

We want to do what we can to support teachers and their students who may have to spend long periods at home during the COVID 19 outbreak.

We've pulled together some useful activities your students can do at home. While the materials are taken from a previous qualification, they are all relevant to modern-day personal finance.

There are several activities and questions for your students to work through. The answers to questions are at the end, so they can check their knowledge themselves.

We hope that these topics may be useful and support your work with your students during these challenging circumstances.

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Managing Director of Financial Capability

Award in Personal Finance

Teacher Support Material

Topic 1: Know the different sources of income

After completing this topic, you will be able to:

- list and explain the different types of income;
- understand some of the laws about working, including those relating to working hours and the National Minimum Wage;
- list and explain some government benefits;
- explain income tax;
- explain National Insurance;
- list the features of payslips; and
- understand how pay can be calculated and complete basic pay calculations.

What is 'income'?

'Income' is all of the money that a person receives over a given period of time. This includes:

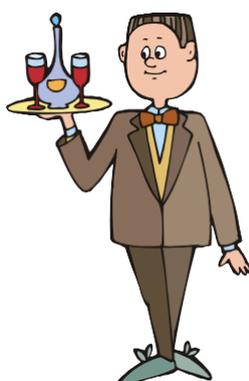
- earnings from a job;
- earnings from being self-employed;
- pocket money;
- gifts; and
- benefits from the government (that is, money paid by the government to help certain people, such as those who are disabled or those who have children).

What are 'earnings'?

'Earnings' means the money that you get for doing a job. It comes from the verb 'to earn', which means to get something because you have worked for it.

Earnings are called 'wages' or 'salary'.

- The word 'wages' is usually used when talking about how much a person is paid per hour, for example £7.60 per hour. Wages are normally paid weekly.
- The word 'salary' is usually used when talking about a job for which the person's pay is expressed as an annual figure, for example £15,000 a year. (Sometimes, you will see it written as £15,000 pa, or 'per annum' – which is another way of saying 'a year'.) Salaries are normally paid monthly.

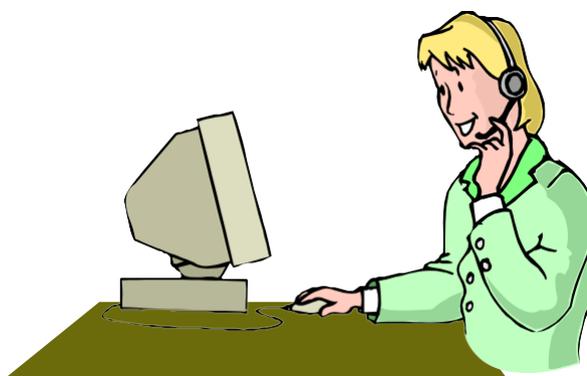


Examples of jobs for which the earnings are likely to be referred to as 'wages' – that is, expressed as an hourly rate – include:

- waiting tables in a coffee shop;
- cleaning;
- gardening;
- 'temping' (that is, working on a temporary basis);
- car park attending; or
- farm labouring.

Examples of jobs for which the earnings are likely to be referred to as a 'salary' – that is, expressed as a yearly figure – include:

- bank cashier;
- receptionist;
- secretary;
- call centre worker;
- teacher;
- nurse; or
- civil servant (that is, someone who works for the government).



Different types of income



Activity 1a

Consider the following people.

- Ali delivers newspapers for The Corner Shop and earns £3 an hour. He also gets £5 each week for pocket money.
 - Bethany babysits for her neighbours and earns £3.40 an hour. She also gets an allowance from her grandma of £40 each month.
 - Connor works in a sports shop called Jump on Saturdays and earns £4.85 an hour. He also helps his father at his shop for an hour each day after college for £20 a week.
 - Demi is a receptionist at Dolby and Crane Ltd, earning £18,000 a year. Before that, she was unemployed and received a government benefit that paid her £56.80 per week.
 - Evan is a painter/decorator who works for himself (that is, he is 'self-employed'). He charges £200 a day. He also works as a DJ at a club on Saturdays and at weddings, for which he charges £100 a time.
- a) Which one is earning a salary?
- b) How does this salary calculate as weekly and monthly pay?



Activity 1b

Work out how much monthly pay each of the following salaries would offer.

- a) £20,00
- b) £26,00
- c) £50,00

How much weekly pay would each of the following salaries offer?

e) £27,00

f) £42,00

Hourly pay

When someone's pay is expressed as an hourly rate, they have to work out how much they will get at the end of the day or at the end of the week. The following activity offers some examples.



Activity 1c

a) John goes to college from Monday to Friday. On Saturdays, he works for seven hours at a snooker hall and he earns £6.95 an hour. The snooker hall boss pays him out of the till. How much does John get each week?

b) Ranjit works in a cafe. He works 25 hours a week in the winter and 35 hours a week in the summer. He is paid £5.50 an hour. How much does he get a week in the winter and how much does Ranjit get a week in the summer?

c) Pavlos has a friend called George, who owns a field next to a zoo. In the summer, when the zoo car park is full, George lets people park in his field for £1 per day; he pays Pavlos £7.25 an hour to collect the car parking fees.

If Pavlos works from 8.00 am until 6.30 pm, six days a week, how much does he earn each day? How much does he earn each week?



Earnings from being self-employed

If a person is 'self-employed', this means that they work for themselves. They do not have a boss to pay them wages or a salary; instead, they find their own work and collect the money that they earn for that work from their customers. An example of a self-employed person would be a painter/decorator, or a plumber.

The money that a self-employed person receives for the work that they do is not called 'wages' or 'salary'. It is simply called 'earnings' or 'income'.

Case study

Eric is a self-employed painter. He has been doing this type of work for 20 years, so a lot of his customers are people whom he has known for years and who will ring him every now and again to do a painting job for them. They will also tell their friends how good Eric is at painting and he will get other jobs that way.

Eric charges £150 a day for painting the inside of a house and £180 a day for painting the outside. (He charges more for the outside because it is more dangerous.) If he were to work for five days a week on the inside of someone's house, he would get £750, but this is *not* his income, because he has to buy paint and brushes out of that money. If the paint and brushes were to cost £100, his income would be £650.

