PERSONAL FINANCE

Seventh Canadian Edition

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Dr. Dlabay has served as a consultant to corporations, educational institutions, and government agencies. He has presented more than 140 workshops and seminars in over 20 states to encourage teachers to actively involve students in the learning process with video presentations, newsletters, interviews, and Internet research activities.

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Ernie is the test bank author and subject-matter expert for a number of Finance textbooks and consults to small and medium-sized businesses regarding financial performance and optimal finance strategies.

Brief Contents

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INVESTING YOUR FINANCIAL RESOURCES

Preface

THIS BOOK AND REALITY

Although the 2008 recession was 10 years ago, it remains fresh in most people's minds. Markets have recovered since, but there is still a lot of uncertainty from a macro-economic standpoint on how things will work out. Governments are using fiscal policy to try to create stimulus as quantitative easing programs subside; Europe is struggling to maintain the European Union, as protectionism is becoming a political platform for many countries (e.g., Brexit), including the United States. Here in Canada, we've recently experienced a phenomenal real estate boom that financial analysts and economists consider unsustainable. Debt levels are extremely high with personal household debt to GDP at 101 percent as of January 1, 2017.[1]

The seventh Canadian edition of *Personal Finance* aims to take a hard look at these extraordinary times and provide context to the economic woes that continue for many of us since those fateful days in 2008. While we do not pretend to have all the answers as these economic changes unfold, we do invite you to join us in asking the difficult questions: Where do we go from here? How can we better adapt to the new and emerging realities for the money, banking, consumer, and investment markets?

People around the world continue to react in disbelief to the changes in the value of their savings and investments over time as pension, insurance, and retirement funds are implicated. It is within this climate of change that personal financial management becomes more important than ever. We learn the consequences of poor decision making and what can happen to a society that is all too comfortable living beyond its means, and the institutions that facilitate this way of life. We also explore the major implications on future planning when individuals don't know exactly where their money is being spent. As financial managers, we have seen it all: From clients with lower incomes, who are able to live comfortably, to those of a higher tax bracket, who are struggling with overwhelming debt and unmanageable budgets. Knowing where your money is going and how it impacts your future goals is half the battle and a concept that a lot of people still don't think that much about.

As teachers and professionals, we stress the importance of being fully aware of the decisions you make and understanding opportunity costs and associated consequences. The seventh Canadian edition of *Personal Finance* aims to provide this basic understanding and show how financial decisions will impact you at every stage of life. Access to information and advice is easier than ever, but it's how we apply this information that counts. Progress has to be actively done by everyone. Personal financial management is not the only secret to a happy life, but living within your means does go a long way to reducing the stress and anxiety that can accompany and help us to overcome the hard economic times.

UPDATED CONTENT IN THE SEVENTH EDITION

There are numerous changes, updates, and new exhibits in this edition. A **Continuous Case** and **Daily Spending Diary** are two of the big additions made to each chapter. These can be used by students individually or during class discussions. The reader might find the following highlights especially useful:

Chapter 1

- Additional questions and examples on financial planning.

Chapter 2

- Updated information on creating personal budgets and personal financial planning tools.

[1] https://tradingeconomics.com/canada/households-debt-to-gdp

Chapter 3

- Updated information on Tax-Free Savings Accounts.
- Revised tax rates, exemption amounts, and a tax example using 2016 T1 General.

Chapter 4

- Modernized the chapter to include information regarding phone apps and online banking.
- Added content on identity and property theft.

Chapter 5

- Expanded discussion on abusing credit and the effects of poor money habits.
- Added information on credit card fraud, costs, features, benefits, and policies for fraudulent charges.
- Updated discussion to include Beacon scores equivalent to the U.S. FICO and VantageScore, as well as added details about newly enacted legislation that limits how much people can borrow against their homes.

Chapter 6

- Updated information on bursaries and student loans such as the Ontario Student Assistance Program (OSAP).
- Updated discussion on high fees targeted to students and recent graduates by lenders.

Chapter 7

- Added CMHC information.
- Expanded discussion of renting vs. buying.
- Explored the risk of rising rates on house-buying plans for those looking at variable rate mortgages.
- New end-of-chapter questions.

Chapter 8

- Updated information on errors and omissions in insurance.
- Discussed underlying factors affecting auto insurance.
- Added information on how recent natural disasters in Canada have impacted the insurance industry and policy holders.
- New end-of-chapter questions.

Chapter 9

- Added information on government disability plans.
- Added an updated life insurance needs worksheet.
- Added focus on students discovering and utilizing CPP & EI regarding disability plans.

Chapter 10

- Updated examples on new dividend and TFSA rates.
- Added new online sources and mobile investing applications.
- Added updated rules affecting REITs.
- Greater exploration of Canadian investment trends.

Chapter 11

- Revised discussion of specific stock transactions: links and exhibits more consistent with current investment research and trading technology.
- Discussed role of full-service brokers in an online trading world.

Chapter 12

- Removed bond price estimate calculation in place of accurate bond price calculation.
- Updated sample bond transactions, bond yields, and real return bonds, and improved discussion on why bond valuation is important.
- Updated information on the government's decision to eliminate Canada Saving Bonds.

