor. You may need to sign and return a form.

Legal Documents

There are many different types of legal documents that can help you plan how your affairs will be handled in the future. Many of these documents have names that sound alike, so make sure you are getting the documents you want. Also, State laws vary, so find out about the rules, requirements, and forms used in your State.

Wills and ***trusts*** let you name the person you want your money and property to go to after you die.

Advance directives let you make arrangements for your care if you become sick. There are two ways to do this:

- A ***living will*** gives you a say in your health care if you become too sick to make your wishes known. In a living will, you can state what kind of care you do or don't want. This can make it easier for family members to make tough healthcare decisions for you.
- A ***durable power of attorney for health care*** lets you name the person you want to make medical decisions for you if you can't make them yourself. Make sure the person you name is willing to make those decisions for you.

For legal matters, there are two ways to give someone you trust the power to act in your place:

- A ***general power of attorney*** lets you give someone else the authority to act on your behalf, but this power will end if you are unable to make your own decisions.
- A ***durable power of attorney*** allows you to name someone to act on your behalf for any legal task, but it stays in place if you become unable to make your own decisions.

One or more interactive elements has been excluded from this version of the text. You can view them online here: https://library.achievingthedream.org/lfccpersonalfinance/?p=68

Resources

You may want to talk with a lawyer about setting up a general power of attorney, durable power of attorney, joint account, trust, or advance directive. Be sure to ask about the lawyer's fees before you make an appointment.

You should be able to find a directory of local lawyers at your library, or you can contact your local bar association for lawyers in your area. Your local bar association can also help you find what free legal aid options your State has to offer. An informed family member may be able to help you manage some of these issues.

Getting Your Affairs in Order FAQs

Who should you choose to be your health care proxy?

If you decide to choose a proxy, think about people you know who share your views and values about life and medical decisions. Your proxy might be a family member, a friend, your lawyer, or someone with whom you worship.

My aging parents can no longer make their own health care decisions. How do I decide what type of *care is right for them?*

It can be overwhelming to be asked to make health care decisions for someone who is no longer able to make his or her own decisions. Get a better understanding of how to make health care decisions for a loved one, including approaches you can take, issues you might face, and questions you can ask to help you prepare.

How do you help someone with Alzheimer's or dementia get their affairs in order?

A complication of diseases such as Alzheimer's is that the person may lack or gradually lose the ability to think clearly. This change affects his or her ability to participate meaningfully in decision making and makes early planning even more important. Find legal and financial planning tips, including information on advance directives, resources, and additional advance planning advice.

I am considering becoming an organ donor. Is the

Interested in organ donation and transplantation? Find resources *process different for older adults?*

There are many resources for older organ donors and recipients available from the U.S. government. Find information for potential donors and transplant recipientsover age 50, including how to register to be a donor.

I want to make sure my affairs are in order before I die, but I'm not sure where to begin.

The National Institute on Aging has a resource about End of Life: Helping With Comfort and Care. This guide can help you and your loved ones discuss key issues at the end of life, including finding hospice care, what happens at the time of death, managing grief, and preparing advance directives along with resources for more information.

For More Information about Getting Your Affairs in Order

AARP
1-888-687-2277 (toll-free)
1-877-434-7598 (TTY/toll-free)
1-877-342-2277 (español/línea gratis)

member@aarp.org(email)
www.aarp.org

CaringInfo
1-800-658-8898 (toll-free)
caringinfo@nhpco.org (email)
www.caringinfo.org

Centers for Medicare & Medicaid Services
1-800-633-4227 (1-800-MEDICARE/toll-free)
1-877-486-2048 (TTY/toll-free)
www.medicare.gov

Eldercare Locator
1-800-677-1116 (toll-free)
www.eldercare.gov

National Elder Law Foundation
1-520-881-1076
info@nelf.org (email)
www.nelf.org

For more information on health and aging, including the free booklets *Long-Distance Caregiving: Twenty Questions and Answers* and *End of Life: Helping with Comfort and Care*, contact:

National Institute on Aging
Information Center
P.O. Box 8057
Gaithersburg, MD 20898-8057
1-800-222-2225 (toll-free)
1-800-222-4225 (TTY/toll-free)
niaic@nia.nih.gov(email)
www.nia.nih.gov
www.nia.nih.gov/espanol

Sign up for regular email alerts about new publications and other information from the NIA.

Visit www.nihseniorhealth.gov, a senior-friendly website from the National Institute on Aging and the National Library of Medicine. This website has health and wellness information for older adults, including information about planning for end-of-life care. Special features make it simple to use. For example, you can click on a button to make the type larger.