Pocket money

You may have earned some pocket money or an allowance for a few years.



Activity 1e

Discuss the following matters within your group.

- *Do you all get pocket money or an allowance?*
- *When did you start to receive it?*
- *How much do you get?*

Did you know?

British children received an average of £6.35 a week in pocket money in 2014.



Gifts

You may get gifts of money, especially for birthdays and other special days (such as Christmas or Easter), or for passing your exams, or for getting an 'A' grade on a project.

You may be given a few pounds by a family member when they visit, or you may be given some money when you first pass your driving test to put towards a car.

Even though gifts are not regular amounts on which you can count, they are still classed as income because they provide you with extra money to spend.



Activity 1f

Discuss as a group the occasions on which you get gifts.

- *Which people are the most likely to give you money as a gift?*
- *Do you save this money for a special purchase?*

Income tax

We all have to pay tax on our earnings. This means that we have to give part of what we earn to the government.

Income tax is used to pay for services provided by the government, such as education and health care.



What other services can you think of that are provided by the government? For what other things do you think the government uses this money?

The good news is that we do not have to pay tax on *all* of our earnings. Each person is allowed to earn a certain amount of money free of tax. This is called the ‘personal allowance’. If you earn more than the personal allowance, you have to give a portion of it to the government. This is called income tax and it is worked out using percentages.

The basic rate of income tax for the year 2015–16 is 20 per cent.

Did you know?

The personal allowance from April 2015 is £10,600. So, if Connor were to earn £4,000 in a year, he would not pay any tax.

Because Demi earns £18,000 a year, she will have to pay tax. She will have to pay tax on that part of her earnings which falls above the £10,600 personal allowance.

Demi will have to pay tax on:

$$£18,000 - £10,600 = £7,400$$

She will have to give the government:

National Insurance (NI)

All employees also have to pay National Insurance (NI). This is used by government to pay for things such as JSA and basic State Pension. National Insurance is worked out on your weekly pay.



Some people still refer to NI as ‘stamp’ because, in the old days, you had to buy stamps to put in a book to show that you had paid your NI contributions (NICs).

Did you know?

The rate of NI for the year 2015/16 is 12 per cent of earnings above £155 per week. This means that you do not have to pay NI on the first £155 of your earnings, but must pay to the government 12 per cent of that part of your earnings which falls above that figure.

Demi's salary of £18,000 works out at £346.15 a week. She will pay NI on:

$$£346.15 - £155 = £191.15$$

Demi will have to give the government:

Pay as you earn (PAYE)

If you are employed, the tax and NI that you have to give to the government is taken from your earnings by your employer at the same time as you are paid. This is called a 'deduction', because the money is deducted from your pay. ('Deducted' means taken off.)

This means that employees pay as they earn – that is, they receive their earnings *after* these amounts of money have been taken off.



Payslips

The employer must give each employee a written payslip showing details of the pay earned and the amounts deducted.

We will look now at Demi's payslip as an example. ***Demi's payslip appears on the facing page.***

Looking at Demi's payslip from the top down, the boxes show:

- the **employer's name** – that is, where Demi works ('Dolby and Crane Limited');
- the **date** – that is, the date on which her earnings will be paid ('1 June 201X');
- the **payment period** (usually a month or a week) – that is, the period for which Demi is being paid (one month spanning '01/05/201X to 31/05/201X'); and
- the **payment method** – that is, how Demi's earnings will be paid ('credit transfer', meaning that her salary will be paid directly to her bank account).

There are two important definitions to remember in relation to pay:

- **gross pay** refers to the total amount earned *before* deductions;
- **net pay** refers to the amount that the employee actually receives *after* deductions for tax and NICs.



Activity 1h

How much money will Demi be paid on 1 June 201X?

Dolby and Crane Limited

Date: 01/06/201X

Payment period		Payment method	
01/05/201X to 31/05/201X		Credit transfer	
Tax code	Employee no	Employee name	NI number
1060L	26	Demi Morgan	NS102030P
PAYMENTS		DEDUCTIONS	
Description	Amount	Description	Amount
Basic salary T	1500.00	PAYE tax	123.33
		NI	99.40
Gross pay	1500.00	Total deductions	222.73
Net pay	1277.27		
Taxable pay to date	3000.00	Tax paid to date	246.66
		NI paid to date	198.80

T = taxable

The payslip also gives the following information about Demi.

Tax code	All employees have a 'tax code' that tells the employer how much they can earn before they must start paying income tax. If the employee is paid monthly (ie 12 times a year), the tax code tells the employer to give the employee $\frac{1}{12}$ th of their personal allowance each month. Remember: In 2015–16, each person is allowed to earn £10,600 each year before they pay tax, so they get £883.33 free of tax every month and pay tax on earnings above that figure.
Employee number	Demi is employee no 26 at Dolby and Crane Limited. This number is used by the organisation to identify Demi in its payroll system. A payroll system is a computer program that is used to calculate pay.

Employee name	Demi's name appears here.
National Insurance number	Everyone is issued with an NI number on their 16th birthday. People keep this NI number for the rest of their lives. It works like a personal account number with the government. This account records all of the tax payments and NI contributions (NICs) that people make. National Insurance numbers are made up of two letters followed by six numbers and one letter.

The payslip gives the following information about the amount of money being paid to Demi.

Payments	Employers list here all of the payments that they are making.
Basic salary	This is the amount of Demi's salary for this month. Demi earns £18,000 a year: $£18,000 / 12 = £1,500$
Gross pay	This figure shows Demi's gross (that is, total) earnings this month – ie the amount of her earnings <i>before</i> Dolby and Crane deducts income tax and NICs. The 'T' shows that this amount is taxable.
Net pay	This figure shows Demi's earnings after Dolby and Crane has made deductions for income tax and NICs. This is the amount of money that will go into her bank account on 1 June 201X: $£1,500 - £222.73 = £1,277.27$
Taxable pay to date	This figure shows Demi's total taxable pay for the tax year so far. The tax year starts in April. This is the pay for May, so Demi has received two months' salary this tax year: that for April and that for May. The amount shown is therefore her basic monthly salary multiplied by 2.

