JA Finance Park

Topic Reference Guide
What’s in this Packet?

As you make your way through JA Finance Park, you may come across new terms or ideas. This packet includes some basic information about the core concepts applied in this simulation. You may want to read through the information now, or refer back to these pages as a reference. You may also want to check out the JA My Way for more information on a wide range of topics related to personal finance, careers, and starting your own business. Visit the following address for details, jamyway.org

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Financial Institutions

Introduction
Nearly everyone who works buys a car, rents an apartment or purchases a house, buys food and clothing, and uses the services of a financial institution. Financial institutions help people with their financial transactions. Today’s students need to be prepared to use these services as they move into the world on their own.

As participants in the JA Finance Park program, students will use financial institutions, such as banks, to help them handle their money and complete financial transactions. They will maintain an account, make decisions about credit, and use a debit card. They also will track various investments.

A financial institution is an organization established to assist people with their financial matters. Credit unions, banks, savings and loans, and investment firms are examples of financial institutions. In our increasingly complex world, they have become a necessity. They help us save for the future with simple savings accounts and more complex investments. They hold and transfer money for individuals and businesses alike. Many handle credit and loan transactions, as well. Mortgage and consumer loans for houses, cars, and home improvements are common services provided by financial institutions. Most financial institutions now offer online banking where transactions can be made from an off-site computer.

Financial Institution Fact Sheet

Who uses financial institutions?
Almost everyone, at one time or another, uses a financial institution. Most people decide to keep their money in a financial institution, such as a bank or credit union. Making a large purchase, such as a car or house, usually involves applying to a financial institution for a loan. Payment for smaller items, such as food and clothing, is often by a check or debit card issued by a financial institution. The services of financial institutions are many and varied.

What do I need to know about financial institutions?
At JA Finance Park, you will need to know how to maintain a bank account, make decisions about credit, and use a debit card. You also will be involved with various investments—stocks and mutual funds—and you will track them to see how they are doing. This knowledge about financial institutions will serve you not only at JA Finance Park, but also as you move out into the world.

Why do I need to know about financial institutions?
Although financial institutions are evolving in terms of the services they offer, there always will be some type of financial institution available to manage money. They will play a big role in your life! For the next four weeks, you will study financial institutions to better prepare you to be a smarter consumer. As a participant in the JA Finance Park program, you will use financial institutions to help you handle money and make financial transactions. It is important for you to know how to use these institutions to your personal advantage to make the most out of your money.
When would I use a financial institution?
You will be surprised how many times you will need the services of a financial institution when you move out into the adult world. When working, you’ll probably be paid by check or direct deposit, and you will need a place to deposit or cash your check. If you decide to buy a car, house, boat, or motorcycle, you may need to obtain a loan from a financial institution. You likely will decide to start saving for the future through a savings account or other investments, and this will be accomplished with the assistance of a financial institution. Would you like to purchase an airline ticket or catalog item over the telephone or Internet? You’ll need a credit card issued through a financial institution.

Where would I find a financial institution?
Locating a personal financial institution should not be difficult. Many are visible as you drive down the street, while others, such as banks that issue credit cards, may be headquartered in another state. Major financial institutions have branches located in town centers so their customers will not have to travel great distances to use their services. ATM machines connected to these institutions are found at convenience stores, grocery stores, and professional sports facilities; in malls; and as freestanding, drive-through facilities. You can find financial institutions almost anywhere you look.

How do I use a financial institution?
The how-to of using a financial institution is closely linked to the purpose of the institution. Most financial institutions publish informational brochures or booklets on the services they offer. Service representatives are available in person, by telephone, or by e-mail to help you with any questions you may have. Because there are a wide variety of financial institutions, you will learn how to select the type best suited for your needs.
Debit Cards: Beyond Cash and Checks

Debit cards, also known as check cards, look like credit cards or ATM (automated teller machine) cards. A debit card operates like cash or a personal check. When you use a debit card, you buy now and pay now. Debit means subtract. As a rule, debit cards allow you to spend only what is in your bank account. Your purchase is instantly deducted from your checking or savings account.

Debit cards are accepted at many businesses, such as grocery stores, retail stores, gas stations, and restaurants. You can use a debit card anywhere merchants display your card’s brand name. Using a debit card gives you an alternative to carrying a checkbook or cash. Some stores might be more likely to accept a debit card than your personal check because the payment is approved and credited to the merchant immediately.

When you use a debit card, you are subtracting your money from your own bank account. A credit card, on the other hand, involves using credit. A debit card is not the same as a credit card. Credit is money given to you by a bank or other financial institution. It is a loan. You can use the credit card with the understanding that you will repay the money you have used, plus interest and any finance charges, if you do not pay the debt in full each month.

