

Budgets and Financial Records

8.1 *Budgeting and Planning*

8.2 *Legal Agreements and Record Keeping*

Consider **THIS**

Sarah has a part-time job, attends school six hours a day, and participates in two after-school sports. She no longer receives a monthly allowance from her parents. She pays for all of her own clothes, gas, insurance, and entertainment. Last year, she was able to save over \$600.

“How do you do it?” asked her friend Anna. “I work more hours than you do, my parents pay for my clothes and most of my expenses, and I still don’t have any money left over for entertainment. I didn’t save a dime last year!”

“I have a budget,” said Sarah. “Every time I get paid, I put aside money for savings. I know how much I spend on everything I buy. Keeping a good record of income and expenses helps me plan better, so I don’t run out of money. That doesn’t mean I can buy anything I want, but it does mean that I know how much I can spend, which helps me stretch my money to cover as many things as possible.”

Budgeting and Planning

GOALS

- Explain the purpose of financial planning and prepare a personal budget.
- Explain the need for and create a net worth statement and a personal property inventory.

TERMS

- disposable income, p. 162
- financial plan, p. 162
- budget, p. 163
- fixed expenses, p. 164
- variable expenses, p. 164
- assets, p. 166
- liabilities, p. 166
- net worth, p. 167

FINANCIAL PLANNING BASICS

Do you have unlimited resources to buy all the things you want? Some people do, but if you are like most Americans, to achieve financial success, you will have to plan and work for it. Planning, budgeting and keeping good records provide the road map that leads to financial security.

GETTING STARTED

We all have to start somewhere. Even if you don't have much income, it will help to make a plan. There are two elements to consider—your income and your expenses. Your gross income is important, but it doesn't represent money over which you have control. Your **disposable income** is the money you have left to spend or save after taxes and other required deductions are taken. If you spend all of your income, there won't be money to set aside for the future. In order to use your income to your best advantage, you need a financial plan.

All the money you receive is spent, saved, or invested. You may spend it for things you need or want, save it for future needs, or invest it to earn more money. A **financial plan** is a set of goals for spending, saving, and investing the money you receive. Financial planning helps you do the following:

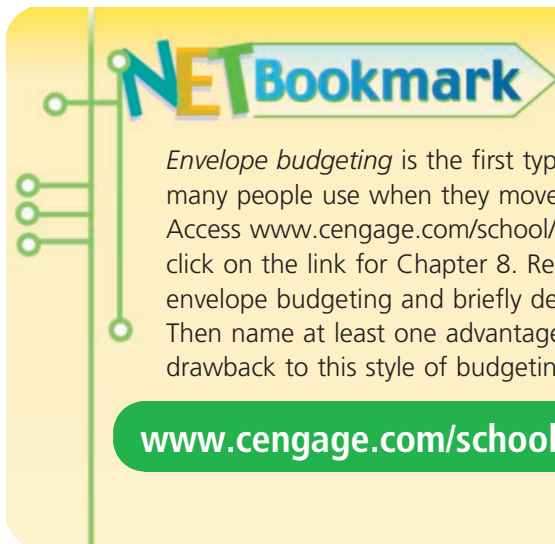
- Determine and evaluate your choices.
- Prioritize your choices so your money goes as far as possible.
- Avoid careless and wasteful spending.
- Organize your financial resources (sources of income) so you can achieve your financial goals.
- Avoid money worries by planning your saving, spending, and borrowing to live within your income.

The first step in financial planning is understanding your *resources*—the sources and amounts of money you expect to receive—as well as understanding your obligations. Before you can prepare a budget, you may wish to keep track of money coming in and going out for a month or two. This will give you a clearer idea of what you can expect. Many people keep a journal or log where they record everything they spend. They may keep receipts for cash items. This

record forms the basis of understanding what's going on in your current financial picture.

VISUALIZING YOUR FUTURE

Once you have a good idea of what comes in and how it goes out, you can then start thinking about ways you'd like to change that. For many people, just keeping track of what you receive and how you spend it makes a difference. When people can actually see how much they spend on something, they may decide there are other things they'd rather do. But taking the next step—actually preparing a budget—will take your financial planning visions to reality.



Envelope budgeting is the first type of budget system many people use when they move out on their own. Access www.cengage.com/school/pfinance/mypf and click on the link for Chapter 8. Read the article about envelope budgeting and briefly describe how it works. Then name at least one advantage and one possible drawback to this style of budgeting.

www.cengage.com/school/pfinance/mypf

PREPARING A BUDGET

The next step toward achieving your financial goals is to prepare a budget. A **budget** is a spending and saving plan based on your expected income and expenses. In a budget, money coming in (earnings plus borrowing) must equal money going out (spending plus saving). The budget must balance. A budget helps you plan your spending and saving so that you won't have to borrow money or use credit to meet your daily needs.

Steps in Preparing a Budget

The steps in preparing a budget are as follows:

1. Estimate your total expected income for a certain time period. Include all money you expect to receive. Use a weekly, biweekly, or monthly budget—whichever best matches how often you expect to receive money.
2. Estimate your expenses, or money you will need for day-to-day purchases—for example, lunches, fees, personal care items, and clothing.
3. Decide how much of your income you want to save—to set aside for future needs. Most experts advise saving 10 percent of your disposable income each pay period. By saving, you will have money to pay for future needs, both expected and unexpected.
4. Balance your budget. If your expenses plus savings exceed your income, adjust your budget to make them balance. To do this, you may have to delay buying some items you want but don't need. Or, you may decide to save a little less this month. If you can't cut your expenses, then you have to increase your income.

Figure 8.1 on the next page shows a high school student's budget for one month. This student expects to receive a total of \$380 and plans to use the money for certain needs and wants and to save part of it as well. Notice that the total income equals the total of expenses plus savings. The budget balances.