Chapter 13

- Added information on ETFs.
- Revised coverage of mutual fund characteristics.
- Updated mutual fund examples and return rates through 2017.

Chapter 14

- Updated information on pension plan types, including details of recent changes to both CPP and OAS.
- Added TFSAs to the retirement planning discussion; greater discussion of similarities and differences between these and RRSPs.
- Improved focus on defined pension plans and transfer options.

Chapter 15

- Updated discussion on testamentary trusts as a planning tool and the recent tax changes introduced.
- Added discussion of the RDSP (Registered Disability Savings Plan) and options for estate planning.
- Added probate fee chart and discussed the pros and cons of trying to avoid probate.

Appendix A: Daily Spending Diary

- New to this edition, this spending diary provides a useful template that helps students better understand their spending patterns.
- Record sheets provided.
- Great addition to text's focus on better understanding spending habits and identifying spending activities that can be improved.

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The McGraw-Hill Education team is ready to help you assess and integrate any of our products, technology, and services into your course for optimal teaching and learning performance. Whether it's helping your students improve their grades or putting your entire course online, the McGraw-Hill Education team is here to help you do it. Contact your Learning Solutions Consultant today to learn how to maximize all of McGraw-Hill Education's resources.

For more information, please visit us online: http://www.mheducation.ca/he/solutions.

Walkthrough

CHAPTER OPENING CASES describe situations that the learner will face or is currently facing. A case begins each chapter's discussion by presenting a problem, dilemma, or circumstance that clearly needs immediate attention. The questions accompanying the case correspond to the sequence of the chapter's contents and link procedures that may otherwise seem unrelated.

Dean Mitchell/Getty Images

CHAPTER 2

Money Management Strategy: Financial Statements and Budgeting

LEARNING OBJECTIVES

LO1 Recognize relationships among financial documents and money management activities.
LO2 Create a system for maintaining personal financial records.
LO3 Develop a personal balance sheet and cash flow statement.
LO4 Create and implement a budget.
LO5 Calculate savings needed to achieve financial goals.

LEARNING OBJECTIVES

LO1 Analyze the process for making personal financial decisions.
LO2 Develop personal financial goals.
LO3 Assess economic factors that influence personal financial planning.
LO4 Determine personal and financial opportunity costs associated with personal financial decisions.
LO5 Identify strategies for achieving personal financial goals for different life situations.

LEARNING OBJECTIVES structure the chapter, and each objective is repeated at the appropriate point in the main body of the chapter. The learning objectives appear again in the summary at the end of the chapter and are used to organize end-of-chapter questions, problems, and exercises; they also appear in the instructor's materials.

SUMMARY OF LEARNING OBJECTIVES

LO1 **Analyze the process for making personal financial decisions.**
Personal financial planning involves the following process: (1) determine your current financial situation; (2) develop financial goals; (3) identify alternative courses of action; (4) evaluate alternatives; (5) create and implement a financial action plan; and (6) re-evaluate and revise the financial plan.

LO2 **Develop personal financial goals.**
Financial goals should (1) be realistic; (2) be stated in specific, measurable terms; (3) have a time frame; and (4) indicate the type of action to be taken. They are affected by a person's values, attitude toward money, and life situation.

LO3 **Assess economic factors that influence personal financial planning.**
Financial decisions are affected by economic factors such as consumer prices, interest rates, and employment opportunities.

LO4 **Determine personal and financial opportunity costs associated with personal financial decisions.**
Every decision involves a trade-off with things given up. Personal opportunity costs include time, effort, and health. Financial opportunity costs are based on the time value of money.

Future value and present value calculations enable you to measure the increased value (or lost interest) that results from a saving, investing, borrowing, or purchasing decision.

LO5 **Identify strategies for achieving personal financial goals for different life situations.**
Successful financial planning requires specific goals combined with spending, saving, investing, and borrowing strategies based on your personal situation and various social and economic factors.

STUDENT WORK has been incorporated into selected Financial Planning boxes and depicts how former students have approached a number of decisions relevant to them. These samples serve to model for the students' peers how they tackled difficult questions by highlighting methods of analysis and suggested courses of action.

FINANCIAL PLANNING FOR LIFE'S SITUATIONS offers information that encourages the learner to take action. This feature is based on the principle of active learning; it presents example situations to prompt learners to apply newly acquired concepts and make unique financial planning decisions.

Financial Planning for Life's Situations

Is It Taxable Income? Is It Deductible?

Certain financial benefits individuals receive are not subject to federal income tax. Indicate whether each of the following items is or is not included in taxable income when you compute your federal income tax.

	Yes	No
Is it taxable income . . . ?		
1. Lottery winnings	____	____
2. Child support received	____	____
3. Workers' compensation benefits	____	____
4. Life insurance death benefits	____	____
5. Provincial bond interest earnings	____	____
6. Bartering income	____	____
7. GST/HST credit	____	____

Note: These taxable income items and deductions are based on the 2016 tax year and may change due to changes in the *Income Tax Act*.

Indicate whether each of the following items is or is not deductible when you compute your federal income tax.