Finally, the payslip offers the following information about deductions made by Demi's employer.

PAYE tax	As a pay-as-you-earn (PAYE) employee, Demi's income tax is paid on her behalf directly from her month's salary. She is paying the income tax as she earns the money, rather than paying one big tax bill at the end of the tax year. In this month, the payroll computer has calculated her tax as £123.33.
NI	This figure shows the NICs made on Demi's behalf this month. The payroll computer worked this out to be £99.40.

Total deductions	This figure shows the total amount that Dolby and Crane is taking off Demi's gross pay this month, ie: $£123.33 + £99.40 = £222.73$
Tax paid to date	This figure shows the total PAYE tax paid on Demi's behalf this tax year. On this payslip, it is the tax amount for two months: $£123.33 \times 2 = £246.66$
NI paid to date	This figure shows the total amount of NICs paid on Demi's behalf in this tax year. On this payslip, it is the NICs for two months: $£99.80 \times 2 = £198.80$

Employers must give employees payslips at the time, or just before, they are paid. Where Demi works, payslips are delivered by the mailroom in envelopes marked 'Private and Confidential'.

There is no standard layout for a payslip, but working regulations say that a payslip must contain *at least*:

- the gross amount of the earnings (that is, the amount of earnings *before* deductions);
- the reasons for, and the amounts of, all deductions;
- the net amount of the earnings (that is, the amount of earnings *after* deductions); and
- an explanation of how the earnings are being paid.



Activity 1i

a) Jimmy has gross monthly pay of £900 and total deductions of £30.73. How much money will be paid into his bank account this month?

b) Lizzie has gross monthly pay of £1,060. She has to pay income tax of £35.33 and NICs of £46.60. How much is her net pay?



Review questions

1. What are 'earnings'?
2. Mandeep is 16 years old. He wants to get a job in the local library over the summer holidays. What is the maximum number of hours for which the law will allow him to work in a week?
3. What is the current National Minimum Wage (ie that applying from October 2015) for a person aged 17?
4. Spence started work in October 2015 when he was aged 18. What is the National Minimum Wage that he had to be paid at that time?
5. How does the government spend the income tax that it collects?
6. How does the government spend NICs?
7. When do you get an NI number?
8. For what is your NI number used?
9. What is 'net pay'?
10. What is 'gross pay'?
11. Karl earns £14,000 a year. Look at Karl's payslip overleaf.
 - a) Complete the box for net pay.
 - b) What is Karl's NI number?
 - c) What is Karl's employee number and what does this mean?
 - d) How will Karl's money be paid?
 - e) What does 'Tax paid to date' mean?

Seahorse Designs Limited

Date: 01/07/201X

Payment period		Payment method	
01/06/201X to 30/06/201X		Credit transfer	
Tax code	Employee no	Employee name	NI number
944L	48	Karl Brown	HL123456N
PAYMENTS		DEDUCTIONS	
Description	Amount	Description	Amount
Basic salary T	1166.67	PAYE tax	56.67
		NI	59.40
Gross pay	1166.67	Total deductions	116.07
Net pay	<u> </u>		
Taxable pay to date	3500.01	Tax paid to date	170.01
		NI paid to date	178.20

T = taxable

Learning activities



Internet

Visit www.gov.uk and select 'Working, jobs and pensions'. Next, click 'Your pay, tax and the National Minimum Wage'. Find out what employees should do if their employer does not pay them the National Minimum Wage.



Group

Look at some job advertisements on your local paper's website.

- Some jobs will advertise the pay as a weekly amount. Calculate how much this would be if it were to be expressed as a gross annual salary.
- Similarly, for those jobs that are advertised with an annual salary, calculate how much this works out at per week and per month,

(You have to work out only the gross figures; there is no need to do the tax or National Insurance calculations – unless you feel you are up to the challenge!)



Individual

Ask a member of your family or a family friend if you may see their payslip. Identify what each of the items on the payslip means.



Key points for Topic 1

You should now understand:

- types of income, including salary and wages, and monthly and weekly pay;
- working hours and the National Minimum Wage;
- government benefits, such as Jobseeker’s Allowance (JSA) and Education Maintenance Allowance (EMA);
- what ‘income tax’ means;
- what ‘National Insurance (NI)’ means;
- what ‘pay as you earn (PAYE)’ means;
- what ‘gross pay’ and ‘net pay’ mean; and
- how to work out net pay.

Topic 2: Understand the different savings providers and the features of savings products

After completing this topic, you will be able to:

- understand what a savings account is;
- explain why savings accounts are safe from a bank going bust or from the bank being robbed;
- explain the different types of savings account, including instant-access accounts, notice accounts, regular savers accounts, and cash individual savings accounts (ISAs);
- list the features of savings accounts that will help you to decide on the best one;
- list the advantages and disadvantages of the different savings products;
- understand about tax on savings;
- explain what AER is;
- work out simple interest calculations; and
- define and list the different providers of savings products.

Savings and where to put them

There are lots of different types of savings account and many different organisations that offer them. If you have some money to save, it is very important to know the various types of savings account that are available and to understand the benefits that each of them offers before making your decision.

When you put your money in a savings account, it earns interest. This means that you will be paid by the bank or building society (or whatever organisation you choose) for leaving your money with it.



Can you remember from where the interest you receive on your savings comes?

When you save your money at a bank, you are actually lending the bank your money. The bank will then use your money, and money from other savers, to make loans to other people. The people who borrow from the bank will pay interest on their loans – that is, they will pay back more than they borrowed. This is called ‘interest’.

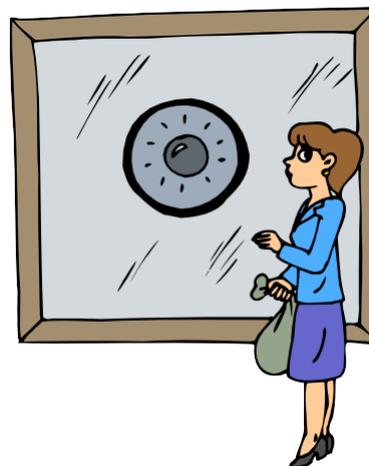
The bank will pay some of the interest that it receives from its borrower to its savers, as a sort of reward. The savers do not mind their money being used in this way, because if it were left at home instead, it would not make any interest at all.