What you should know about debit cards:

- Obtaining a debit card is often easier than obtaining a credit card.
- Using a debit card instead of writing checks saves you from showing identification or giving out personal information.
- Using a debit card frees you from carrying cash, traveler’s checks, or a checkbook.
- Debit cards might be more readily accepted than checks by merchants.
- The debit card is a pay-now product with no grace period for payments.
- Use of a debit card may not offer the same protection as a credit card for items you purchase that are not delivered, are defective, or were misrepresented.
- Returning goods or canceling services purchased with a debit card is handled the same as if you made the purchase with cash or a check.
- With a debit card, you are using your own money. It is estimated that two-thirds of American households now use debit cards. Debit cards will continue to rival cash and checks as a form of payment as consumers continue to look for convenient ways to make purchases.
Credit Cards Overview

A credit card:

- Is safe. If your card is lost or stolen and used by a thief, the most you can be held liable for is usually $50.

- Provides emergency buying power. The car broke down? A trip to the emergency room? With a credit card, you can cover those emergencies and pay the bill later.

- Offers protection. You may be able to use special credit card regulations to dispute a charge if there is a problem with merchandise or services you bought with your card.

- Is convenient. When you’re shopping with a credit card, you don’t need to make sure you have enough cash on hand, or hope that a merchant accepts your check. There’s hardly a merchant these days who won’t accept a major credit card for payment, and they’re always an accepted method of payment for telephone and Internet purchases. Personal checks, on the other hand, may not be accepted by all retailers. However, credit cards can support impulse buying—buying before you can afford the item.

- Can build your credit rating. Pay your bills on time, and a major credit card can help you build an excellent credit rating. In fact, the single strongest reference on a credit report is a major credit card, paid on time over time.

- Travels well. In many countries, major credit cards are widely accepted. You’ll often get a favorable exchange rate, as well. Some cards offer benefits like emergency card replacement or free car insurance on a car rented with your card.

- Is flexible. With a credit card, you have the option of paying your bill in full (and usually avoiding any interest charges that way), or making smaller payments. If not paid off monthly, interest is accrued on the balance.

- May have perk benefits—ranging from free frequent flier miles to extended warranties on merchandise you buy with the card and free movies or gasoline.

- Can be used to withdraw cash at ATM machines using the card’s PIN (personal identification number). However, cash withdrawals are usually calculated at a higher interest rate than purchases. Credit cards often have an annual fee. Cards with benefits almost always have an annual fee.
A Big Decision
Using Credit

The decision to purchase an item using credit—borrowing rather than saving and paying cash—is to be taken seriously. How badly do you need the desired item? Is it something that you can live without, or is it a need you must satisfy immediately? Saving requires that you wait, while buying on credit allows you to purchase goods and services now in exchange for a promise to pay later. Cash? Credit? There are advantages and disadvantages to both methods of payment. You need to consider them carefully.

Credit use has many benefits. Credit allows you to buy major items, such as cars and houses, without having to save the entire purchase amount. Even though you don’t have enough money to spend, you can enjoy an item now. Credit cards also are widely accepted at a variety of stores, allowing you to buy wherever you are. When using a credit card, you don’t have to carry much cash, which is great if you’re traveling. If you see something on sale at a great price but have no cash, you can buy it anyway just by signing your name.

A credit card allows you to be a telephone or Internet shopper. Buying on credit also permits you to inspect your purchase before it is fully paid for. If something goes wrong with a purchased item, it may be easier to return it when paid for with a credit card. In an emergency, a credit card allows you to respond immediately, even if you have no cash. Another advantage to credit is that it allows you to keep accurate records of your spending and combine multiple purchases into one lump payment.

There also is a downside to using credit. There are varying fees associated with credit, such as interest, finance charges, and annual fees. All of these add to the real cost of purchases. If you buy an item on sale, you must remember that the interest and charges could amount to more than the savings (especially if you don’t pay off the credit card bill each month).

Also remember that when charging, you are spending future earnings now, which means you are giving up purchases you may want to make in the future. Perhaps the biggest disadvantage of credit buying, however, is that it encourages impulse buying. If left unchecked, this impulse buying can lead to disastrous problems, such as the repossession of cars and homes when payments aren’t made on time. A poor credit rating can ruin your chances for a future home or car loan. It can even affect your ability to get a job.

Credit can be a tool for successfully managing your money and improving your lifestyle, or it can lead to bankruptcy and financial ruin. Credit reporting agencies keep records on your credit experience. If you are a responsible borrower, you will have a good credit rating. If not, you will have a poor credit rating. Whether to use credit is an important decision. Consider all the advantages and disadvantages to make the best decision.