A Typical Monthly Budget

Some people create a monthly budget by taking an annual budget and dividing it into 12 months. This can be very helpful for those people who do

FIGURE 8.1 *Simple Budget*

Evan Anderson Budget for September	
Income	
Part-time job (15 hours/week)	\$320
Allowance for household chores	20
Birthday gift (check from grandparents)	<u>40</u>
Total Income	<u>\$380</u>
Expenses	
Daily lunches	\$ 80
Supplies	20
Clothes	40
Entertainment (movies and golfing)	<u>140</u>
Total expenses	\$280
Savings	
Credit union account	<u>\$100</u>
Total expenses plus savings	<u>\$380</u>

not have a regular monthly income. A budget will help them plan and adjust spending to cover expenses during the low-income times.

Figure 8.2 shows a monthly budget for a married couple. Mike and Jennifer both work and have no children. They estimate their income by adding together the net pay from both of their paychecks. They also expect income from savings and investments.

There are two types of expenses. **Fixed expenses** are costs that do not change from month to month. You are obligated to pay them regardless of income changes. For example, people must pay rent or a house payment, utility bills, a car loan, and insurance premiums when they are due. Most financial experts recommend that a family have fixed expenses of no more than 50 to 60 percent of take-home, or net, pay. However, this standard is difficult to achieve for young people just starting life on their own. But with time, pay raises, and careful budgeting, a family can achieve that goal.

Variable expenses are costs that vary in amount and type, depending on the choices you make. For example, your grocery bill can be larger or smaller, depending on what you choose to buy. Other examples of variable expenses are costs for eating out, going to movies, and buying clothes.

Mike and Jennifer aren't sure how much they can save each month. By subtracting estimated expenses from estimated income, they determine that they have a *cash surplus* (income exceeds expenses). They apply the cash surplus to savings, which is approximately 12 percent of their monthly income ($\$430 \div \$3,500$). This enables them to set aside money for emergencies, short-term savings, and long-term investing.

FIGURE 8.2**Budget for a Couple****Mike and Jennifer Harris Budget**

	Monthly	Yearly
Income		
Salary (Mike) after taxes	\$1,600	\$19,200
Salary (Jennifer) after taxes	1,800	21,600
Interest on savings	50	600
Earnings on investments	<u>50</u>	<u>600</u>
Total income	<u>\$3,500</u>	<u>\$42,000</u>
Expenses		
Fixed expenses:		
Rent	\$1,000	\$12,000
Utilities	150	1,800
Car payment	300	3,600
Insurance:		
Car	100	1,200
Life and Health	<u>75</u>	<u>900</u>
Total fixed expenses	\$1,625	\$19,500
Variable expenses:		
Cell phones	\$ 60	\$ 720
Gasoline	150	1,800
Car repairs and maintenance	60	720
Cable/Internet	90	1,080
Groceries	400	4,800
Clothing	200	2,400
Personal care:		
Dry cleaning, household	50	600
Medicine, cosmetics	50	600
Insurance deductibles and co-pays	50	600
Recreation and entertainment	100	1,200
Gifts, donations, miscellaneous	<u>300</u>	<u>3,600</u>
Total variable expenses	<u>\$1,510</u>	<u>\$18,120</u>
Total fixed and variable expenses	<u>\$3,135</u>	<u>\$37,620</u>
Cash surplus (total income minus total expenses)	\$ 365	\$ 4,380
Savings (allocation of cash surplus)		
Emergency savings fund	\$ 35	\$ 420
Short-term savings	100	1,200
Long-term investments	<u>230</u>	<u>2,760</u>
Total savings and investments	<u>\$ 365</u>	<u>\$ 4,380</u>
Total expenses plus savings	<u>\$3,500</u>	<u>\$42,000</u>

PERSONAL RECORDS

Good personal records makes budgeting and long-range planning easier. Your records also make it easier to prepare income tax returns, credit applications, and other financial forms. You should keep five types of personal records: income and expense records, your net worth statement, a personal property inventory, tax records, and other miscellaneous documents.

INCOME AND EXPENSES RECORDS

Your W-2 forms show the money earned and deductions taken from your paycheck during the year. The W-2 forms also state the amount of taxes, including Social Security taxes, withheld. You may need these forms later as proof of earnings and deductions when you want to collect benefits, such as Social Security. Other records of income include statements from banks showing interest earned on savings and statements from investment companies listing dividends earned from stock or other investments.

Expense items include receipts listing charitable contributions, medical bills, or work-related expenses. When you prepare your budgets and tax returns, these receipts and statements serve as documentation (proof) of income and expenses. Store these documents in a safe place for future reference.

NET WORTH STATEMENT

A *net worth statement*, such as the one shown in Figure 8.3, shows a person's net worth based on his or her assets and liabilities. **Assets** are items of value that a person owns. Assets accumulate over your lifetime and are called wealth. A wealthy person has many assets of different types, from cash in accounts to real estate owned.

Money or debts you owe to others are called **liabilities**. A responsible person plans to pay off his or her debts in the future. Short-term liabilities will be paid

FIGURE 8.3 Net Worth Statement

Net Worth Statement Anisa Newkirk January 1, 20—			
Assets		Liabilities	
Checking account	\$ 500	Loan on car	\$1,800
Savings account	800	Loan from parents	<u>100</u>
Car value	3,000	Total liabilities	\$1,900
Personal property: (inventory attached)	<u>5,000</u>		
Total assets	<u>\$9,300</u>	Net Worth	
		Assets minus liabilities	<u>\$7,400</u>
		Total	<u>\$9,300</u>

off soon, usually within a year or less. This might be money you borrowed from a friend. Long-term liabilities are paid off over several years, such as a car loan.

When you subtract your liabilities from your assets, the difference is known as **net worth**. As net worth increases, you are growing in overall wealth. Over time, your assets are increasing while you are paying off debts. When assets are greater than liabilities, a person is said to be *solvent*, or in a favorable financial position. When liabilities are greater than assets (you owe more than you own), a person is said to be *insolvent*, or in a poor financial position. Many people are insolvent at certain times during their lives, such as when they are attending college and until they can get a good job to start paying off their student loans.