The savers can get their money back whenever they want it because the bank always keeps enough cash to pay its savers back whenever they ask it to do so.

How safe is your money?

People put their money in a savings account with a bank or a building society or other organisation because it is safer than keeping it at home.

A bank keeps only a certain amount of cash at any one time, but it will always pay you on request what you have in your account. Even if a high number of people were all to ask for all of their money back at one time (known as a 'run on the bank'), the government would step in to help the bank in the short term.



But what would happen if the bank were to go bust?

In the UK, the government guarantees all savings in banks up to £85,000 per person. This means that if the bank were to go bust, the government would make sure that people get their money back – or at least the first £85,000 of it. If someone has more than this to save, it will be sensible for them to spread it around different banks because a person is only covered for £85,000 per provider.

So what if the bank gets robbed?



If money is stolen from a bank, the bank can still afford to pay back your money. This is because most of the money that we use nowadays is not notes and coins, but electronic money – that is, transfers that occur only on computer.

Think about it: a person's wage or salary is automatically credited to their account; their bills are paid by direct debit; and most of their purchases are made by debit card. This means that if cash is stolen from a bank, it is only a very small amount compared with the amount of electronic money that the bank holds.

So your money is safe if you deposit it with a well-known bank or building society.

Did you know?

Computer hackers pose a bigger threat to banks than bank robbers, because hackers might be able to access the banks' records and steal money electronically. Banks spend thousands of pounds each year on sophisticated security systems to prevent this from happening.

How is interest calculated?

Interest is calculated as a percentage of the money that you have in your savings account each year and it is added to your savings balance. You can either leave the interest there or you can take it out and spend it. If you leave it in the bank, more interest will be added the following year, and the year after, and your savings will grow.



Case study

Danielle has collected £100 from this year's Christmas presents and she has decided to open a bank savings account. She has found a bank that pays 2 per cent interest.

If she leaves her £100 in the account for a year without touching it, she will earn:

$$2\% \times £100 = £2$$

Her account will now hold:

$$£100 + £2 = £102$$

Next year, Danielle will earn:

$$2\% \times £102 = £2.04$$

Her account will now hold:

$$£102 + £2.04 = £104.04$$

In this way, Danielle will see her money will grow.



Tax on interest

Interest on savings is also income and so you have to pay tax on it, as was described in Topic 1. Before your interest is added to your account, the account provider will deduct the tax and pay it straight to the government. If you do not pay tax (because your earnings are below the personal allowance – see Topic 1), you can complete a special form and you will receive the interest ‘gross’.

Gross interest is the full amount of interest, with no tax taken off. It is just like gross pay and net pay:

- **gross interest** is interest on which no tax has been paid;
- **net interest** is interest on which tax has been paid.

Young people and children are most likely to need to complete the special form.

Types of savings account

There are many different types of savings account available and which one you choose will depend on which will best suit your circumstances. You might want to put away a large sum of money for a long time or you might want to save a small amount of money each month out of your earnings.

Other things to consider include the following.

- What is the interest rate on the account?
- How much money do you have to save each month – that is, is there a minimum or maximum amount?
- Can you take your money out at any time or do you have to give the bank some notice – for example, three months?
- Are there any other withdrawal restrictions or penalties?
- Can you access your account details online?
- Is there a minimum balance below which you cannot go?
- Can money be transferred into the account from another one?



The following sections outline a few of the different types of savings account available.

Instant-access accounts

The features of instant-access accounts include the following.

- These accounts allow you to take your money out *at any time* (hence the name ‘instant access’).
- Money can be taken out by going into a branch or by transferring it into a current account.

- Such transfers can be completed by letter, phone call, or online.
- Interest paid on instant-access accounts is generally very low.
- You can usually open an instant-access account with a very small amount, such as £1.
- You can put in or take out as much as you like, whenever you like.

Notice accounts

The features of notice accounts include the following.

- With notice accounts, you must tell the bank in writing *before* you want to take out some money.
- The amount of notice that you have to give to the bank will vary – for example, some accounts require seven days' notice, some require one month's notice and some require three months' notice.
- You get a better rate of interest on a notice account than you do on an instant-access account.
- Generally, the longer the notice period that applies to the account, the higher the interest rate.
- If you desperately want your money out and cannot give the required notice, the bank will charge you a penalty.
- These accounts are good for people who have some money to save that they do not expect to need for a while.

Regular savers accounts

The features of regular savers accounts include the following.

- These accounts are for people who want to save a fixed amount on a regular basis, such as monthly.
- Some people will have one of these accounts and arrange for a transfer to be made from their current account as soon as they get paid. Such transfers can be made by standing order.
- Higher interest rates are paid for regular savings accounts than for instant-access accounts because the bank expects you to be putting more money in, not taking it out.
- There are usually minimum and maximum amounts – such as a minimum deposit of £10 per month and a maximum deposit of £200 per month.
- Sometimes, you are not allowed to take the money out until you have had the account for a minimum amount of time. If you need to do so, there will be a penalty fee.



Cash individual savings accounts (ISAs)

In the 2014 Budget, the Chancellor of the Exchequer changed some of the rules of individual savings accounts (ISAs). The features are much the same as before. The features of cash ISAs include the following.

- The interest on an ISA is tax-free.
- There is a maximum amount that you are allowed to invest in an ISA each year – in 2015–16, that amount is £15,240.
- An ISA cannot be held in joint names.
- The money saved in an ISA is instantly available.
- The interest rate is usually better on an ISA than on an ordinary savings account.



Activity 2a

Complete the following table to show one advantage and one disadvantage of each of the different types of saving account at which we have looked above.

Type of savings account	Advantage	Disadvantage
Instant-access account		
Notice account		
Regular savers account		
Cash ISA		



Activity 2b

Visit the websites of a range of different banks and building societies.