Now You Try It
Create a chart and, using the information found in the article above, list the advantages and disadvantage of using credit. Answers can be found on the next page.
## A Big Decision
### Advantages and Disadvantages Answer Key

<table>
<thead>
<tr>
<th>Advantages of Credit</th>
<th>Disadvantages of Credit</th>
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<tr>
<td>• Allows you to make a purchase now instead of waiting.</td>
<td>• Fees, such as interest, finance charges, and annual fees, add to the real cost of purchases.</td>
</tr>
<tr>
<td>• Allows you to buy major items, such as cars and houses, without having to save the entire purchase amount beforehand.</td>
<td>• By charging, you are spending future earnings, which means giving up purchases you may want to make in the future.</td>
</tr>
<tr>
<td>• Can enjoy goods and services even though you don’t have the money on hand.</td>
<td>• Encourages impulse buying, which if left unchecked can lead to disastrous problems, such as the repossession of cars and houses, when payments aren’t made on time.</td>
</tr>
<tr>
<td>• Cards are accepted at a variety of stores, allowing you to make purchases almost anywhere.</td>
<td>• Can cause a poor credit rating if bills aren’t paid on time. A poor credit rating can ruin your chances for a future home or car loan. It can even affect your ability to get a job.</td>
</tr>
<tr>
<td>• You don’t have to carry much cash.</td>
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<tr>
<td>• Allows for shopping over the telephone or Internet.</td>
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<tr>
<td>• Allows for an immediate response or solution in emergencies, even if you have no cash.</td>
<td></td>
</tr>
<tr>
<td>• Allows you to keep accurate records of your shopping.</td>
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Planning Your Future

To spend your money wisely, it is important to create and follow a monthly budget. Also important to smart spending is planning for the future.

You will be more successful in saving, investing, and budgeting if you know what you want your money to do for you. What are your goals? Do you want to save money for something you need or something you want? Do you plan to use your money soon or to spend it sometime in the future?

Following a budget for everyday expenses is essential to spending your hard-earned money wisely. Including saving and investing in your budget helps to ensure you'll meet your goals. The key to success is careful planning and sticking to that plan.

The first step to achieving your goals is to define them. Answering the following questions may prove helpful in developing a smart plan and ultimately reaching your goals.

- What are your goals? Do you want a new bike or a car? Do you want to live on your own someday? Do you want to go to college? It is essential that you clearly define your goals to understand what you are planning.

- How much money will you need to achieve your goals? Are your goals attainable?

- When will you need the money? Will you need some right away or perhaps several years in the future? Knowing when you plan to use the money will help you determine how you will need to raise it.

Once you have answered the above questions, you are ready to create your saving and/or investing plan.

Did you find that you needed the money soon? If so, a savings account may need to be a part of your plan. Putting money into a savings account is a safe way to save money and earn a modest interest rate. You have quick access to your money in a savings account.

Are you saving for college or furnishings for your own apartment someday? If so, investing your money for the longer term may be an option. Stocks and mutual funds allow you to invest your money and earn, over time, a higher rate of return than money placed in a savings account. Stocks and mutual funds are not as safe as your savings account; the money you put into these investments is not insured like your money in the savings account. You can lose part or all of the money you invest. However, stocks and mutual funds can pay you a greater return on your investment than the interest earned on your savings account. If you can wait to use the money and take the risk of investing, stocks or mutual funds may be the option for you.

Identifying your goals, understanding the best way to reach your goals, creating a plan, and staying with your plan are essential steps to ultimately getting what you want out of your money.
Investing: Risks & Rewards

Every investment has risks and rewards, which a smart investor evaluates and weighs.

**Savings accounts** have the lowest risk because bank and credit union accounts are insured by the government (Federal Deposit Insurance Corporation, or FDIC) for up to $100,000. The rewards, in interest earned, often are less than with other, riskier investments. Savings accounts pay a modest interest rate, often less than what stocks or mutual funds yield. Banks also offer certificates of deposit (CDs), which are just as safe, but offer higher interest rates than savings accounts. The downside is that you have to commit larger amounts of money for longer periods of time; if you cash in a CD before its maturity date, you have to pay a penalty for early withdrawal. With a savings account, you can take funds out at any time with no penalty.

**Bonds** also tend to be low risk and low reward. U.S. Savings Bonds, for example, pay a guaranteed rate of return that tends to be lower than stock or mutual fund returns, but they’re essentially safe. The terms—length of loan until maturity, amount, and frequency of interest payments—are spelled out at the start. You lose money only if the borrower can’t repay the loan when the bond reaches maturity, or if you have to sell the bond before it matures. There are organizations, such as Standard and Poor’s, that rate bond issuers to help investors evaluate their risk. Because bonds aren’t insured, you could lose all or some of your original investment, but this is far less likely than with stocks.