	Yes	No
Is it deductible . . . ?		
8. Life insurance premiums	____	____
9. Recurring spousal support payments	____	____
10. Fees for traffic violation tickets	____	____
11. Mileage for driving to volunteer work	____	____
12. A notary's fee for preparing a will	____	____
13. Income tax preparation fee	____	____

Answers: 5, 6, 9—yes; 1, 2, 3, 4, 7, 8, 10, 11, 12, 13—no.

Financial Planning Calculations

Tax Credits versus Tax Deductions

Many people confuse *tax credits* with *tax deductions*. Is one better than the other? A tax *credit*, such as tuition fees or medical expenses, results in a dollar-for-dollar reduction in the amount of taxes owed. A tax *deduction*, such as an RRSP contribution, reduces the taxable income on which your taxes are based.

All non-refundable tax credits reduce taxes payable with the limitation that taxes payable cannot be reduced below zero. Aside from charitable donations that total more than $200, political donations and the dividend tax credit (which require additional procedural calculations), the amount claimed is multiplied by 15 percent to arrive at the tax credit. For example, if $100 is spent on tuition, then about $15 can be claimed as a direct reduction of taxes ($100 × 0.15).

On the other hand, a deduction of $100 may or may not reduce your taxes by $15 because the tax savings arising from the deduction depend on your marginal tax rate. Note that tax savings are simply equal to the deduction multiplied by the marginal tax rate. Thus, it should be apparent that a tax credit of one dollar is worth more than a deduction worth one dollar. However, making a comparison of whether spending on a deductible item is better than spending on an item that generates tax credits requires a careful specification of several variables, including your marginal federal rate, the province in which you reside, the rules attributed to the tax credit in question, and so on. Careful financial planning helps you use both tax credits and tax deductions to your maximum advantage.

$100 Tax Deduction

↓

Reduces your taxable income by $100. The amount of your tax reduction depends on your tax bracket. Your federal taxes will be reduced by $15 if you are in the 15 percent tax bracket and by $22 if you are in the 22 percent tax bracket.

FINANCIAL PLANNING CALCULATIONS features approximately 100 mathematical applications that the learner must master. All these calculations are situated in decisions that are typical of what learners encounter but may have shied away from due to the numbers behind these operations. The procedures illustrated in these calculations reinforce concepts introduced in the chapter in an applied setting. They are also tied to end-of-chapter questions and exercises.

ADVICE FROM A PRO is a great example of distributed expertise and multiple perspectives. In this box, industry professionals provide the kind of advice one can internalize in order to make sense of the informational deluge that all of us face.

Advice from a Pro

A Pro Speaks on Tax Planning

Any attempt to calculate your investment return must include the least exciting, most annoying financial subject: taxes. Even the word makes me cringe!

The government will get their share of your money—no exceptions. Smart tax planning helps you pay less tax legally. The federal government isn't fooling around: Those who use illegitimate techniques to avoid paying taxes get socked with high-priced penalties or jail time. Pay your taxes on time!

Around the first of the year, you will begin to receive a series of statements from the jobs at which you have worked or financial institutions where you hold accounts. This includes brokerage firms, banks, mutual funds, and other intermediaries. Find the receipts from any charitable donations you've made and proof of any employment-related expenses you plan on writing off. Keep these materials together; lost forms waste time and money!

Your tax return has several sections of which you need to be aware. Generally, your income should be added up, including any losses. Figure your taxable income, factor in additional credits or taxes, and write a cheque. *You've just paid your taxes!*

For those with a home business, complicated returns, or sketchy paperwork, some professional tax guidance is highly recommended—*and worth it!* Spending some money on a tax preparer or CPA might seem daunting but will ensure that your return is filed accurately and rapidly.

Did you know?

Tax Freedom Day provides Canadians with a true picture of their tax burden. According to the Fraser Institute's annual calculations, income earned prior to June 7, 2016, was used to pay the total tax bill imposed by all levels of government. This means that, on the average, every dollar you earned in the first half of 2016 was not for you, but for the government.

SOURCE: C. Lammam, M. Palacios, F. Ren "Canadians Celebrate Tax Freedom Day on June 7, 2016" (June 7, 2016); fraserinstitute.org.

DID YOU KNOW? boxes contain up-to-date facts, figures, and answers to frequently asked questions. They are featured several times within each chapter and typically elicit an "a-ha!" moment from the learner. These are not just catchy, but provide well-researched insights that are often missed and quoted by students in discussion forums.

CONCEPT CHECKS are a valuable device to help learners digest conceptual chunks within a section before they proceed further into the chapter. These questions also serve to refocus students' attention on the learning objective that applies to each section.

CONCEPT CHECK 3–1

1. How should you consider taxes in your financial planning?
2. What types of taxes do people frequently overlook when making financial decisions?
3. Who must file an income tax return?

FINANCIAL PLANNING ACTIVITIES provide an opportunity for students to translate learning objectives into research, which in turn feeds into decisions they may be ready to make. A "To Do" list includes various procedures, techniques, and sources of information.