See if you can find the savings accounts that match each of the types at which we have looked above. You may have to look carefully, because the providers may name them differently.

Draw up a table of the interest rates for each type of account. Use the AER (see below) as the interest rate for your comparisons.

a) Which is the best provider for each type of savings account?

b) Which type of account might be best for you?

The rate of interest and the annual equivalent rate (AER)

As you have seen, there are many different types of savings account, each of which works in different ways. Some accounts pay the interest at the end of every year; some of them pay the interest at the end of every month.

It is hard to compare the accounts that are available from different providers if they are not all using the same way of calculating and paying interest. When trying to attract new customers to open accounts with them, providers must consequently quote interest as an 'annual equivalent rate' (AER). This is the interest rate that would be paid if interest were to be paid only once a year.

Because all account providers must provide the information in the same way, people are able to compare the interest rate paid by one provider with the interest rates paid by others and choose the account that best suits them.



Activity 2c

Complete the following calculations.

a) How much interest will be paid in a year on £4,000 saved in an account paying an AER of 3 per cent?

b) *How much interest will be paid in a year on £1,200 saved in an account paying an AER of 2 per cent?*

c) *How much interest will be paid in a month on the amount saved in b) above?*

Other providers of savings products

Banks and building societies are not the only providers of savings products. Other organisations that offer a range of such products include:

- the Post Office;
- National Savings and Investments (NS&I);
- credit unions;
- savings stamps; and
- Christmas clubs.

The Post Office

The Post Office offers its own savings accounts, such as an 'Instant Saver' account, an ISA and some bonds – that is, a way of investing lump sums for a longer period of time.



Activity 2d

Visit the Post Office website, www.postoffice.co.uk, click on 'Savings' and look at 'All Savings Accounts'. If you select 'Instant Saver', you will find some useful information.

National Savings and Investments (NS&I)

NS&I is one of the largest and best-known savings organisations in the UK, and it offers a wide range of savings products to personal savers and investors.

Did you know?

The National Savings movement began in 1861 at the Post Office Savings Bank. It has always had two aims:

- to give people a place to save that is safe, because it is backed by the government, and which is easy to manage, because it is provided via the Post Office; and
- to collect money from savers and lend it to the government to help it to pay for public services that are not fully financed by taxes.

The fact that the money invested in NS&I is loaned to the government means that these investments are very safe.

There is a wide range of products available from NS&I, from instant-access accounts and ISAs to longer-term investments. Some of these pay interest monthly; some of these pay interest annually. Some of the NS&I savings accounts are tax-free, but there are limits on how much you can put in them.

Premium Bonds are one of the products that NS&I offers. These do not pay interest; rather, your bond numbers are entered into a draw each month and you can win a range of cash prizes.

You can find NS&I savings products at the Post Office, alongside its own range of savings accounts.

Credit unions

‘Credit unions’ are financial co-operatives owned and controlled by their members. They offer savings accounts, and are local, ethical and know what their members want. Many credit unions now offer a range of services including savings accounts, ISAs and Christmas savings clubs.

Each credit union has a ‘common bond’, which determines who can become a member. The common bond may be that those who can become members must all live or work in the same area, must work for the same employer, or must belong to the same association, such as a church or trade union.

Savings stamps



'Savings stamps' schemes – also known as 'savings clubs' – are run by many supermarkets and some local shops. The idea is simple: you put away a little bit each month over the year to pay for a big shopping spree, such as Christmas or any special event (such as a wedding).

The scheme involves you recording your savings either in a booklet with stamps (hence the name) or, more usually nowadays, using an electronic card. They generally allow you to save between £20 and £500 at a time.

The advantage of a savings stamps scheme is that you can put a little money to one side each time you go shopping. The disadvantages are that you are not paid any interest and that you have to spend the money at the shop with which you have saved.

Christmas clubs

'Christmas clubs' are schemes in which you save a small amount of money on a regular basis towards the high costs of Christmas. This can be done through a supermarket or another type of shop, such as your local butcher, but you can spend your saved Christmas club money only at the supermarket or shop with which you have saved it.

There is a Christmas club scheme available through the Post Office, which is slightly different in that it allows you to spend your savings wherever you like.

NOTE: Both savings stamps schemes and Christmas clubs involve a certain amount of risk. Because your money is being looked after by the shop or business with which you are saving, if that business were to go bust, you would risk losing your money.

This happened to a Christmas club called Farepak, which collapsed in 2006, the result of which was a loss of savings totalling £37m and affecting some 114,000 people. (That is an average loss of £325 per saver.)

After all of the administration involved in sorting out the Farepak affair was completed, customers were paid back just over half of their investment. This was more than many of them had been expecting to receive, but they still lost half of their money.



Review questions

1. What is the maximum amount guaranteed by government for savings accounts with banks or building societies per person?
2. What does 'AER' stand for?
3. List four things that you may want to consider when choosing a savings product.
4. What does 'NS&I' stand for?
5. Why is NS&I a safe place to save?
6. List all of the savings products that you can obtain at the Post Office.
7. Mark is 15 years old. He has £100 that he was given on his birthday. He wants to put the money into a bank or building society account to keep it safe and to earn interest. He does not know when he will decide to spend the money.

Mark visits the following banks and building societies to find out what they offer.

ABC Bank Limited	<ul style="list-style-type: none"> • Offers a savings account with an AER of 1.55% • Mark can take his money out of the account whenever he likes. • He can open the savings account with £1. • The bank will give Mark a free mouse mat when he opens the account.
Big Bank Limited	<ul style="list-style-type: none"> • Offers a savings account with an AER of 1.75% • Mark must give three months' notice if he wants to take his money out of the account. • He can open the account with £10. • The bank will give Mark a free music CD when he opens the account.
Local Building Society	<ul style="list-style-type: none"> • Offers a savings account with an AER of 2.01% • Mark can take his money out of the account whenever he likes. • He can open the account with £1. • The building society does not offer free gifts.
County Building Society	<ul style="list-style-type: none"> • Offers a savings account with an AER of 1.75% • Mark can take his money out of the account whenever he likes. • He can open the account with £1. • The building society will give Mark a free 'Savers' ringbinder when he opens the account into which he can put his statements when he receives them.