**Stocks** are a riskier investment, but have a potentially higher reward. Traditionally, stocks have paid higher average returns than any other kind of investment. With the purchase of a corporation’s stock, you become a shareholder in a business. This means you share in the company’s success as well as its failure. If the corporation does well, its value increases, and so does the value of your shares. If it does poorly, its value decreases, and so does that of your shares. You could lose some or all of the money you invest.

Stock or share prices can be volatile, meaning they can go up or down. Even professional investors can’t always predict whether stocks will gain or lose value, and they can lose money. Unlike savings accounts or CDs, stocks are a gamble.

Say you bought 100 shares of a company’s stock at $5 per share. Two months later, you read that the company is failing, and each share is worth only $2. You have lost $3 per share, or $300, of your $500 investment! This loss wouldn’t be covered by any insurance; it’s just gone, unless you’re willing to hang on long enough for the stock’s value to increase again, which it may or may not do. If you can afford to wait and continue buying shares, you can actually purchase more shares for the same investment (because each share will cost you less).

**Mutual funds** are shares of a fund owned by its many investors and managed by a professional. They have many of the same risks associated with stocks: you could lose some or all of your money because the investment is not insured. As with stocks, there is a greater chance of rewards in higher dividends or earnings. Stocks and mutual funds will go up and down in value, so they are best suited to long-term investors who won’t need the money soon.
There are different kinds of mutual funds, with different levels of risks and rewards.

- Basically, the riskier the fund, the greater the potential reward.
- One popular type is the money market fund that seeks short-term investments to provide interest or dividend income. These usually offer a higher rate of interest than insured bank accounts, but they can pay better, too. Money markets, like all mutual funds, are not insured, and their value can go up or down.

Many people try to balance these risks and rewards by investing in both savings and bonds, as well as stocks and mutual funds. This is called diversifying. The more types of investments you have, the more diversified your portfolio, or collection of investments. This way, the risk is spread out. If one investment does poorly, another may do better.
How Taxes Affect Income and Purchases

What are taxes?
Taxes are funds, or money, that local, state, and federal governments collect to pay their bills.

Who pays taxes?
People who hold jobs, buy things, or own property pay taxes. In short, just about everyone pays taxes.

How do I pay taxes?
Paying taxes is an almost invisible activity for most of us: sales tax is automatically included in the total price when a purchase is made at a store or in a utility bill (and later sent to the local or state tax collectors). When we receive a paycheck, income taxes are automatically withheld by employers and set aside in a tax account to be paid to the Internal Revenue Service (IRS). Once a year, we are required to file income tax forms and send in any additional tax still owed to the IRS or apply for a refund if too much tax was withheld from our pay.

How am I affected by taxes?
Taxes affect us all. With a state or local sales tax, we have an additional cost on nearly everything we purchase. Our take-home pay is reduced by the amount of income tax we owe. Property, such as a car, house, or business, also will be taxed. We pay taxes on utilities, such as electricity, cable, and telephone service. What is all that money used for? It is applied to a whole range of “free” services. From the roads we travel on, the public schools we attend, the police and fire protection we depend on, the armed forces that protect our country, the Social Security paid to our grandparents, to the parks we play in—all are funded with tax money.

Why do I need to know about taxes?
If you plan to work and make major purchases or buy property, you need to understand how taxes will affect your take-home pay. At JA Finance Park, you will be required to pay income and payroll (Social Security and Medicare) taxes on the money you receive in wages. You must, therefore, be able to calculate your net monthly income to know exactly how much money you’ll have left to spend after taxes.
The Tax Flow

It has been said that taxes are what we pay to have a civilized society. Taxes are needed to pay for the services we have come to expect from government. Many of these services are for things most people could not afford individually, such as an army or highway system.

A tax is a required payment of money to local, state, or federal government. Income tax, sales tax, and property tax are the three main sources of tax income.

Income Tax

An income tax is a tax on an individual’s earnings from wages, salary, tips, interest, rents, capital gains, and dividends. It is the largest source of tax revenue for the federal government. Federal income tax usually is the largest single amount withheld from workers’ paychecks. Each year on or before April 15, American citizens calculate what they owe in taxes and pay any amount due (beyond what was withheld from their pay) or request a refund (if they overpaid). The following are some characteristics of the American income tax system:

- Federal income tax is based on one’s ability to pay. This is called progressive taxation: The higher a person’s income, the greater the percentage he or she pays.
- The IRS relies on individual honesty and responsibility for citizens to pay their income taxes. This is called voluntary compliance.
- Income taxes are figured on a pay-as-you-earn basis. As you receive income, you pay the estimated tax owed. It is an employer’s responsibility to withhold tax from your paycheck and deposit it with the IRS.
- You, rather than the government, prepare and file (send) your tax forms (tax return) each year, determine your own tax liability, and pay any tax due or request a refund. This is called self-assessment.