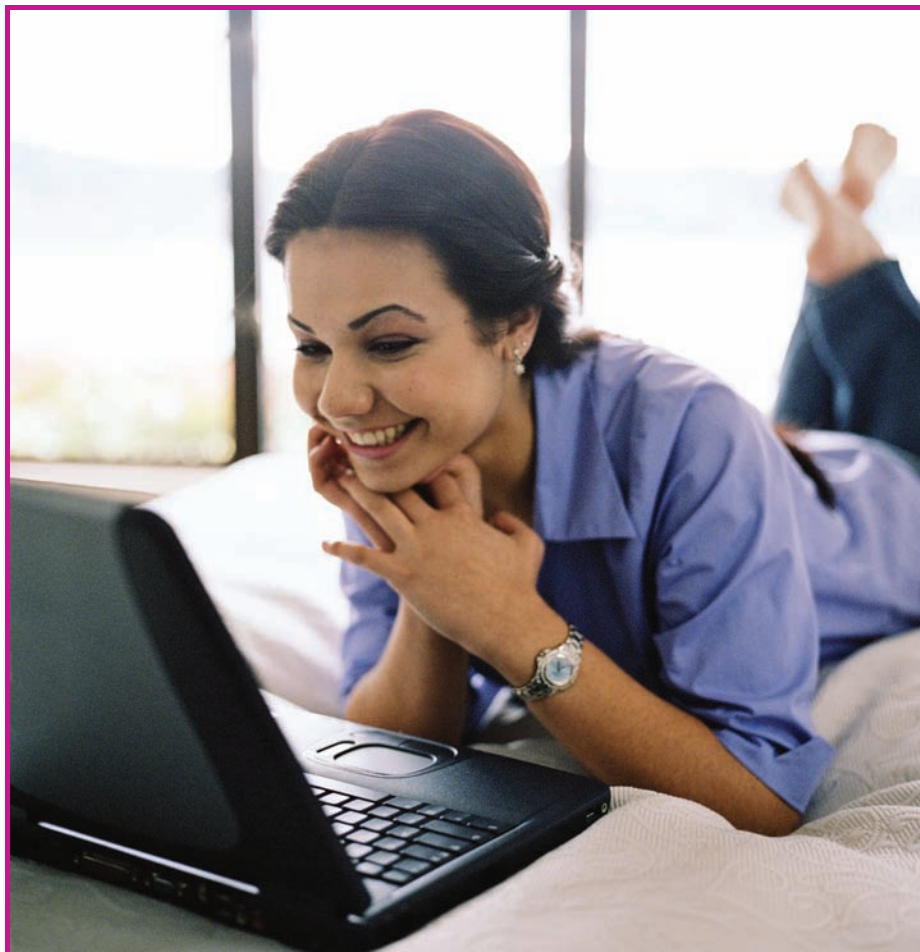
You will need your net worth information (lists of assets and liabilities) when you apply for a loan or credit. The bank or other financial institution will want you to be a good risk—a person who will likely pay back the loan. A net worth statement also helps you keep track of how you spend your money and what you have to show for it at the end of the year. If you create a net worth statement yearly throughout your life, you can check to be sure that your financial position is improving over time.

■ PERSONAL PROPERTY INVENTORY

A *personal property inventory* is a list of the valuable items you own, along with their purchase prices and approximate current values. Personal property includes anything of value inside your home—clothing, furniture, appliances, and so forth. A personal property inventory is useful in the event of fire, theft, or property damage. The inventory will help you list lost items and their value when you make an insurance claim. As a further safeguard, photograph items of value, attach the photographs to the inventory, and keep this information in a safe deposit box or other secure place to use as evidence in the event the property is damaged, lost, or stolen.

A personal property inventory also helps you see what you have to show for the money you have spent. It should include other items you own as well, including investments, savings accounts, and CDs. Reviewing it will help you assess your spending patterns. As you buy new items and dispose of others, you should revise the inventory.

Figure 8.4 is a personal property inventory for a young adult. Keeping track of your assets is a good idea.



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What items would you include in your personal property inventory?

FIGURE 8.4**Personal Property Inventory**

Personal Property Inventory Anisa Newkirk January 2, 20—			
Item	Year Purchased	Purchase Price	Approximate Current Value
Sphinx XTL DVD Player with big-screen TV	2008	\$ 3,200	\$1,300
Bedroom furniture (bed, dresser, lamp, clock)	2006	2,000	1,200
Clothing, jewelry	-----	3,000	500
MBD motor bike	2005	1,800	1,000
CD collection, digital camera, scanner, CD burner	2006	<u>2,000</u>	<u>1,000</u>
		<u>\$12,000</u>	<u>\$5,000</u>

TAX RECORDS

All taxpayers should keep copies of their tax records for at least three years after they file their tax return. *Tax records* include the tax return itself (a copy of the signed form), W-2 forms, and other receipts verifying income and expenses listed on each return. Keep your tax records in a safe place in case of an audit. The IRS has the legal right to audit your tax returns and supporting records for three years from the date of filing (longer if fraud or intentional wrongdoing on your part can be proved).

OTHER RECORDS

Many consumers also keep lists of credit card numbers and phone numbers to call if those cards are lost or stolen. As a part of your financial plan, it's a good idea to reflect on the number of credit accounts you have along with the balances for each, the interest rates being charged, and the monthly payments required. It's important to use credit wisely. You must have good credit for the times when you will need it (such as buying a house), but you must also be careful not to overuse credit and hurt your ability to plan for your financial future.

You may choose to keep other records as well, including the following:

- Car titles
- Insurance policies
- Birth and marriage certificates
- Passports

These documents are sometimes needed for certain financial transactions. The original documents should be placed in a safe place (such as a safe deposit box), and photocopies should be kept for easy reference.