Which account should Mark open if he:

- a) wants to earn the most interest?
- b) wants to take his money out with no notice?
- c) wants the best free gift?

Learning activities



Internet

- Visit www.moneyfacts.co.uk and find out which savings accounts are offering the highest interest rate at the moment. Check what terms and conditions are attached to these accounts.
- Visit www.moneyadvice.service.org.uk, click on 'Saving and investing', and find the advice on choosing savings options.
- Visit www.moneyadvice.service.org.uk and search for 'Christmas clubs'. Click on 'Saving for Christmas – Clubs and schemes'. Read about what they are, how they work and their risks.



Group

Visit the financial providers in your high street and get lists of interest rates for savings accounts. Compare the interest rates and the conditions for these accounts, and decide which account is best from your point of view. List the reasons for your choice.

Remember that the account that each member of your group considers to be the 'best' might be different – because each person's preferences and attitudes to risk and reward will be different.



Individual

Look out for savings stamps schemes and Christmas clubs when you are out shopping. If possible, collect an information leaflet on each.



Key points for Topic 2

You should now understand:

- the features of savings accounts that will help you to choose between them;
- what 'AER' is;
- simple interest calculations;
- different types of savings account, such as instant-access accounts, notice accounts, regular savers accounts and cash ISAs;
- the advantages and disadvantages of these savings products;
- why savings held with banks and building societies are safe;
- why the Post Office is a good alternative provider of savings products;
- what 'NS&I' is and be able to name two of its products;
- how savings stamps schemes work and where you can buy them;
- what 'Christmas clubs' are and some of the providers of Christmas clubs; and
- the advantages and disadvantages of savings stamps schemes and Christmas clubs.

Topic 3: Basic borrowing products and providers

After completing this topic, you will be able to:

- appreciate the reasons why people want to borrow;
- understand another meaning of the word 'credit';
- list the main providers of lending;
- explain what 'APR' is;
- explain what an 'overdraft' is;
- explain what a 'credit card' is;
- explain what a 'store card' is;
- explain what a 'personal loan' is; and
- complete simple interest calculations.

Why borrow?

There are times when people want to buy something, but do not have enough cash. For example:

- Su wants to buy her brother a CD for his birthday;
- Lia wants to book her holiday before she gets extra pay next month;
- Hector wants to buy a video camera; and
- Kris wants to buy a car.

In all of these cases, they have a choice:

- they can borrow money to buy now;
- they can save money to buy later; or
- they can decide not to buy at all.



Some items cost so much money that saving up enough cash is not a realistic option for most people, because it would take too long. This might be the case, for example, if you are thinking of buying a car or a large piece of furniture.

People need to borrow to be able to buy these items and use them while they are repaying the loan.

People may need other items immediately, so waiting until they have saved enough cash is not an option. This might be the case, for example, if you have to replace a damaged car tyre or a broken window.

How do lenders make money from lending?



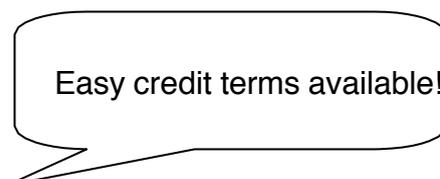
The basics of borrowing

When people borrow money, they need to repay:

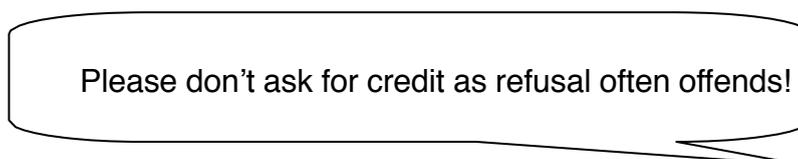
- the amount that they borrowed; *plus*
- interest on the amount that they borrowed (which is calculated as a percentage); *plus*
- any fees or charges that the lender may demand.

Credit

We already know that 'credit' means money paid into a bank account – but 'credit' can also mean something else. To give somebody 'credit' means to lend to them. For example, in shops, you might see notices as follows.



This means that if you wish to borrow some money to pay for the things that you are buying, the shop can offer you a loan. (Usually, it is not the shop lending the money, but rather a bank offering 'credit' through the shop.)



This means that the shop does not offer any credit – that is, it does not lend to its customers, or arrange for any kind of loan for them.



You have to be 18 years old or over to be able to borrow on credit. If you are under the age of 18, how might you be able to borrow money?

Different ways of borrowing

Nowadays, most people are comfortable using credit, as long as they can afford the repayments.



Activity 3a

Think about all of the occasions on which people borrow money – for example, to buy cars, furniture, electrical goods, clothes, holidays and presents, etc. Think about where people can borrow money from – that is, the lenders.

Now, list as many different types of lender as you can.

Smaller loans, such as those of only a few pounds to buy cinema tickets, are usually a very informal arrangement between family and friends. No paperwork is required, the money is usually given to you straight away and no interest is usually paid. This type of lending can be called an 'IOU' (that is, 'I owe you').



This type of arrangement is normally a verbal promise made between friends or family to repay the money borrowed.

It is also the only way in which a young person under the age of 18 is able to borrow.

Of course, the more you borrow, the longer the period of time over which you are usually able to pay the money back. Think about a loan to buy a house: this can be paid back over 25, or even 30, years – a very long time.



Can you think of some reasons why you might not want to borrow from friends and family? Why might you not want to lend to your brother or sister or to your best friend?

Types of borrowing

Overdraft

An overdraft on your current account is a way of borrowing.

You can ask your bank or building society for an overdraft. It will agree the amount of money that you can borrow (known as your 'overdraft limit'). Spending within your limit is called an 'arranged', or 'authorised', overdraft.

You may be charged a fee for arranging an overdraft.

If you borrow without the bank's permission (for example, by issuing a cheque without having enough money in your account to cover it), this is known as an 'unauthorised'

overdraft. The bank or building society may pay the cheque – but it will charge you for doing so. Basically, you are being penalised for not checking if you are allowed to borrow before you do it.