The federal government uses tax money to pay for different programs to help the country and its citizens. Examples of these programs are:

- Social Security, Medicare, and other retirement programs
- National defense, veterans, and foreign affairs
- Interest payments on the national debt
- Physical, human, and community development programs (natural resource, environmental, transportation, job training, and education programs)
- Social programs (Medicaid, food stamps, health programs, unemployment compensation, assisted housing)
- Law enforcement and government administration (prisons, FBI, CIA, and the general costs of federal government, including the collection of taxes)
Sales Tax

Sales taxes, those extra pennies or dollars added to purchases, are a source of income for most state governments. Each state decides its own sales tax. Counties and cities also may charge a sales tax. Some items are taxed, and some are not. Items not taxed are tax-exempt.

Examples of taxed items may be:
- Household items
- Restaurant food
- Furniture
- Gasoline
- Utilities
- Shoes and clothing
- Motel and hotel bills
- Liquor
- Tobacco products

Examples of nontaxable items may be:
- Groceries
- Medicine
- Medical services
- Insurance

Sales taxes provide income to state and local governments, but they are criticized by some for being regressive, meaning individuals or families with low incomes may pay a greater percentage or pro-proportion of their incomes in sales taxes than do families with higher incomes.

Property Tax

Property taxes are paid based on the value of property—anything from private homes and cars to commercial buildings and factories. This property value is determined by local governments. Property taxes often are the primary source of local government income.

Local and state governments use sales and property tax revenues to pay for services and facilities, such as the following:
- Public schools and local libraries
- Local roads and streets
- Streetlights
- Garbage collection, recycling
- Police, jails, courts
- Local parks and recreation
- State employment services
- Social services
- Firefighters
- Elections
- Mass transportation
Social Security Fact Sheet

Social Security is a social insurance system created to provide economic security for Americans who are retired, sick, or too disabled to work, as well as for the families of workers who have died. Workers are required to participate. Benefits are based on past work. The Social Security Administration, which runs the program, is a branch of the federal government with an office in nearly every community.

Benefits: People are entitled to Social Security payments or benefits if they or someone in their family contributed part of their earnings as workers. The benefits have expanded over the years to include unemployment insurance, old-age assistance, aid to dependent children, and grants to the states to provide various medical care and assistance. Benefits are weighted in favor of low-income workers and families. About one out of every six Americans receives Social Security benefits.

Medicare: Since the Medicare bill was signed in 1965, the Social Security Administration became responsible for this social insurance program. Medicare covers health expenses for almost all Americans age 65 or older.

Social Security is funded primarily through a payroll tax on workers and their employers. This tax appears as FICA (Federal Insurance Contributions Act) on a paycheck. Social Security taxes paid by today's workers are used to pay benefits to tomorrow’s beneficiaries. Social Security funds are invested in special trust funds, and the earnings on the investments are used to help pay benefits. Over the years, more than $4.5 trillion has been paid into the trust funds, and more than $4.1 trillion has been paid out in benefits. The remainder is currently on reserve in the trust funds and will be used to pay future benefits.

A Social Security number is used by the government to keep track of you and your earnings throughout your lifetime. When someone applies for Social Security benefits, the Social Security Administration assigns a number—which never changes throughout an individual’s lifetime—and uses this number to tell if an individual is eligible for benefits and how much he or she is entitled to. Your parents need your Social Security number when they claim you as one of their dependents on their income tax return. Today, most parents apply for a child’s Social Security number at the hospital when that child is born. This Social Security number, which every worker must have, is printed on a Social Security card.

Do you have a Social Security card? If you do not yet have a card, you can call your local Social Security office to request an application. You also can complete the application process via the Internet at https://www.ssa.gov/myaccount/.

Keep your Social Security number and card in a safe place to prevent theft. It is not necessary to carry your Social Security card with you. In fact, it is recommended that you don’t carry it with you. You will need to show your card to your employer when you start a job, or give your Social Security number to the bank to apply for a loan. When you show somebody your card or give out your Social Security number, make sure you know why your number is needed and how your number will be used. It’s important to be careful with your Social Security number to prevent their misuse.
Calculating Net Monthly Income

Definitions

<table>
<thead>
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<th>Gross Annual Income (GAI)</th>
<th>Total pay or earnings made over a one-year period before any deductions have been taken.</th>
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<tr>
<td>Gross Monthly Income (GMI)</td>
<td>Total amount of earnings made over a month before any deductions (1/12 of GAI).</td>
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<tr>
<td>Net Monthly Income (NMI)</td>
<td>Amount of monthly income remaining after all deductions have been taken. (This amount is sometimes referred to as “take-home” pay.)</td>
</tr>
<tr>
<td>Net Annual Income (NAI)</td>
<td>Amount of income that one has to spend in a year after all deductions have been taken.</td>
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Formulas