National Institute on Aging
National Institutes of Health
U.S. Department of Health and Human Services

Publication Date: July 2016
Page Last Updated: May 2, 2017

38. Estate and Gift Taxes

Estate Tax

The estate tax is a tax on your right to transfer property at your death. It consists of an accounting of everything you own or have certain interests in at the date of death.

Frequently Asked Questions on Estate Taxes

Find some of the more common questions dealing with basic estate tax issues.

Gift Tax

If you give someone money or property during your life, you may be subject to federal gift tax.

Frequently Asked Questions on Gift Taxes

Find some of the more common questions dealing with gift tax issues as well as some examples of how different types of gifts are treated.

Filing Estate and Gift Tax Returns

Learn when to file estate and gift taxes, where to send your returns, and get contact information if you need help.

What's New – Estate and Gift Tax

Stay up to date with the tax law changes related to estate and gift taxes.

Deceased Taxpayers – Probate, Filing Estate and Individual Returns, Paying Taxes Due

Information to help you resolve the final tax issues of a deceased taxpayer and their estate.

39. Planning Your Own Funeral

To help relieve their families, an increasing number of people are planning their own funerals, designating their funeral preferences, and sometimes paying for them in advance. They see funeral planning as an extension of will and estate planning.

- Funeral Planning Tips
- Prepaying

Funeral Planning Tips

Thinking ahead can help you make informed and thoughtful decisions about funeral arrangements. It allows you to choose the specific items you want and need, and compare the prices offered by several funeral providers. It also spares your survivors the stress of making these decisions under the pressure of time and strong emotions. You can make arrangements directly with a funeral establishment.

An important consideration when planning a funeral pre-need is where the remains will be buried, entombed, or scattered. In the short time between the death and burial of a loved one, many family members find themselves rushing to buy a cemetery plot or grave — often without careful thought or a personal visit to the site. That's why it's in the family's best interest to buy cemetery plots before you need them.

You may wish to make decisions about your arrangements in advance, but not pay for them in advance. Keep in mind that over time, prices may go up and businesses may close or change ownership. However, in some areas with increased competition, prices may go down over time. It's a good idea to review and revise your decisions every few years, and to make sure your family is aware of your wishes.

Put your preferences in writing, give copies to family members and your attorney, and keep a copy in a handy place. Don't designate your preferences in your will, because a will often is not found or read until after the funeral. And avoid putting the only copy of your preferences in a safe deposit box. That's because your family may have to make arrangements on a weekend or holiday, before the box can be opened.

Prepaying

Millions of Americans have entered into contracts to arrange their funerals and prepay some or all of the expenses involved. Laws of individual states govern the prepayment of funeral goods and services; various states have laws to help ensure that these advance payments are available to pay for the funeral products and services when they're needed. But protections vary widely from state to state, and some state laws offer little or no effective protection. Some state laws require the funeral home or cemetery to place a percentage of the prepayment in a state-regulated trust or to purchase a life insurance policy with the death benefits assigned to the funeral home or cemetery.

If you're thinking about prepaying for funeral goods and services, it's important to consider these issues before putting down any money:

- What are you are paying for? Are you buying only merchandise, like a casket and vault, or are you purchasing funeral services as well?
- What happens to the money you've prepaid? States have different requirements for handling funds paid for prearranged

funeral services.

- What happens to the interest income on money that is prepaid and put into a trust account?
- Are you protected if the firm you dealt with goes out of business?
- Can you cancel the contract and get a full refund if you change your mind?
- What happens if you move to a different area or die while away from home? Some prepaid funeral plans can be transferred, but often at an added cost.

Be sure to tell your family about the plans you've made; let them know where the documents are filed. If your family isn't aware that you've made plans, your wishes may not be carried out. And if family members don't know that you've prepaid the funeral costs, they could end up paying for the same arrangements. You may wish to consult an attorney on the best way to ensure that your wishes are followed.

40. Saving and Investing

Find popular topics about saving and investing.

What's on This Page

- Manage Finances and Save Money
- Steps to Make a Budget
- Saving for Retirement
- Savings Bonds
- Treasury Securities
- Trusts
- Things to Consider Before You Invest
- Tools to Research Investments
- Choose a Financial Professional
- Pyramid Schemes

Manage Finances and Save Money

To help you manage your money and reach your saving goals:

Create a Budget

A budget is your plan for how you will spend money over a set period of time. It shows how much money you make and how you spend your money. Creating a budget can help you:

- Pay your bills on time.

- Save for unplanned expenses in the future.
- Prepare for retirement.