ISSUES IN YOUR **WORLD**

LIVING WITHIN YOUR INCOME

To be financially responsible, you must recognize that you are responsible for your own financial future.

A balanced personal budget is the first step to financial security. Living within your income means that you spend less than you make and that you plan savings for future as well as current needs.

Setting financial goals is the next step to securing your financial future. You can't achieve future financial goals if you aren't paying your current bills on time.

It is easy to believe advertisements that create demand. Emotional appeals are designed to get you to buy things you don't need in order to be more popular or to keep up with your friends. Ask yourself the following questions:

- *Do I need it?*
- *Why am I buying it?*
- *How else could I spend the same money?*
- *How will buying it affect my financial goals?*

Many people have a limit on how much money they will spend without a careful analysis and a family decision to spend the money. Whatever your limit, before spending a large sum or accepting a loan that will take a big bite from your future earnings, think through the decision carefully.

Living within your income is an important part of being happy. Regardless of the amount of your income, careful planning and budgeting can enhance your lifestyle and secure your future.

THINK CRITICALLY

1. *Make a list of things you'd like to have, along with the purchase price of each. Read this list a week from now. Do you still want the same things? If so, what do you plan to do to buy one or more of them?*
2. *Do you know people who live within their income? If so, ask one of them to share how he or she does it. Based on the advice you receive, create a list of budgeting tips.*
3. *Do you know people who live beyond their income? What do you observe about their stress, financial stability, and financial goals?*

Assessment

KEY TERMS REVIEW

Match the terms with the definitions.

- ___ 1. Costs that change in amount and type, based on your choices
- ___ 2. A spending and savings plan
- ___ 3. Money you have left to spend each month
- ___ 4. The difference between assets and liabilities
- ___ 5. Costs that do not change from month to month
- ___ 6. Debts you owe to others
- ___ 7. A set of goals for spending, saving, and investing money
- ___ 8. Items of value that you own

- a. assets
- b. budget
- c. disposable income
- d. financial plan
- e. fixed expenses
- f. liabilities
- g. net worth
- h. variable expenses

CHECK YOUR UNDERSTANDING

- 9. What is the first step in budgeting?
- 10. How are fixed expenses different from variable expenses?
- 11. Why would you prepare a net worth statement?

APPLY YOUR KNOWLEDGE

- 12. Using Figure 8.1 as a model, prepare a simple budget for yourself. If your budget does not balance, make adjustments until it does. How much will you set aside for savings? Assume that you can set aside this same amount each month. Locate a savings planner tool and calculate your total savings after 12 months, at 6 percent interest, starting with \$0 savings.

THINK CRITICALLY

- 13. Financial planning should begin early in your life. Many people revise their plans as major life events occur, such as getting married or having children. Explain how a financial plan is based on personal values and choices and why some people choose not to do any planning.
- 14. Why is it important to save personal records, such as receipts and credit card statements? Provide an example of a time when you did not save something and found that you later needed it.

Legal Agreements and Record Keeping

GOALS

- List the elements of a legally binding agreement.
- Design an effective filing system for your personal records.

TERMS

- contract, p. 171
- counteroffer, p. 173
- consideration, p. 173
- notarized, p. 174
- negotiable, p. 175
- co-signer, p. 175
- warranty, p. 176
- spreadsheet, p. 178
- database, p. 178

LEGALLY BINDING AGREEMENTS

As your finances become more complex, it is likely that you will enter into legally binding agreements. A **contract** is a legally enforceable agreement between two or more people. For example, if you buy a suit and you want it altered, the sales clerk fills out a ticket. The ticket lists the changes requested and the promised date of completion. This ticket is a contract between you and the store. The store agrees to make the alterations by the stated date and for the stated price, and you agree to pay the price.

Other common legal agreements are credit accounts, mortgage loans, and rental agreements. When you sign up for a retail credit card, the store agrees to give you products now in exchange for payment on your account later. When you rent an apartment, the landlord agrees to let you live in the apartment, and you agree to pay the rent by a certain day each month. Each of these cases constitutes an *express contract*. Express contracts can be oral or written. What makes them express is that the parties have stated the terms of their agreement in words.

Figure 8.5 shows a credit application from a retail store. A credit application asks you to agree to certain conditions before opening an account. Attached to the application will be an explanation of finance charges and how they are computed. When you sign the application, you are agreeing to pay finance charges if your balance is not paid in full each month. Be sure you have read everything contained in the agreement before you sign it. If something is not clear, ask for an explanation so you can understand your rights and responsibilities before you enter into the contract.



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Why do people enter into legal agreements?

In addition to written agreements, you take part in many unwritten agreements. An *implied contract* is not written but is created by the actions or conduct of someone. The “terms” of an implied contract are assumed. For example, suppose you mow your neighbor’s lawn and she pays you \$25. You continue to mow her lawn, and she continues to pay you. This is an implied contract based on the actions of each person. One person accepts something of value, knowing that the other person expects something of value in return. Although the terms of your agreement were never explicitly stated, it would be unfair or unjust if the neighbor stops paying you for mowing her lawn.