GMI = GAI divided by 12
NMI = GMI minus all monthly deductions

Example 1

GAI $28,000

GMI $28,000 divided by 12 = $2,333.33

Deductions to be subtracted from GMI:

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<table>
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<tr>
<td>Monthly Federal Income Tax</td>
<td>$ 400</td>
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<tr>
<td>Monthly Social Security (FICA)</td>
<td>$ 193</td>
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<tr>
<td>Monthly Medicare</td>
<td>$ 35</td>
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Total Monthly Deductions $628

\[
\text{GMI} \quad \frac{\text{NMI}}{\text{GMI} - \text{Total Monthly Deductions}} \quad \frac{\text{NMI}}{\text{GMI} - \text{Total Monthly Deductions}}
\]

Example 2

GAI $56,000

GMI $56,000 divided by 12 = $4,666.67

Deductions to be subtracted from GMI:

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<tbody>
<tr>
<td>Monthly Federal Income Tax</td>
<td>$ 982</td>
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<tr>
<td>Monthly Social Security (FICA)</td>
<td>$ 289</td>
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<tr>
<td>Monthly Medicare</td>
<td>$ 68</td>
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Total Monthly Deductions $1,339

\[
\text{GMI} \quad \frac{\text{NMI}}{\text{GMI} - \text{Total Monthly Deductions}} \quad \frac{\text{NMI}}{\text{GMI} - \text{Total Monthly Deductions}}
\]

Net Annual Income (NAI) $3,327.67
Budgets in Personal Financial Planning

**What do I need to know about budgets?**
A budget is a plan for spending money. As you can imagine, the budget for the federal government is larger and more complicated than the budget for your family. But they both have categories for spending and amounts of money that can be used in each of those categories. For this unit, you need to know the difference between income and expenses, what common categories are in a household budget, how to calculate the amount of money that can be spent in each category, and how your goals and the things you want to buy affect your budget decisions.

**Who uses a budget?**
Any time people figure out if they have enough money to buy something or decide how to spend their money, they are practicing elements of budgeting. The federal government uses a budget, your school has a budget, the local hair salon has a budget, the committee to plan a field trip has a budget, and most households have a budget. Any person, organization, business, or institution that needs to decide how to spend money uses a budget.

**Where would I find a budget?**
Many families have a written budget showing how much will be spent in categories like rent, utilities, food, and clothing. Other people keep exact records of all their expenses and income, adjusting their budget frequently. Still others have a vague idea of where their money goes and keep a budget of sorts in their head.

**How does a person plan a budget?**
Budgets are personal and unique to each situation. There are many decisions to make when creating a budget. Some people choose to spend a greater portion of their money on a new car, while others choose an older car and spend more money on clothes or housing. Some of these decisions influence other decisions. For example, if you choose to buy a large house, then your electric bills also will be large. If you have a lot of medical expenses, you probably don’t have as much money to spend on recreation or vacations. Budgets also must be flexible. When a person’s income changes, the budget usually must change, too.

**Why do I need to know about budgeting?**
Sooner or later, you will have to plan your own budget. Learning what categories are included in most personal budgets and the percentages of income people usually spend in each category will prepare you for this task. To ensure a sound financial future, planning is a must. Budgeting is a very important part of this planning. A budget helps outline income and planned expenditures for a specific time period.

**When would I use a budget?**
Whenever you have to plan how to spend money, you are budgeting. As you take on more responsibilities—including a job, car, place to live, pets, possessions, and a family—you will need to determine how much money you have to spend on each of these categories. In preparation for these future responsibilities, you will practice creating a household budget during class and at JA Finance Park.
Budget Categories and Decisions

Introduction
The budget-planning process can be compared to a puzzle. You move the pieces around until they fit. Of course, “fit” means to avoid overspending or even to have money left over.

When planning a budget, some people first subtract a portion of their net monthly income to save. This ensures that money will be set aside for long-term goals before they have the chance to spend it on something else.

Next, many budget for primary expenses, such as housing, utilities, transportation (car payments and fuel, for example), health insurance, and medical expenses. These payments are for necessities and should be paid first.

Decisions made on primary expenses, or those expenses that are not necessities, obviously affect secondary expenses. You can only spend what you have left. For example, you can only spend as much on entertainment as your budget allows, or be willing to give up something else if you want to spend more. Economists define opportunity cost as the next best alternative given up when making a choice. If more money is needed for clothes, then perhaps less could be spent on eating out or recreation. Budget decisions in one category will affect decisions in other categories.