Overdrafts enable people to take more money out of their bank current account than they have put into it. For example, you might have £50 in your current account. If you withdraw £60, you are using an overdraft of:

$$£60 - £50 = £10$$

Case study

Carl gets paid on the last Friday of every month.

He finds it difficult to manage his money because his rent must be paid in the middle of every month. Carl's rent is a large amount, so he sometimes runs out of cash before his next payment from work. Occasionally, he has written a cheque that has taken more money out of his bank account than he has deposited there. These occasions were mistakes, because Carl lost track of how much money was in his account at different times in the month.



I have enough money. My problem is timing...

I wish I got paid in the middle of the month!

Carl asks to talk to his bank manager, who arranges an overdraft of £100 for Carl. This means that Carl can write a cheque or withdraw cash for up to £100 more than he has in his account.

Carl decides that he will borrow for only a few days each month and that he will repay the total amount borrowed as soon as he is paid.

As long as Carl keeps within the authorised overdraft amount, he will not pay any penalty fees. The interest that he pays on his overdraft is calculated on the proportion of this money that he uses (that is, borrows) each day. For example, if Carl uses £20 for two days, he will pay less interest than if he uses £60 for two days.

What are the advantages and disadvantages of an authorised overdraft as a way of borrowing money?

Personal loans

People can also borrow by getting a loan from a bank or building society. Loans can be made for a specific purpose, such as for the purchase of a car.

A personal loan is a way of borrowing a sum of money for a period of time. For example, someone might borrow £10,000 to be repaid over three years, or £2,000 to be repaid over two years, etc. It is up to the borrower to look for the repayment period that will suit them best.



The monthly repayments for a personal loan are the same each month and the interest rate will not change.

Loans tend to be made for larger sums of money than overdrafts. An overdraft is designed to be used for short periods of time, such as a few days a month, and for smaller sums of money, such as a few hundred pounds. Loans are for larger sums of money, such as several thousand pounds, and for longer periods of time, such as 12 months, three years, five years, seven years, or even 15 years.

When you look at the cost of a personal loan, the lender will tell you the monthly repayments, which will be the same each month, as well as the total cost of the loan.



Why is it a good idea for the repayments to be the same each month?



Credit cards

Credit cards allow you to buy now and pay later. These plastic cards can be used to pay for goods and services in person in shops, restaurants and petrol stations, etc, and to withdraw cash (for a charge). They can also be used from a distance to buy goods and services on the

telephone, by mail order and on the internet.

Using a credit card means that the cardholder is borrowing money from the card company. Cardholders are told the maximum amount of money that they can borrow on the card. This is known as their 'credit limit'.

Each month, the cardholder will receive a statement listing all of the transactions that they have made on their card. Cardholders can decide to repay all of the credit that they have used during the month or to repay only part of it. Cardholders who repay all of their borrowing do not pay any interest. Cardholders who repay only some of their borrowing by the payment date will pay interest on the amount of debt left over.

A cardholder must make a minimum repayment that is equivalent to more than a single month's interest. This means that the repayment will cover the whole of that month's interest plus some of the amount outstanding.

A cardholder who makes only the minimum repayment each month will find that it takes them a long time to reduce their debt.



Case Study

Fiona has a credit card. She spent £100 on the card when she first got it and makes only the minimum repayment of 4 per cent each month.

If Fiona continues making only the minimum repayments, she will still owe the credit card company £40 at the end of three years!

Month **Debt from previous month**

£ **Interest on debt @1.6%**

per month **New purchases on card**

£ **Amount owed this month Repays minimum at 4%**

£ **Debt rolled over to next month**

£

Jan	0	0	100.00	100.00	4.00	96.00
Feb	96.00	1.54	0.00	97.54	3.90	93.64

Credit cards can be very useful because they allow you to spread borrowing across a few months, but they work out as an expensive way of borrowing money if the debt is not repaid for a long time. All of the main banks and building societies also provide credit cards.



Activity 3b

Visit the websites of the main banks and building societies.

Look at the credit cards advertised and draw up a table showing the main features. You might like to use the headings suggested in the table below, which demonstrates an entry for NatWest (as at March 2015).

Bank	Credit card name	APR	Fees	Other information
NatWest	Cashback Plus credit card	17.4 %	£24pa	Variable cashback depending on retailer
	Clear Rate Platinum credit card	11.1 %	£24pa	One low rate on purchases and balance transfers
	Student credit card	18.9 %	Nil	Maximum credit limit £500 Online and mobile management
	Private Black credit card	14.9 %	Nil	Build up NatWest YourPoints. Only available to Black Account holders



When you compare the interest rates for credit cards and those for overdrafts and personal loans, credit cards are often more expensive. When is a credit card a good idea for borrowing?

Did you know?

Credit card transactions are processed using computer networks owned by payment systems.

The two biggest payment systems in the world are **Visa** and **MasterCard**.

You will see the logos of these companies on credit cards, as well as the name of the bank that has issued the card. You will also see these logos displayed in shops, restaurants, petrol stations, etc, as a way of showing that you can pay with that type of credit card at that place.



What are the advantages and disadvantages of credit cards as a way of borrowing money?

Many people use credit cards because they are flexible. Once your limit has been agreed, you can use the card as much as you like. You do not have to apply for an overdraft.

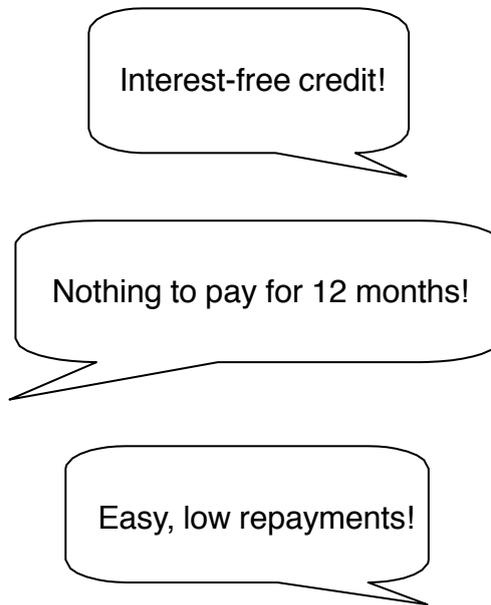
Having a credit card can, however, encourage you to spend money that you have not got. You will need to plan carefully to make sure that you can repay the money that you have borrowed.