FINANCIAL PLANNING ACTIVITIES

1. *Searching the Web for Tax Information.* Using Web sites such as the Canadian Tax Foundation at http://www.ctf.ca, or Canoe Money at http://www.canoe.ca, or library resources, obtain information about the tax implications of various financial planning decisions. LO1
2. *Researching Tax-Exempt Income.* Using library resources or the Web, determine the types of income that are exempt from federal income tax. LO2
3. *Planning Your Tax Payment.* Survey several people about whether they get a federal tax refund or owe taxes each year. Obtain information about the following: LO2
   a. Do they usually get a refund or owe taxes when they file their federal tax return?
   b. Is their situation (refund or payment) planned?
   c. Why do they want to get a refund each year?
   d. Are there situations where getting a refund may not be a wise financial decision?

LIFE SITUATION CASES provide opportunities for the learner to understand real-life situations that individuals face. These cases allow the student to assume the role of a consultant who can identify underlying problems, establish a framework for analysis, clarify issues, and propose possible solutions.

LIFE SITUATION CASE

A Single Father's Tax Situation

Ever since his wife's death, Eric Armano has faced difficult personal and financial circumstances. His job provides him with a fairly good income but requires him to hire a caregiver for his daughters, ages 8 and 10, nearly 20 days a month. This requires him to use in-home child-care services that consume a large portion of his income. Since the Armanos live in a small apartment, this arrangement has been very inconvenient.

Although Eric has created an investment fund for his daughters' education and for his retirement, he has not sought to select investments that offer tax benefits. Overall, he needs to look at several aspects of his tax-planning activities to find strategies that will best serve his current and future financial needs.

Eric has assembled the following information for the current tax year:

Earnings from wages	$47,500
Interest earned on GIC	$ 125
RRSP deduction	$ 2,000
Savings account interest	$ 65
Federal income tax deducted at source	$ 4,863
Total non-refundable tax credit amounts	$13,200
Child-care deduction	$ 6,300
Filing status: Head of household	

Questions

1. What are Eric's major financial concerns in his current situation?
2. In what ways might Eric improve his tax-planning efforts?
3. Is Eric typical of many people in our society with regard to tax planning? Why, or why not?
   a) What additional actions might Eric investigate regarding taxes and personal financial planning?
4. Calculate the following:
   a) What is Eric's 2016 federal taxable income? (Refer to Exhibit 3–1).
   b) What is his total 2017 federal tax liability? What is his average 2016 federal tax rate?
   c) Will Eric receive a tax refund or owe additional taxes to the federal government for 2016?

THE CONTINUING CASE reinforces the benefits of case-based teaching by linking the major concepts presented in each of the five sections in the text. It provides an opportunity to identify and analyze a range of personal financial decisions about several topics in a given section. Students begin to appreciate the broad connections between chapters and sections.

CONTINUING CASE

Planning Your Tax Strategy

Jamie Lee Jackson, age 26, is in her last semester of college and is waiting for graduation day, just around the corner! It is the time of year again when Jamie Lee must file her annual income taxes. Last year, she received an increase in salary from the bakery, which brought her gross monthly earnings to $2,550 and also opened up a TFSA, to which she contributed $300. Her savings accounts earn 2 percent interest per year, and she also had received an unexpected $1,500 gift from her great aunt. Jamie was also lucky enough last year to win a scholarship of $2,000, most of which was deposited into her regular savings account after paying off her credit card balance.

Current Financial Situation

Assets:

Chequing account: $2,250
Savings account: $6,900 (interest earned last year: $125)
Emergency fund savings account: $3,900 (interest earned last year: $75)
TFSA balance: $350 ($300 contribution made last year)
Car: $3,000

Liabilities:

Student loan: $10,800
Credit card balance: $0

Income:

Gross monthly salary: $2,550

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It is our hope that this text will make a difference in the lives of your students.

Ernest J. Kerst
Lewis Stevenson

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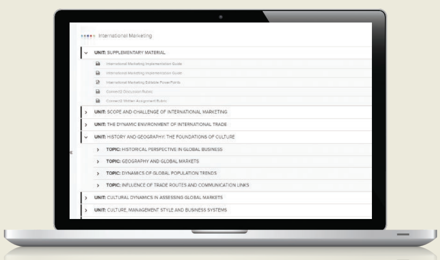

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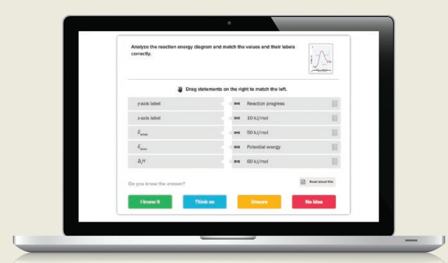

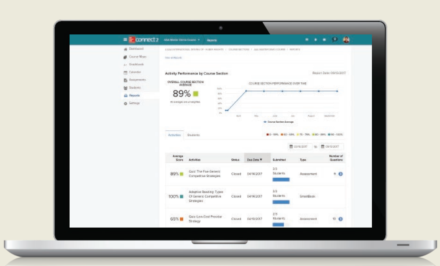

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For more information, please visit www.mheconnect2.com

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PART 1

Planning Your Personal Finances

Image Source/Getty Images

CHAPTER 1

Personal Financial Planning: An Introduction

LEARNING OBJECTIVES

LO1 Analyze the process for making personal financial decisions.