Now You Try It
Brainstorm possible budget categories:

________________________________________________________________________
________________________________________________________________________
________________________________________________________________________

A budget, as a written log of income and expenses, will record primary expenses and secondary expenses to be paid. Some examples of each are:

<table>
<thead>
<tr>
<th>Primary</th>
<th>Secondary</th>
</tr>
</thead>
<tbody>
<tr>
<td>Housing</td>
<td>Accessories</td>
</tr>
<tr>
<td>Utilities</td>
<td>Household repairs</td>
</tr>
<tr>
<td>Health/life insurance</td>
<td>Appliances, furnishings</td>
</tr>
<tr>
<td>Medical/dental expenses</td>
<td>Entertainment</td>
</tr>
<tr>
<td>Transportation</td>
<td>Charitable giving</td>
</tr>
<tr>
<td>Food</td>
<td>Miscellaneous</td>
</tr>
<tr>
<td>Clothing</td>
<td></td>
</tr>
</tbody>
</table>
How Do I Use this Personal Financial Knowledge and Planning in JA Finance Park?

As consumers, most of us have incomes and expenditures. As these two factors become more complicated, it becomes helpful to have a budget. To promote further understanding of the concept of budgeting and to provide some actual practice for your day at JA Finance Park, you will develop a typical monthly budget. You will be successful if you balance your income and expenditures and have a little extra income at the end of the month.

For this budget simulation, you will receive a Life Situation Card chosen randomly, which describes an imaginary life status (including job, salary, marriage status, and number of children in the family) and provides information that is necessary before you can begin to plan your budget. After deducting taxes, you will calculate your net monthly income (NMI) to find out exactly how much money is available to spend each month. You will study a family budget that provides typical budget percentages. Using these percentages as a guide, you will determine the maximum amount that may be spent in each of the given categories. Once you know how much is available to spend in each category, you will collect option sheets that list what is available for each category, in the price range that best suits your income. Don’t forget that while you search and make decisions, you must provide for the needs and wants of your spouse and children, as well as yourself.

Once you have found and compared budget options, you must make a final decision on how to spend your allotted money in each category. This will involve setting priorities for the budget areas that are considered most important. Remember, you have a maximum and a minimum amount to spend in each area.

You must spend within that range for each budget category. Creating a budget is a lot like working a puzzle—every little piece must fit in order for it to work.
Practicing Net Monthly Income (NMI)

Using the sample Life Situation data below, complete Lines 1–9 to calculate your net monthly income (NMI). Use your Life Situation Card to identify your federal income tax, Social Security tax, and Medicare tax amounts, along with your gross annual income (GAI).

Sample Life Situation Card

<table>
<thead>
<tr>
<th>Bank Teller</th>
<th>Monthly federal income tax: $258</th>
</tr>
</thead>
<tbody>
<tr>
<td>Annual Salary: $26,000</td>
<td>Single</td>
</tr>
<tr>
<td>You drive nine miles to and from work.</td>
<td>No children</td>
</tr>
</tbody>
</table>

Calculating NMI

1. Gross annual income (Life Situation Card) $
2. Gross monthly income (divide Line 1 by 12 months) $
3. Monthly federal income tax amount (Life Situation Card) $
4. Monthly Social Security tax amount (Life Situation Card) $
5. Monthly Medicare tax amount (Life Situation Card) $
6. Total monthly taxes (total Lines 3, 4, and 5) $
7. Monthly income (Line 2 minus Line 6) $
8. Additional monthly income, if any. $

9. Net Monthly Income (NMI) (total Lines 7 and 8) $

Transfer Line 9 (Net Monthly Income) to the NMI line on the Budget Guidelines worksheet on the next page.
Practicing Budget Guidelines

Using the formula percentages provided, calculate all of the minimum and maximum guideline percentages for each of the budget categories, and write the amounts on the lines provided. Refer to these amounts as you begin to make your budget decisions. All budget decisions must be between the minimum and maximum guidelines listed.