FIGURE 8.5

Credit Application

CREDIT CARD APPLICATION (Please print. Not valid unless signed below.)			
Title (optional): Mr. <input checked="" type="checkbox"/> Mrs. <input type="checkbox"/> Ms. <input type="checkbox"/> Other _____			
First Name	<u>Richard</u>	MI	<u>J</u> Last Name <u>Washington</u>
Street Address	<u>45 Cleveland Avenue</u>		Apt. # _____
City	<u>Portland</u>	State	<u>OR</u> Zip + 4 <u>97201-1072</u>
Home Phone	<u>(513) 555-0181</u>	Business Phone	<u>(513) 555-9213</u> E-Mail _____
Soc. Sec. #	<u>999-00-9384</u>	Est. Monthly Charges	<u>\$100.00</u> # Cards Desired <u>1</u>
Former Address _____ (if less than 1 year at current address)			
City	_____	State	_____ Zip + 4 _____
Mother's Maiden Name	<u>Hawkins</u>	Years Employed	<u>3</u> Position <u>Payroll specialist</u>
Present Housing: Own <input type="checkbox"/> Rent <input checked="" type="checkbox"/> Live with Parents <input type="checkbox"/>			
# of Dependents (exc. self) <u>1</u> Student? Full <input checked="" type="checkbox"/> Part <input type="checkbox"/>			
<p>Note: An applicant, though married, may apply for a separate Account in his or her own name. If your spouse will use this Account, please indicate his or her name, and social security number for credit reporting purposes.</p>			
First Name of Spouse	<u>----</u>	MI	<u>----</u> Last <u>-----</u> Soc. Sec. # _____
<p>I HAVE READ AND AGREE TO BE BOUND BY THE TERMS OF THIS APPLICATION (INCLUDING THE ADDITIONAL APPLICATION PROVISIONS AND ACCOMPANYING FEDERAL AND STATE NOTICES AND SUMMARY OF CREDIT TERMS PRINTED TO THE RIGHT AND BACK).</p>			
<p>I understand and agree that if I am approved for an Account, (i) the Central Credit Bank, N.A., Retail Installment Credit Agreement (the “Agreement”) that I will receive with my credit card, will govern my Account, (ii) the Agreement is incorporated by reference into and made a part of the Application, and (iii) THE AGREEMENT INCLUDES AN ARBITRATION PROVISION THAT MAY SUBSTANTIALLY LIMIT MY RIGHTS IN THE EVENT OF A DISPUTE, INCLUDING MY RIGHT TO LITIGATE IN COURT OR HAVE A JURY TRIAL, DISCOVERY AND APPEAL RIGHTS, AND THE RIGHT TO PARTICIPATE AS A REPRESENTATIVE OR MEMBER OF A CLASS IN A CLASS ACTION. I MAY REQUEST THE COMMERCIAL ARBITRATION RULES OF THE AMERICAN ARBITRATION ASSOCIATION, WHICH SERVES AS ARBITRATION ADMINISTRATOR, BY CALLING 1-800-555-0155. I understand and agree that the Bank will first consider this application with respect to the credit card program described in this application. If for any reason, at the Bank’s sole discretion, I do not qualify for this program, I request the Bank consider this application with respect to alternative credit card programs. My signature on this Application represents my signature on the Agreement.</p>			
<p>NOTICE TO THE APPLICANT: (1) DO NOT SIGN THIS APPLICATION/AGREEMENT BEFORE YOU READ IT OR IF IT CONTAINS ANY BLANK SPACES. (2) YOU ARE ENTITLED TO A COMPLETELY FILLED IN COPY OF THE RETAIL INSTALLMENT CREDIT AGREEMENT</p>			
<p>x <u>Richard J. Washington</u> Signature of Card Applicant</p>		<p><u>3/11/--</u> Date</p>	

■ CONTRACT ELEMENTS

To accomplish its purpose, a contract must be *binding*. That is, all who enter into the contract are legally bound to abide by its terms. A contract is legally binding when it contains these four elements:

- Agreement
- Consideration
- Contractual capacity
- Legality

Agreement

A contract has legal agreement when a valid offer is made and accepted. Both the *offer* (made by a person called the offeror) and *acceptance* (made by a person called the offeree) must express a voluntary intent to be bound. When one person makes an offer and another person changes it, the second person is making a counteroffer. The **counteroffer** is a new offer because it changes the original offer. It has to be accepted or rejected by the first person.

On the Internet, you may click on an “acceptance” of an offer. This click-on acceptance is considered a voluntary intent to be bound. If you do not intend to enter a binding agreement, or if you accidentally hit the wrong button, notify the online seller immediately of your error (and lack of intent to be bound).

It is important that both parties to an agreement genuinely agree to the contract terms. Genuine agreement does not exist when there is a mistake, fraud (an intentional misrepresentation), duress (threats), or undue influence (having free will overcome by a person who has a special interest, such as a parent or guardian).

Consideration

Consideration is something of value exchanged for something else of value. Consideration may be an item of value, money, a promise, or a performed service. If one person is to receive something but gives nothing in return, the contract may not be enforceable. The idea behind consideration is that each party to the agreement receives something of value. When you buy a pair of shoes, you get the shoes and the store gets your money. The shoes and the money are items of consideration.

Contractual Capacity

Contractual *capacity* refers to the competence (legal ability) of the parties to enter a contract. Competent parties are people who are legally capable of agreeing to a



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Why is consideration an important element of a contract?

binding offer. Those who are unable to protect themselves because of mental deficiency or illness, or who are otherwise incapable of understanding the consequences of their actions, cannot be held to contracts. Minors have *limited contractual capacity*, which means that they may legally set aside contractual obligations. This privilege is allowed in order to protect minors from those who would take advantage of them.

Legality

To be legally enforceable, a contract must have a lawful purpose. A court will not require a person to perform an agreed-upon act if it is illegal. Some contracts must have a special form in order to be legally enforceable. For example, a contract for sale of real estate would have to contain a specific legal description of the property. A deed to transfer title to property would have to be notarized. When a document is **notarized**, the signature is verified by a notary public, who then applies a notary seal.

■ STATUTE OF FRAUDS

Every state has a statute of frauds. The purpose of this law is to prevent harm due to fraudulent conduct. This law requires that some contracts be in writing and signed to be legally binding. Examples include the following:

- Contracts for the sale of real property (homes and land)
- Contracts that cannot be fully performed in less than a year
- Contracts involving the sale of goods for \$500 and over
- Contracts in which one person agrees to pay the debts of another
- Contracts in consideration of marriage

These types of agreements must be in writing because they involve special rules. For example, a *prenuptial agreement* is a contract that specifies what will happen if a marriage ends in divorce. Generally, if two parties of unequal wealth enter into a marriage, a prenuptial agreement may be required in which the person without wealth agrees that he or she will receive a set amount as a settlement, rather than half of what the other person owns, if the marriage ends. This type of agreement serves to protect an individual's assets from a spouse who may have entered into the marriage fraudulently for financial gain.