Download a budget spreadsheet that you can use to create your own to manage your monthly income and expenses.

Consider Ways to Save

Saving money involves looking for deals and buying the quality items you need at the best price. You can save money by comparison shopping, comparing the prices and quality of products you plan to buy. MyMoney.gov offers ways to manage your spending and build your savings accounts to achieve your saving goals.

Invest in Long Term Goals

Investing is a way to make money grow, by buying shares of stocks, mutual funds, bonds, or real estate. When you invest, there is risk that you could lose the money you invest; in general the greater the earnings you can make, the greater the risk. You can save for long term goals, such as retirement (PDF, Download Adobe Reader) and college education, by investing. Learn how to savefor emergencies, short term and long term goals, and become an informed investor.

Steps to Make a Budget

See this video to learn how to make a budget and plan your finances.

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Saving for Retirement

As you approach retirement, there are many things to think about. Experts advise that you will need about 80 percent of your pre-retirement income to continue your current quality of life. The exact amount depends on your individual needs. Some important factors to consider include:

- At what age do you plan to retire?
- Can you participate in an employer's retirement savings plan, such as a 401(k) plan, or a traditional pension plan?
- Will your spouse or partner retire when you do?
- Where do you plan to live when you retire? Will you downsize, rent, or own your home?
- Do you expect to work part-time?
- Will you have the same medical insurance you had while working? Will your coverage change?
- Do you want to travel or pursue a new hobby that might be costly?

Resources to Help You Prepare for Retirement

To help you plan for retirement:

- Find practical tips for building retirement savings in the Top 10 Ways to Prepare for Retirement(PDF, Download Adobe Reader).
- Use a retirement calculator to find out the best age to claim your Social Security benefits.
- myRA can help you start saving for retirement when you don't have access to an employer-sponsored plan or lack other options to save.
- Find out the trade-offs between taking your pension in a monthly payment or in a lump sum(PDF, Download Adobe Reader).
- Social Security pays benefits that are on average equal to about 40 percent of your pre-retirement earnings. You may be able to estimate your benefits.
- Learn how you can boost your retirement savings at Investor.gov.
- If you have a financial advisor, talk to him or her about your plans.

Savings Bonds

U.S. savings bonds are one of the safest types of investments because they are endorsed by the federal government and, therefore, are virtually risk free.

Visit TreasuryDirect, a website from the U.S. Department of the Treasury, to learn about savings bonds, treasury bonds, and securities: how to buy and redeem your investments, what to do in the event of the death of an owner, and much more. TreasuryDirect is your one-stop shopping site for government securities where you can find information about the wide range of savings options, including EE/E, HH/H, and I savings bonds.

Manage and determine the value of savings bonds using these tools:

- Savings Bond Calculator
- Savings Bond Wizard
- Redemption Tables

You can give savings bonds for many occasions, such as birthdays, weddings, and graduations. Learn how to give savings bonds as gifts.

Treasury Securities

Treasury securities are debts issued by the federal government's Bureau of Fiscal Service. When you buy a treasury security, you are lending money to the federal government for a set amount of time. In return the government promises to pay you back the entire amount, also known as the face value, when the security matures.

There are several types of treasury securities:

- Treasury Bills—Short term securities that mature between a few days and 52 weeks.
- Treasury Notes—Medium term securities that mature between one and 10 years.
- Treasury Bonds—Long term securities, with a 30 year term that pays interest every six months, until the bond matures.
- Treasury Inflation-Protected Securities (TIPS)—Securities with principle values that adjust based on inflation, but with fixed interest rates for five, 10, or 30 year maturities.
- Savings Bonds—Securities that offer a fixed interest rate over a fixed period of time.
- Floating Rate Notes (FRNs)—Securities with variable interest rates, so that as bank interest rates increase or decrease, the interest rates on the FRNs change in the same direction.

You can purchase treasury securities for yourself or as gifts. You can purchase them in several ways:

- Banks, brokers, and other financial institutions through the Commercial Book-Entry System.
- Online through Treasury Direct
- Payroll savings plans
- Public auctions

Trusts

A trust (or trust fund) is a legal entity that allows a person (the grantor, donor, or settlor) to transfer assets to another person or organization (the trustee). Once the grantor establishes the trust, the trustee controls and manages the assets for the grantor or for another beneficiary—someone who will ultimately benefit from the trust. To help you decide if a trust is right for you, first consult a licensed attorney experienced with estate planning and trust matters.