LO2 Develop personal financial goals.

LO3 Assess economic factors that influence personal financial planning.

LO4 Determine personal and financial opportunity costs associated with personal financial decisions.

LO5 Identify strategies for achieving personal financial goals for different life situations.

SOPHIA'S FINANCIAL PLAN

Sophia, 23, completed her Bachelor of Science one year ago. The major cost of her tuition and books was covered by a scholarship. Through wise planning, she was able to save $25,000 from her part-time jobs. Acting on a suggestion from her parents, Sophia met with a financial planner, who advised her to invest her money in low-risk bonds and saving certificates.

Sophia works in an office in Toronto, Ontario, and she earns $45,000 a year. In approximately three years, she would like to return to school and start her master's degree. Then she would like to buy a house. Sophia wants to live on her salary and invest the $25,000 for her education and future home.

QUESTIONS

1. How did Sophia benefit from her parents' advice and her own financial planning?
2. What decisions does Sophia need to make regarding her future?
3. How could various personal and economic factors influence Sophia's financial planning?
4. What would be the value of Sophia's $25,000 in three years if it earned an annual interest rate of 6 percent?
5. Conduct a Web search to obtain information that Sophia may find useful.

OVERVIEW

Personal financial planning has many important pieces. We begin with an overview of a six-step planning process, which will help you to review, revise, and align your goals with your changing circumstances. We then take a closer look at developing your financial goals by considering factors that may influence your goals and your changing life situation. We end this section by suggesting guidelines that can help you set realistic goals you can achieve.

Since financial planning has many variables, the next section considers the influence of prevailing economic factors including an overview of market forces, financial institutions, and global conditions that tend to have a major impact on your financial goals and plans.

Although opportunity costs are discussed in step 4 of the financial planning process, we emphasize the importance of financial opportunity costs—and, more specifically, the time value of money. Time value concepts and mechanics are key to understanding how future and present values take into account expectations of inflation and interest rates and how compounding and discounting affect monies over time.

Finally, the last section of this chapter identifies strategies that are consistent in achieving personal financial goals. In fact, all of the subsequent topics in this text are summarized to give you a preview of the important areas that will be explored in detail so that your financial plan considers all important aspects. This framework is the basis from which you can develop a way of thinking and, more importantly, implement practices and habits that will become the hallmark of effective personal financial decisions.

THE FINANCIAL PLANNING PROCESS

LO1 Analyze the process for making personal financial decisions.

Money and personal wealth are topics of discussion that are hard to get away from. Television and YouTube provide 24/7 access to programs showing entrepreneurs accessing capital or house flippers performing home improvement. When it comes to handling your finances, you will need to choose how you will manage your money and how, or if, you will prepare for unexpected expenses, your family, and your eventual retirement.

Most people want to handle their finances so that they get full satisfaction from each available dollar. Typical financial goals include things such as a new car, a larger home, advanced career training, extended travel, and self-sufficiency during working and retirement years. To achieve these and other goals, people need to identify and set priorities. Financial and personal satisfaction are the result of an organized process that is commonly referred to as *personal money management* or *personal financial planning*.

Personal financial planning is the process of managing your money to achieve personal economic satisfaction. This planning process allows you to control your financial situation. Every person, family, or household has a unique financial position, and therefore any financial activity must also be carefully planned to meet specific needs and goals.

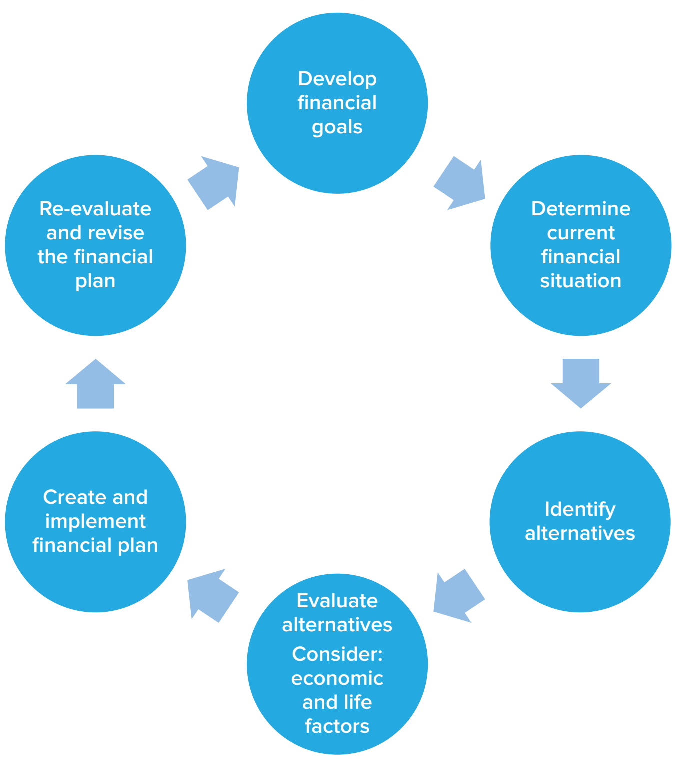
A comprehensive financial plan can enhance the quality of your life and increase your satisfaction by reducing uncertainty about your future needs and resources. The specific advantages of personal financial planning include:

- Increased effectiveness in obtaining, using, and protecting your financial resources throughout your lifetime.
- Increased control of your financial affairs by avoiding excessive debt, bankruptcy, and dependence on others for economic security.
- Improved personal relationships resulting from well-planned and effectively communicated financial decisions.
- A sense of freedom from financial worries obtained by looking to the future, anticipating expenses, and achieving your personal economic goals.