■ RESPONSIBILITIES IN AGREEMENTS

When people enter into contracts, they have several responsibilities. They should do the following:

- Fill in all blank spaces or indicate N/A for items that are not applicable.
- Write all terms clearly. Vague phrases are often not enforceable.
- Enter dates, amounts, and other numbers correctly and clearly.
- Be sure the seller has supplied all relevant information, including rate of interest, total finance charges, cash payment price, and so on.
- Understand all terms contained in the agreement. Do not sign it until you have read it. Your signature acknowledges that you have read and understood the contract.
- Check that no changes have been made after you have signed it. Your initials at the bottom of each page will prevent substitution of pages.
- Keep a copy of the agreement. Put it in a safe place for future use.

Although as a consumer, you are protected by numerous consumer protection laws, you may need legal services occasionally. Your best protection is to arm yourself in advance by understanding the agreements into which you enter.

■ NEGOTIABLE INSTRUMENTS

In contracts, the word **negotiable** means legally collectible. A negotiable instrument is an unconditional written promise to pay a specified sum of money upon demand of the holder. The negotiable instruments most people use are checks (discussed in Chapter 9) and, to a lesser extent, promissory notes.

A promissory note, like the one shown in Figure 8.6, is a written promise to pay a certain sum of money to another person or to the holder of the note on a specified date. A promissory note is a legal document, and payment can be enforced by law.

The person who creates and signs the promissory note and agrees to pay it on a certain date is called the *maker*. The person to whom the note is made payable is known as the *payee*. A promissory note is normally used when borrowing a large sum of money from a financial institution.

In some cases, creditors (those extending credit) will require a co-signer with a good credit rating as additional security for repayment of a note. A **co-signer** is a person who promises to pay the debt of another person. The co-signer's signature is also on a note. Young people and people who have not established a credit rating are often asked to provide a co-signer for their first loan. If someone asks you to co-sign a loan, do so only if you are sure the person is financially responsible. If that person fails to repay the debt, you will be legally responsible to repay it.

When one person agrees to pay the debts of another person, that agreement must be in writing (signed by the co-signer) to be enforceable.

FIGURE 8.6 Promissory Note

PROMISSORY NOTE	
\$ 400.00	January 15, 20--
I (we) Marilyn Huykamp, jointly and severally,	
do agree and promise to pay to Emerald Furniture Co.	
the sum of Four hundred and 00/100 dollars	
with interest at the rate of 9% from January 15, 20-- , payable in	
monthly installments of \$ 69.67 beginning February 1, 20--	
and on a like day each month until paid in full, the last payment	
due July 1, 20-- . Said payment shall include interest.	
In the event of default, the maker hereof agrees to pay attorneys' fees and	
court costs in collection of this note.	
<div>Marilyn Huykamp</div>	
Maker	

■ WARRANTIES

A **warranty**, also called a *guarantee*, is a statement assuring quality and performance of a product or service. If the product fails, the warranty usually states what remedies are available, such as return of the product for the purchase price or repair of the product at no extra charge. The warranty may be in writing or assumed to exist by the nature of the product. Still, a warranty is not a safeguard against a consumer's poor buying decision.

All products contain *implied warranties*. For example, all products have the warranty of merchantability. This means that a product will do what it is made to do. For example, a new tennis ball must bounce. If it does not bounce, you can return the defective ball, even if there is no written warranty.

Specific *written warranties* often guarantee that a product will perform to your satisfaction for a certain period of time. Many written warranties state that you may return a product for repair or replacement if it ceases to work because of a defect. However, warranties will not protect against normal wear and tear of the product.

Figure 8.7 illustrates a limited warranty that might accompany a home product. Read it carefully to determine what the manufacturer does and does not guarantee.

FIGURE 8.7 *Limited Warranty*

Limited Warranty 12 Y 845

<p>This product is guaranteed for one year from the date of purchase to be free of mechanical and electrical defects in material and workmanship. The manufacturer's obligations hereunder are limited to repair of such defects during the warranty period, provided such product is returned to the address below within the warranty period.</p> <p>This guarantee does not cover normal wear of parts or damages resulting from negligent use or mis-</p>	<p>use of the product. In addition, this guarantee is void if the purchaser breaks the seal and disassembles, repairs, or alters the product in any way.</p> <p>The warranty period begins on the date of purchase. The card below must be received by the manufacturer within 30 days of purchase or receipt of said merchandise. Fill out the card completely and return it to the address shown.</p>
---	---

Owner's Name: _____

Address: _____

City, State, Zip: _____

E-Mail Address: _____

Date of Purchase: _____

Store Where Purchased: _____

Return to: **ALCOVE ELECTRICAL, INC.**
 42 West Cabana
 Arlington, VA 23445-2909

To register your warranty online,
visit our web site at
www.alcoveelectrical.com.

Serial No. 12 Y 845

PERSONAL RECORD KEEPING

As you begin to accumulate financial records and legal documents, you should have a good filing system to help organize, store, and retrieve needed information. Many people use a simple paper filing system. An electronic filing system may be a more convenient way to organize some records.

PAPER FILING SYSTEM

A typical home filing system would include folders and labels and a file cabinet. Most households need folders for each category shown in Figure 8.8. You may have additional categories. Name your folders with a descriptive word or short phrase that tells you immediately what records it contains. File your folders alphabetically.