Reasons to Set Up a Trust

Some common reasons for setting up a trust include:

- Providing for minor children or family members who are inexperienced or unable to handle financial matters
- Arranging for management of personal assets, if you become unable to handle them yourself
- Avoiding probate and immediately transferring assets to beneficiaries upon death
- Reducing estate taxes and providing liquid assets to help pay

for them

- The terms of a will are public while the terms of a trust are not, so privacy makes a trust an appealing option.

Types of Trusts

Trusts can be living (inter vivos) or after-death (testamentary). A living trust is one that a grantor sets up while still alive and an after-death trust is usually established by a will after one's death. Living trusts can be irrevocable (can't be changed) or revocable (can be changed), although revocable trusts don't get the same tax shelter benefits as irrevocable ones do.

The most common type of trust is the revocable living trust. If there's a specific purpose in mind for the trust, dozens of different options exist (charitable trusts, bypass trusts, spendthrift trusts, and life insurance trusts). Two types of trusts can help pay for long-term care services:

- **Charitable Remainder Trusts** – This trust allows you to use your own assets to pay for long-term care services while contributing to a charity of your choice and reducing your tax burden at the same time. You can set up the trust so that you receive payments from the trust to pay for long-term care services while you are alive.
- **Medicaid Disability Trusts** – These trusts are limited to persons with disabilities who are under age 65 and qualify for public benefits. Parents, grandparents, and legal guardians often set up these trusts to benefit people with disabilities and a non-profit organization manages the assets. This is the only kind of trust that is exempt from rules regarding trusts and Medicaid eligibility.

Trust Scams and Fraud

If someone approaches you to set up a trust, be careful. Before signing any papers to create a living trust, will, or other kind of trust, make sure to explore all options and shop around to compare services. Some other tips to avoid trust scams and fraud include:

- Avoid high-pressure sales tactics and high-speed sales pitches.
- Stay away from salespeople who give the impression that specific organizations and recognized brands back or sell the trust.
- Research and get information about local probate laws from the Clerk or Register of Wills.
- If someone tries to sell a living trust to you, ask if they are an attorney. Some states restrict the sale of living trusts to licensed attorneys.
- If you buy a trust in your home or in another location that is not the seller's permanent place of business, remember you have the right to take advantage of the Cooling Off Rule and cancel the transaction within three business days.

Things to Consider Before You Invest

Do you have a financial goal in mind, such as saving for retirement, paying for college, or buying a new house? If so, then you may decide to invest your money to earn enough to fund your goals. Before you invest, make sure you have answers to all of these questions:

- **How quickly can you get your money back?** Stocks, bonds, and shares in mutual funds usually can be sold at any time, but there is no guarantee that you will get back all the money you invested. Other investments, such as limited partnerships, certificates of deposit (CDs), or IRAs, often restrict your ability to cash out your holdings.

- **What can you expect to earn on your money?** While bonds generally promise a fixed return, earnings on most other securities go up and down with market changes. Keep in mind, just because an investment has done well in the past, there is no guarantee it will do well in the future.
- **What type of earnings can you expect?** Will you get income in the form of interest, dividends, or rent? Some investments, such as stocks and real estate, have the potential for earnings and growth in value. What is the potential for earnings over time?
- **How much risk is involved?** With any investment, there is always the risk that you will not get your money back or the earnings promised. There is usually a trade-off between risk and reward–the higher the potential return, the greater the risk. While the U.S. government backs U.S. Treasury securities, it does not protect against loss on any other investments.
- **Are your investments diversified?** Some investments perform better than others in certain situations. For example, when interest rates go up, bond prices tend to go down. One industry may struggle while another prospers. Putting your money in a variety of investment options can reduce your risk.
- **Are there any tax advantages to a particular investment?** U.S. savings bonds are exempt from state and local taxes. Municipal bonds are exempt from federal income tax and, sometimes, state income tax as well. Tax-deferred investments for special goals, such as paying for college and retirement, are available that let you postpone or even avoid paying income taxes.

More Information on Investing

To learn more about investing, refer to these resources:

- You can find useful tips on investing at Investor.gov, a website from the Securities and Exchange Commission (SEC).
- For all of your investment-related questions, contact the SEC's Office of Investor Education and Advocacy.
- To get help preparing to invest, consult the Financial Industry Regulatory Authority (FINRA).

Tools to Research Investments

To help you make informed decisions when investing and avoid investment fraud, there are a variety of research tools available:

- Find investor news and alerts and a guide to investment products at Investor.gov, a website from the Securities and Exchange Commission (SEC).
- The SEC requires public companies to disclose financial and other information to help you make sound decisions. You can view the text of these files on EDGAR.
- The Financial Industry Regulatory Authority (FINRA) has up-to-date market data and information for a wide range of stocks, bonds, mutual funds, and other securities.
- If you are considering investing in collectible coins, refer to the U.S. Mint. Before you purchase coins or coin-related products, research the seller with a government agency, such as your state consumer protection office or the Federal Trade Commission (FTC).