We all make hundreds of decisions each day. Most of these decisions are simple and have few consequences. Some are complex and have long-term effects on our personal and financial situations. While everyone makes decisions, few people consider how to make better decisions. As Exhibit 1–1 shows, the financial planning process is a logical, six-step procedure:

1. Develop financial goals.
2. Determine your current financial situation.

Exhibit 1–1 The Financial Planning Process



3. Identify alternative courses of action.
4. Evaluate alternatives.
5. Create and implement a financial action plan.
6. Re-evaluate and revise the plan.

STEP 1: DEVELOP YOUR FINANCIAL GOALS

You should periodically analyze your financial values and attitude toward money. They will play a major role in shaping your financial goals. Inevitably, financial planning will become necessary when you have a need for something; this need will shape your goals.

Analyzing your **values** involves identifying what beliefs you hold with respect to money and how these beliefs lead you to act in certain ways. For example, you may believe that it is wrong to borrow in order to purchase consumer goods, such as expensive clothes. Because of this belief, you shop for clothes only once you save the money. You do not charge the clothes to a credit card when you know you won't have the funds to pay the bill once it arrives.

You should also be aware of your attitude toward money. Do you view money as a form of security? If so, you are likely a good saver. Do you view money as a means by which you can express your appreciation of others? If so, you probably enjoy giving lavish gifts to your friends and family and may risk overspending.

Finally, how are financial decisions made in your family? Is there one individual who makes all major financial decisions, such as how much to borrow to buy a home, and who leaves decisions of lesser importance to others? Or are financial decisions a joint effort and responsibility?

Being aware of your values, attitude toward money, and financial decision-making process will help you differentiate your needs from your wants and will lead you to a clearer definition of your financial goals. Financial goals represent what you hope to achieve with your money. They should be realistic, stated in specific dollar terms and time frames, and listed in order of priority. As discussed later in the chapter, they are also closely linked to your life situation and can be influenced by external economic factors as well.

STEP 1 EXAMPLE Kent has several goals, including obtaining an advanced degree in global business management within five years, paying off his $28,500 student loan within 10 years, and working in Latin America for a multinational company once he completes his education.

STEP 2: DETERMINE YOUR CURRENT FINANCIAL SITUATION

In the first step of the financial planning process, you determine your current financial situation regarding income, savings, living expenses, and debts. Preparing a list of current asset and debt balances and amounts spent for various items gives you a foundation for financial planning activities. The personal financial statements discussed in Chapter 2 will provide the information you need to match your goals with your current income and potential earning power.

STEP 2 EXAMPLE Within the next two months, Kent will complete his undergraduate studies with a major in international studies. He has worked part time in various sales jobs. He has a small savings fund ($2,700) and more than $28,500 in student loans. What additional information should Kent have available when planning his personal finances?

STEP 3: IDENTIFY ALTERNATIVE COURSES OF ACTION

Developing alternatives is crucial for making good decisions. Although many factors will influence the available alternatives, possible courses of action usually fall into these categories:

- *Continue the same course of action.* For example, you may determine that the amount you saved each month is still appropriate.
- *Expand the current situation.* You may choose to save a larger amount each month.

- *Change the current situation.* You may decide to use a money market account instead of a regular savings account.
- *Take a new course of action.* You may decide to use your monthly savings budget to pay off credit card debts.

Not all of these categories will apply to every decision situation; however, they do represent possible courses of action. For example, if you want to stop working full time to go to school, you must generate alternatives under the category "Take a new course of action."

Creativity in decision making is vital to effective choices. Considering all of the possible alternatives will help you make more effective and satisfying decisions. For instance, most people believe they must own a car to get to work or school. However, they should consider alternatives such as public transportation, carpooling, renting a car, shared ownership of a car, or a company car.

Remember, when you decide not to take action, you elect to "do nothing," which can be a dangerous alternative.

STEP 3 EXAMPLE Kent has several options available to obtain an advanced degree in global business management. He could go to graduate school full time by taking out an additional loan, or he could go to school part time and work part time. What additional alternatives might he consider?

STEP 4: EVALUATE ALTERNATIVES

You need to evaluate possible courses of action, taking into consideration your life situation, personal values, and current economic conditions. How will the ages of dependants affect your saving goals? How do you like to spend leisure time? How will changes in interest rates affect your financial situation?

CONSEQUENCES OF CHOICES Every decision closes off alternatives. For example, a decision to invest in stocks may mean you cannot take a vacation. A decision to go to school full time may mean you cannot work full time. **Opportunity cost** is what you give up by making a choice. This cost, commonly referred to as the *trade-off* of a decision, cannot always be measured in dollars. It may refer to the money you forgo by attending school rather than working, but it may also refer to the time you spend shopping around to compare brands for a major purchase. In either case, the resources you give up (money or time) have a value that is lost.