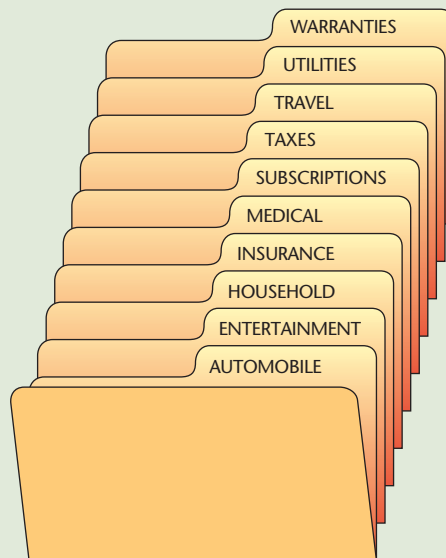
Keep records and receipts in the appropriate folder. For example, in the “automobile” folder, you might want to keep track of oil changes, tune-ups, repairs, and other car expenses. You may also want to keep copies of car titles, car insurance policies, insurance cards, car payment records, and other related information. This way they will be easy to find when you need them.

ELECTRONIC RECORD KEEPING

Many people invest in home computers and software for personal financial planning and record keeping. The advantages of computerized systems include the following:

- Ease of updating information
- Ease of record storage and retrieval
- Speed of making new computations and comparisons

FIGURE 8.8 *Home Filing System*





© Richard Ransier/Corbis

Many people keep financial records on their computer, usually password-protected, or on a travel or flash drive. As with any important files you keep electronically, always keep a current backup of your financial records.

Many software programs can help you keep better records. A **spreadsheet** is a computer program that organizes data in columns and rows and can perform calculations using the data. You can use a general-purpose spreadsheet program to maintain a list of your income and expenses. You can enter a formula that will perform math calculations, such as addition. When you enter a new expense, the formula will recalculate the new sum automatically. You can even design your own budget worksheet in a spreadsheet program. Spreadsheet programs, such as Excel (Microsoft), are easy to use and help you keep information up to date.

A **database** is a computer program that organizes data for easy search and retrieval. The program can sort the data in many ways. For example, if you entered all of your expenses into a database program, you could ask it to give you a report of all expenses associated with travel.

A general-purpose database program can be rather sophisticated. However,

several available software packages are specially designed for financial planning and record keeping. These programs provide spreadsheet and database forms already set up for personal financial management. For example, Microsoft Money and Quicken are popular financial management programs designed to help you keep track of your income and expenses, keep an electronic checkbook, and create budgets.

How can you benefit from having a good filing system?

COMMUNICATION *Connection*



Gather a stack of paper slips or index cards. Set up a paper filing system appropriate for you or your family's personal records. On each slip or card, write the name of a folder along with the various records that folder

would contain. Then file your "folders" alphabetically.

After setting up the filing system, write a brief summary explaining the benefits of using your filing system to your family. Your paper should persuade them to get their records better organized.



Finance officers and managers are responsible for making sure a business or client has money when it is needed. Almost every firm, government agency, and other type of organization have one or more financial managers. They oversee the preparation of financial reports, manage investments, and implement cash management strategies. By doing so, they keep the company on solid financial footing, allowing for growth and expansion.

Financial managers are creative thinkers and problem solvers. They are computer savvy and are very knowledgeable about all aspects of finance, including global issues. They are also very familiar with tax laws and regulations, ensuring the company is in compliance with them.

Employment Outlook

- An average rate of employment growth is expected.
- Those with a master's degree will have the best opportunities.

Job Titles

- Loan officer
- Finance officer
- Treasurer
- Credit manager

Needed Skills

- A bachelor's degree in finance, accounting, or a related field is required.

- Certifications and advance degrees are preferable.
- Experience and analytical skills are essential.

What's it like to work in... **Finance**

Rajiv works in a comfortable office, right next door to the company president. He reports directly to the president and has frequent informal conversations throughout the day. As chief financial officer (CFO), Rajiv has many responsibilities.

Today he will present his financial analysis to meet the CEO's strategic plan for the next three years. With help from the accounting department, he prepares and revises a forecast of financing options and their costs, along with projected cash management changes. His recommendations include major changes in how the company can operate more efficiently. If his decisions are implemented, many people in the company will have to follow new operating policies to help cut costs and increase profits.

What About You?

Would you like to be involved in helping a company grow by analyzing its finances and increasing its ability to operate more efficiently? Would you consider a career in finance?

Assessment

KEY TERMS REVIEW

Match the terms with the definitions.

- | | |
|--|--|
| <p>____ 1. A process that verifies the signature of a person who signs a document</p> <p>____ 2. A computer program that organizes data in columns and rows</p> <p>____ 3. Something of value exchanged for something else of value</p> <p>____ 4. A person who agrees to pay the debt of another person</p> <p>____ 5. An instrument that is legally collectible</p> <p>____ 6. A legally enforceable agreement</p> <p>____ 7. A statement assuring quality and performance of a product or service</p> <p>____ 8. A computer program that sorts data for easy search and retrieval</p> <p>____ 9. Changing an original offer to make a new offer</p> | <p>a. consideration</p> <p>b. contract</p> <p>c. co-signer</p> <p>d. counteroffer</p> <p>e. database</p> <p>f. negotiable</p> <p>g. notarized</p> <p>h. spreadsheet</p> <p>i. warranty</p> |
|--|--|

CHECK YOUR UNDERSTANDING

10. What are the four elements of a binding contract? How is an express contract different from an implied contract?
11. Explain a paper filing system and an electronic filing system. Why do you need backup copies in both systems?

APPLY YOUR KNOWLEDGE

12. Using Figure 8.6 as a model, write a promissory note from you to John Doe. The note is payable in one year in the amount of \$50 with interest of 11 percent and monthly payments of \$4.63. Are you the maker or the payee of the note? What is the total amount you will pay on the note?

THINK CRITICALLY

13. Once you enter into an agreement, you are obligated to perform as agreed. Why do people who enter into agreements later refuse to do what they agreed to do?
14. Why is it important to keep good financial records? If you fail to keep a backup copy and your house burns down, how will you be able to recreate your records?