Choose a Financial Professional

A financial professional can have multiple titles and be authorized to provide various services, including investment, financial planning, and insurance products. When researching a financial professional, find out what the titles and licenses mean, as well as the educational, work experience, and ethical requirements. Keep in mind that a professional title is not the same as a license. The Securities and Exchange Commission (SEC), the Financial Industry Regulatory Authority (FINRA), and state regulators do not grant or endorse any professional titles.

When choosing a broker or investment adviser, research the person's education and professional history as well as the firm the person works for. Make sure you have answers to all of these questions:

- **Has the person worked with others who have circumstances similar to yours?**
- **Is the person licensed in your state?** Your state securities regulator lists individuals and firms that are registered in your state. Ask whether the regulatory office has any other background information. To find out how to contact your state securities regulator, consult the North American Securities Administrators Association (NASAA).
- **Has the person had any run-ins with regulators or received serious complaints from investors?** Contact your state securities regulator or the SEC. To review licensing, employment, and disciplinary information, use FINRA's BrokerCheck tool.
- **How is the person paid?** Is it an hourly rate, a flat fee, or a commission that depends on the investments you make? Does the person get a bonus from their firm for selling you a particular product?
- **What are the fees for setting up and servicing your account?**

Resources to Help You Choose a Financial Professional

For more information on choosing a financial professional, refer to these resources:

- The Commodity Futures Trading Commission's (CFTC's) SmartCheck allows you to check the background of financial professionals and stay informed on the latest fraud schemes.
    - To ask a question, report information, or file a complaint, contact the CFTC.
- The Financial Industry Regulatory Authority (FINRA) has information on the professional designations of financial professionals and the organizations that offer them.
- Both the North American Securities Administrators Association (NASAA) and the National Futures Association can offer helpful information on saving and investing.

Pyramid Schemes

A pyramid scheme, also known as Ponzi scheme, is an illegal form of multilevel marketing. In these scams, your ability to earn profits is based on the number of new participants you recruit, instead of the amount of products or services you sell. Sometimes there actually aren't any real products that are being sold. These types of schemes are common with investment and independent direct selling opportunities.

These schemes rely on the income from new participants in order to pay fake "profits" to people that have been part of the scheme for longer amounts of time. However, the scheme falls apart when there aren't enough new recruits to pay into the system, so the earlier participants no longer receive earnings.

Tips to Avoid Being a Victim

Take steps to protect yourself from being a victim of a pyramid scheme:

- Be wary of "opportunities" to invest your money in franchises or investments that require you to bring in more investors to increase your profit, or recoup your initial investment.
- Be wary if the company sells non-tangible products or technical services, rather than physical items.
- Independently verify the legitimacy of any franchise or investment with the Better Business Bureau, your state Attorney General, or any licensing agencies.
- Be skeptical of success stories and testimonials of fantastic earnings.

File a Complaint

If you are aware of a pyramid scheme or have been the victim of one, file a complaint with your state consumer protection office, state Attorney General, or the Better Business Bureau (BBB). If the pyramid scheme involved securities, you should also file a complaint with your state's securities administrator, or the Securities and Exchange Commission.

PART XIII

MODULE 12: LIVING WITHIN YOUR MEANS/ COST OF COLLEGE

41. College Affordability and Transparency Center

College Scorecard

College Scorecards make it easier for you to search for a college that is a good fit for you. You can use the College Scorecard to find out more about a college's affordability and value so you can make more informed decisions about which college to attend.

Enter

Net Price Calculator Center

Here you will find links to colleges' net price calculators. Net price calculators help you estimate how much colleges cost after scholarships and grants.

Enter

College Navigator

Here you can search for and compare colleges on all sorts of criteria including costs, majors offered, size of school, campus safety, and graduation rates.

Enter

College Affordability and Transparency List

Here you will find information about tuition and net prices at postsecondary institutions. The site highlights institutions with high and low tuition and fees as well as high and low net prices (the price of attendance minus grant and scholarship aid). It also shows institutions where tuition and fees and net prices are increasing at the highest rates.

Enter

90/10 Information

Here you will find a list of for-profit (proprietary) postsecondary institutions that receive more than 90 percent of their revenues from Title IV Federal Student Aid.

Enter

State Spending Charts

Here you will find summary information on changes in state appropriations for postsecondary education, state aid for students, and tuition and fees.

Enter