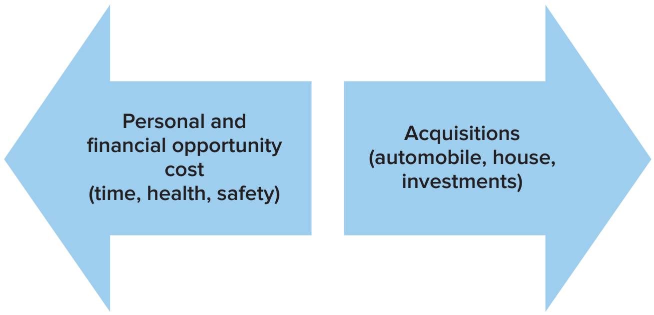
In addition to time spent, personal opportunity costs include effort made and the effects on your health. For example, poor eating habits, lack of sleep, or avoiding exercise can result in illness, time away from school or work, increased health-care costs, and reduced financial security. Financial opportunity costs include interest, liquidity, and safety of investments. It is measured in terms of the **time value of money**, the increases in an amount of money as a result of interest earned. Saving or investing a dollar today instead of spending it results in a future amount greater than a dollar. Every time you spend, save, invest, or borrow money you should consider the time value of money as an opportunity cost (see Exhibit 1–2).

Decision making is an ongoing part of your personal and financial situations. Therefore, you need to consider the lost opportunities that will result from your decisions. Since decisions vary based on each person's situation and values, opportunity costs differ for each person.

EVALUATING RISK Uncertainty is a part of every decision. Selecting a college or university major and choosing a career field involve risk. What if you don't like working in that field or cannot obtain employment in it? Other decisions involve a low degree of risk, such as putting money in a savings account or purchasing items that cost only a few dollars. Your chances of losing something of great value are low in these situations.

In many financial decisions, identifying and evaluating risk is difficult. Some types of risk can affect everyone, such as interest rate risk or inflation risk. They arise from the financial and economic environment in which we live or from the products and services that we choose. Other risks are

Exhibit 1–2 Opportunity Costs and Financial Results Should be Evaluated When Making Financial Decisions



personal in nature, such as the risk of premature death or the risk of disability or loss of health. Some different types of risk are explained in Exhibit 1–3. The best way to consider risk is to gather information based on your experience and the experiences of others and to seek financial planning expertise by consulting various information sources.

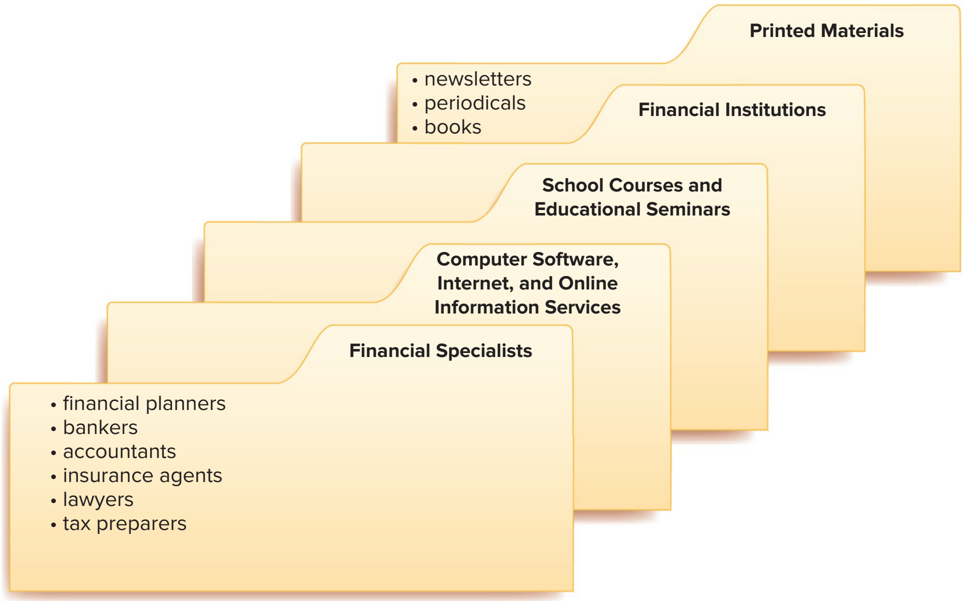
FINANCIAL PLANNING INFORMATION SOURCES When you travel, you often need a road map. Travelling the path of financial planning requires a different kind of map. Relevant information is required at each stage of the decision-making process. This book provides the foundation you need to make personal financial planning decisions. Changing personal, social, and economic conditions require that you continually supplement and update your knowledge. Exhibit 1–4 offers an overview of the informational resources available when making personal financial decisions. Appendix 1A provides additional information.

STEP 4 EXAMPLE As Kent evaluates his alternative courses of action, he must consider his income needs for both the short term and the long term. He should also assess career opportunities with his current skills and his potential with advanced training. What risks and trade-offs should Kent consider?