Chapter Assessment

SUMMARY

8.1

- *Disposable income is the money you have left over to spend or save after paying taxes.*
- *A budget is a spending and saving plan based on expected income and expenses.*
- *To prepare a budget, you should estimate your income and expenses and set a savings goal.*
- *If expenses plus savings exceed income, adjust your spending or saving to balance your budget, or find a new source of income.*
- *Fixed expenses are costs that do not change monthly, while variable expenses change depending on choices made.*
- *Four types of personal records to keep include income and expense records, a net worth statement, a personal property inventory, and tax records.*
- *Net worth is the difference between assets (items of value owned) and liabilities (money owed).*

8.2

- *Contracts are legally binding agreements. They can be express or implied.*
- *An enforceable contract has agreement (offer and acceptance), consideration (an exchange of something of value), contractual capacity (legal ability), and legality (lawful purpose).*
- *Negotiable instruments, such as checks and promissory notes, are promises to pay a specified sum to the holder.*
- *A warranty guarantees a product's quality and performance. It can be written or implied.*
- *Good filing systems can be paper or electronic. Spreadsheet and database programs can facilitate budgeting and record keeping.*

APPLY WHAT YOU KNOW

1. *What choices do you have if your budget doesn't balance? If you had to reduce your spending to balance your budget, which would you try to reduce first: fixed or variable expenses? Why?*
2. *The Statute of Frauds requires that some contracts must be in writing to be enforceable. Give three examples of contracts that must be in writing in order to be enforceable. Why is a written form necessary?*
3. *Using Figure 8.3 as a model, prepare a net worth statement. List your assets and liabilities. Compute your net worth. How can you use this information?*
4. *Using Figure 8.4 as a model, prepare a personal property inventory, listing items of personal property in your room at home. Why should you and your family keep a record such as this?*
5. *After examining the credit application in Figure 8.5, list the kinds of information requested by a retail store. Why do you think a store wants this type of information?*
6. *Bring to class an express warranty from a product you or your family recently purchased. What does the warranty specifically promise to do? List any restrictions (exceptions) that the manufacturer has placed in the warranty.*
7. *Search online for articles or reviews about financial planning software. Write a one-page description of what you could do with the software and what features make one software better than another.*

MAKE ACADEMIC CONNECTIONS

8. **Economics** *Use the Internet to search for information regarding the budget of the United States, prepared by the President. List the major categories of proposed revenues and expenditures. What are some important provisions of the budget? What is the process for getting the federal budget approved?*
9. **Communication** *Write a one-page narrative of the goals you would like to include in your life's financial plan. What would you like to achieve (in general terms) and how do you propose to cover the cost of meeting your objectives?*
10. **Social Studies** *Discuss the role of law in society, such as contract law governing the relationships between people. Explain why laws and rules are important, both in the establishment of and in the enforcement of agreements. What remedies are available to people when the other person in a contract breaches that contract?*
11. **Technology** *Use a spreadsheet program to create a budget template that could be used for a monthly and yearly budget. Use the categories shown in Figure 8.2. Insert formulas for calculating totals.*

SOLVE **PROBLEMS** AND

EXPLORE **ISSUES**

12. Based on the following information, prepare a monthly and yearly budget for Brandy and Kenneth Harbour. Use Figure 8.2 as a model.

Average Income

Net paychecks = \$1,800 monthly

Interest on savings = \$50 monthly

Average Monthly Expenses

Rent payment	\$400
Utilities	120
Gasoline	100
Insurance	150
Groceries	200
Clothing	100
Car payment	210
Car maintenance	50
Cell phone	40
Entertainment and recreation	200

Cash Surplus

Savings	To be determined
Investment fund	60
Miscellaneous	120

13. Based on the following information, prepare a monthly and yearly budget for Cathy Kudyrko. Follow the style shown in Figure 8.2.

Average Income

Net monthly pay is \$1,400

Average Monthly Expenses

Rent	\$410
Insurance	60
Utilities	50
Gasoline	60
Clothing	60
Entertainment	100
Savings	120
Telephone (landline)	15
Car payment	150
Car repairs	20
Groceries	150
Personal care	50
Miscellaneous	155

14. *Revise Cathy's budget when she agrees to share her apartment with a friend. Some expenses can be shared equally. Assume the telephone expense increases to \$30, utilities to \$60, and insurance to \$70. These expenses along with rent are shared equally. What will you advise her to do with the added funds?*
15. *Based on the following information, prepare a net worth statement for Sako Masuta. Follow Figure 8.3. Sako owns a car worth about \$3,000 but owes \$1,500 on it to the bank. He has \$500 in savings and \$100 in checking. His personal property totals \$3,000, and he also owes \$90 to his credit union.*
16. *Based on the following information, prepare a personal property inventory for Sako Masuta. Follow Figure 8.4.*

Sako has these furnishings in his apartment:

- *JWA entertainment system, Model 252, SN 975923, bought last year for \$600, presently worth \$500*
- *Sofa, presently worth about \$800*
- *Bright alarm clock, SN 630AM and Blare radio, Model 2602, SN 413T, bought four years ago, total worth about \$100.*

Sako also has the following personal items:

- *Miscellaneous clothing and jewelry, presently worth about \$800*
- *Quantex wristwatch, presently worth about \$100*
- *Coin collection, valued last year at \$600.*

Sako has photographs of these items. (List a hypothetical purchase price for all items except the entertainment system in preparing your property inventory.)

EXTEND YOUR LEARNING

17. **Legal Issues** *Fraud is misrepresentation of a material (important) fact with intent to deceive another person or company. People who claim to own assets that they did not purchase and then report them lost or stolen are committing insurance fraud. Or they may claim their vehicle or property was stolen and damaged just to collect insurance. Fraud is a serious crime (felony). Insurance companies investigate claims to be certain that people who file claims legitimately owned those items or that the property was actually stolen and/or damaged. Do you know someone who filed a false insurance claim? How can keeping good records, such as a personal property inventory, protect you from being accused of insurance fraud? What other types of records do you think would be helpful in resolving insurance claims?*

For related activities and links, go to www.cengage.com/school/finance/mypf