**Formula:** Maximum Guideline Percentage x NMI = Maximum Guideline Amount

**Example:** \(0.17 \times 2,365 = 402.05\) (Percent written as a decimal. Ex: 17% = .17)

<table>
<thead>
<tr>
<th>Budget Category</th>
<th>Minimum Guideline Percentage</th>
<th>Minimum Guideline Amount</th>
<th>Maximum Guideline Percentage</th>
<th>Maximum Guideline Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Housing (rent/mortgage)</td>
<td>18% of NMI</td>
<td>$</td>
<td>24% of NMI</td>
<td>$</td>
</tr>
<tr>
<td>Utilities</td>
<td>3% of NMI</td>
<td>$</td>
<td>7% of NMI</td>
<td>$</td>
</tr>
<tr>
<td>Electric/Power</td>
<td>3% of NMI</td>
<td>$</td>
<td>7% of NMI</td>
<td>$</td>
</tr>
<tr>
<td>Telephone</td>
<td>1% of NMI</td>
<td>$</td>
<td>5% of NMI</td>
<td>$</td>
</tr>
<tr>
<td>Sewer/Water</td>
<td>1% of NMI</td>
<td>$</td>
<td>5% of NMI</td>
<td>$</td>
</tr>
<tr>
<td>Transportation—Fixed (payment/insurance)</td>
<td>9% of NMI</td>
<td>$</td>
<td>13% of NMI</td>
<td>$</td>
</tr>
<tr>
<td>Transportation—Variable (gas, oil, and repairs)</td>
<td>4% of NMI</td>
<td>$</td>
<td>8% of NMI</td>
<td>$</td>
</tr>
<tr>
<td>Food, Household, and Personal Hygiene</td>
<td>16% of NMI</td>
<td>$</td>
<td>20% of NMI</td>
<td>$</td>
</tr>
<tr>
<td>Health, Life, Medical and Dental</td>
<td>1% of NMI</td>
<td>$</td>
<td>7% of NMI</td>
<td>$</td>
</tr>
<tr>
<td>Plan Your Future (savings/investment)</td>
<td>1% of NMI</td>
<td>$</td>
<td>Personal Choice</td>
<td>$</td>
</tr>
<tr>
<td>Clothing and Accessories</td>
<td>3% of NMI</td>
<td>$</td>
<td>7% of NMI</td>
<td>$</td>
</tr>
<tr>
<td>Home Improvement and Furniture</td>
<td>8% of NMI</td>
<td>$</td>
<td>12% of NMI</td>
<td>$</td>
</tr>
<tr>
<td>Entertainment and Recreation</td>
<td>2% of NMI</td>
<td>$</td>
<td>6% of NMI</td>
<td>$</td>
</tr>
<tr>
<td>Cable TV</td>
<td>1% of NMI</td>
<td>$</td>
<td>3% of NMI</td>
<td>$</td>
</tr>
<tr>
<td>Dining Out</td>
<td>1% of NMI</td>
<td>$</td>
<td>5% of NMI</td>
<td>$</td>
</tr>
<tr>
<td>Charity Contribution</td>
<td>1% of NMI</td>
<td>$</td>
<td>Personal Choice</td>
<td>$</td>
</tr>
<tr>
<td>Unforeseen/Miscellaneous</td>
<td>1% of NMI</td>
<td>$</td>
<td>5% of NMI</td>
<td>$</td>
</tr>
</tbody>
</table>
Practicing Investment Portfolio Tracking

Many people think investing is only for the rich. Nothing could be further from the truth. Starting a savings and investment plan is a difficult step, but, the earlier you begin investing, the more money you will earn. Time is money!

A stock’s value can change at any moment, depending on the market and other conditions. The market report (stock reports), printed daily in the business section of the newspaper, keeps investors up to date on what’s happening in the investment market.

Like most Americans today, you are concerned about your financial future. Whether you were fortunate enough to receive your investment portfolio as a family inheritance, or you saved and invested wisely, is not important. What is important is that you take the responsibility to begin building your stock portfolio.

Create your stock portfolio by selecting three stocks that interest you. Write those stocks on the three lines below and on the Personal Investment Report worksheet. You will receive information about the number of shares you own on your Life Situation Card. For five days during this simulation, you will review your stock value in the stock reports of your local newspaper. You must determine the value of each stock and record it on the Personal Investment Report. At the end of the five days, you will be able to see the growth or decline of your total portfolio. Remember, to determine the current value of your stock each day, you must multiply the number of shares you own by the price at the close of that day.

Stock Value Formula

**Formula:** Number of Shares x Close Price = **Total Value of Stock**

**Example:**
- Apple Computer: 70 x $46.50 = $3,255.00
- General Electric: 50 x $43.25 = $2,162.50
- America Online: 50 x $19.75 = $987.50

**Total Value of Portfolio** = $6,405.00

Select three stocks and determine their value for today:

<table>
<thead>
<tr>
<th>Stock Name</th>
<th># of Shares</th>
<th>Close Price</th>
<th>Total Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>______________</td>
<td>__________</td>
<td>__________</td>
<td>__________</td>
</tr>
<tr>
<td>______________</td>
<td>__________</td>
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</tr>
<tr>
<td>______________</td>
<td>__________</td>
<td>__________</td>
<td>__________</td>
</tr>
</tbody>
</table>

**Total Value of Portfolio** = $________