Exhibit 1–3 Types of Risk

Economic and Product Risk	Personal Risk
Interest Rate Risk Changing interest rates affect your costs when you borrow, and your benefits when you invest.	*Risk of Death* Premature death may cause financial hardship to family members left behind.
Inflation Risk Rising prices cause lost buying power.	*Risk of Income Loss* Your income could stop as a result of job loss or because you fall ill or are hurt in an accident.
Liquidity Risk Some investments may be more difficult to convert to cash or to sell without significant loss in value.	*Health Risk* Poor health may increase your medical costs. At the same time, it may reduce your working capacity or life expectancy.
Product Risk Products may be flawed or services may not meet your expectations. Retailers may not honour their obligations.	*Asset and Liability Risk* Your assets may be stolen or damaged. Others may sue you for negligence or for damages caused by your actions.

Exhibit 1–4 Financial Planning Information Sources



STEP 5: CREATE AND IMPLEMENT A FINANCIAL ACTION PLAN

In this step of the financial planning process, you develop an action plan. This requires choosing ways to achieve your goals. For example, you can increase your savings by reducing your spending or by increasing your income through extra time on the job. If you are concerned about year-end tax payments, you may increase the amount withheld from each paycheque, file quarterly tax payments, or shelter current income in a tax-deferred retirement program. As you achieve your immediate or short-term goals, the goals next in priority will come into focus.

To implement your financial action plan, you may need assistance from others. For example, you may use the services of an insurance agent to purchase property insurance or the services of an investment broker to purchase stocks, bonds, or mutual funds. Your own efforts should be geared toward achieving your financial goals.

STEP 5 EXAMPLE Kent has decided to work full-time for a few years while he (1) pays off his student loans, (2) saves money for graduate school, and (3) takes a couple of courses in the evenings and on weekends. What are the benefits and drawbacks of this choice?

STEP 6: RE-EVALUATE AND REVISE YOUR PLAN

Financial planning is a dynamic process that does not end when you take a particular action. You need to regularly assess your financial decisions. You should completely review your finances at least once a year. Changing personal, social, and economic factors may require more frequent assessments.

Did you know?

Eighty-one percent of those with comprehensive financial plans feel on track with their financial affairs, versus 73 percent with limited planning and only 44 percent with no planning.

SOURCE: http://www.fpsc.ca/value-financial-planning.

Financial Planning for Life's Situations

Using the Internet for Financial Planning

Web . . . email . . . URL . . . online banking!

Just a dozen years ago, these terms made no sense to most people. Even now, many people are still not quite sure about some of them. However, most know that good financial planning requires information, and the Internet is the most efficient source of information.

Throughout this book, the financial planning content presented can be expanded and updated using the Internet. The Web sites we suggest, along with others you locate yourself, allow you to quickly obtain information for making financial decisions appropriate to your life situation. In addition, at the end of each chapter, a feature called "Creating a Financial Plan" gives you an opportunity to use the Web to plan, research, and implement various components necessary for a comprehensive financial plan.

As you study the personal financial topics discussed in this book, the following Internet topic areas are especially useful:

- *Finding cyber-info for personal financial planning:* With thousands of personal finance Web sites available, where do you begin? Some useful ones include http://www.quicken.ca and http://www.advocis.ca.
- *Using online banking:* No more lines. No more overworked bank tellers. No more inhaling exhaust fumes while waiting in the drive-through lane. In addition to existing banks that are online, there are Web-only banks, such as http://www.tangerine.ca.
- *Getting online tax information and advice:* Tax planning should not happen only around April 30. For assistance, go to http://www.cra-arc.gc.ca or http://www.kpmg.ca.
- *Applying for a mortgage online:* Instead of waiting days or even weeks, prospective home buyers can now obtain financing online at sites such as http://www.scotiabank.ca.
- *Buying a car online:* Information that used to be difficult to get is now available to everyone. More than 70 percent of car buyers research their planned purchases online to get information about vehicle features and costs at sites such as http://wwwa.autotrader.ca/?&gclid=EAIaIQobChMIkMrcluTK1gIVCFp-Ch2uiQ-EEAAYASAAEgJQrfD_BwE.
- *Selecting investments online:* As everyone knows, "information is power." This saying is especially true when investing. You can obtain company information and investment assistance at http://www.quicken.ca and http://www.mutualfundsnet.com/ https://www.theglobeandmail.com/globe-investor/funds-and-etfs/funds/v2.
- *Being your own investment broker:* You already know which investments you want to buy? Then it's time to get into the market by going to http://www.bmoinvestorline.com.
- *Planning for retirement:* Whether you are 40 years or 40 minutes away from retiring, you can get lots of help at http://www.retirehappyblog.ca/.

NOTE: Refer to Appendix 1A for information on conducting Internet searches. Also, be aware that Web sites may change or no longer be in use after this book has published.

When life events affect your financial needs, this financial planning process provides a vehicle for adapting to those changes. Regularly reviewing this decision-making process helps you make priority adjustments that bring your financial goals and activities in line with your current life situation.

STEP 6 EXAMPLE Over the next six to 12 months, Kent should reassess his financial, career, and personal situations. What employment opportunities or family circumstances might affect his need or desire to take a different course of action?