The interest rate for credit cards is higher than that for loans and overdrafts.

In-store credit

Many shops also offer in-store credit – for example, furniture shops and electrical retailers. These shops have agreements with organisations such as banks and finance houses (that is, companies that offer credit) to provide these products.

Many of the in-store borrowing products sound very attractive because shoppers are made the following promises.



These promises may look very good, especially in the first year – but repayment has to be made and interest will be charged after the interest-free period.

All in-store credit agreements have to state the annual percentage rate (APR) and you will be able to work out if the deal is the best option for you.



Activity 3c

When you are out shopping, keep an eye out for in-store credit offers. Pick up some leaflets and bring them back to show your class and teacher.

The key point here is that if an offer sounds too good to be true, then there is probably a catch!



Activity 3d

List some of the advantages and disadvantages of in-store credit as a way of borrowing money.

Interest on loans

Lenders make money by charging interest on their lending. To work out the cost of borrowing the money that you want, you will need to work out the interest costs. Interest is stated as a cost for each year.

For example, if you were to borrow £2,500 at an interest rate of 10 per cent, the interest cost each year would be:

$$\underline{\pounds 2,500 \times 10} = \pounds 250 \text{ 100}$$



Activity 3e

Work out the annual, and then the monthly, interest on each of the following loans.

a) £3,000 borrowed at 4 per cent

b) £6,000 borrowed at 6.5 per cent

c) £7,000 borrowed at 8.5 per cent

The interest rates and the annual percentage rate (APR)

Banks do not expect you always to have your calculator with you when you are trying to choose the best way of borrowing and the best provider.

In Topic 2, we looked at the annual equivalent rate (AER) as a method of comparing interest rates on savings.

For loans, all lenders legally must tell you the 'annual percentage rate' (APR), which is worked out using a complicated formula that you do not need to know at this stage.



The APR formula includes:

- the interest rate;
- the period for which you want the loan; and
- any fees charged.

It means that, when you are comparing the costs of one loan against another, you can look at the APR and know which one is cheaper. It stops lenders from advertising a really low interest rate and then surprising the borrower with lots of 'hidden charges' after they have taken the loan.

Fixed APR

The APR on a personal loan is fixed, meaning that it does not change over the life of the loan. To work out your monthly payments, the bank or building society will show you a table like the one on the next page.

12.9% APR								
Mont		12	24	36	48	60	72	84
		£	£	£	£	£	£	£
£1,000	<i>Monthl y repaym</i>	89	47	33	26	22	20	18
	<i>Total to repay</i>	1,068	1,128	1,188	1,248	1,320	1,440	1,512
£2,000	<i>Monthl y repaym</i>	178	94	67	53	45	39	36
	<i>Total to repay</i>	2,136	2,256	2,412	2,544	2,700	2,808	3,024
£4,000	<i>Monthl y repaym</i>	356	189	133	106	89	79	71
	<i>Total to repay</i>	4,272	4,536	4,788	5,088	5,340	5,688	5,964



Activity 3f

Using the table above, find out the following.

a) The monthly cost of a loan of £2,000 for 48 months

b) The monthly cost of a loan of £4,000 for 72 months

c) The monthly cost of a loan of £1,000 for three years

The table also shows the total cost of repaying the loan in full. For example, if you look at a loan of £2,000 over two years, you will see that the total that you will repay is £2,256.



What do you think the difference of £256 represents? Why do you think knowing the total to be repaid is useful?

Variable APR

If the interest rate on your borrowing can change, the APR is said to be 'variable'. Variable APR means that your interest payments can go up or down each month because the interest rate is not fixed.

Equivalent annual rate (EAR)

'Equivalent annual rate' (EAR) is the legal way in which interest rates have to be quoted for overdrafts. The reason that this applies only to overdrafts is that an overdraft is a credit facility attached to a current account. The current account may be in credit some of the time; at other times, the account holder may use the overdraft.

The EAR is a rate that shows what the cost would be if the account were to be overdrawn all of the time.



Activity 3g

Visit the websites of several banks and building societies, and look at the interest rates for an authorised overdraft and a personal loan. You will need to look at the EAR for the overdraft and the APR for the loans.

a) *Why do you need to look at different rates for the two types of borrowing?*

b) *What do you learn about the personal loan rate?*

c) Which is the best bank?

There is no legal maximum for the amount of interest that a lender can charge.

Providers of loans and other forms of credit

Banks and building societies

We already know a lot about banks and building societies from the work that we have done in previous topics.

- Banks make their money by lending out the money that they receive in deposits to people who want loans and by charging more interest to their borrowers than they pay to their savers.
- Building societies make their money in the same way, except that they share the profit that they make with their members (that is, their customers).

You are also likely to be familiar with the names of some of the main providers.

Credit unions

Credit unions are owned and run by their members, for their members. Some credit unions may lend to you as soon as you become a member; others will lend to you after you have shown them that you are able to save regularly.

The APR on the loans offered by credit unions is capped by law, so they often charge much lower interest rates on loans than do other providers (though they may be higher than banks if the amount borrowed is not small).

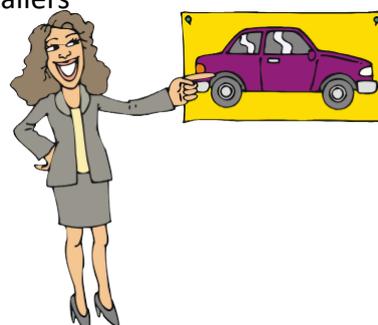
Credit unions may also be able to help you manage your money.

Other providers of credit

You can get loans and credit cards from many shops and retailers on the high street, including supermarkets.

Shops that sell high-value items, such as furniture and cars, have been offering credit services for many years, and they do this for a number of reasons.

For example, a customer might see a new sofa that they would like to buy. They probably have not saved up for a



new sofa and do not want to wait until they have saved up before they can buy it; they want it now. If the furniture store were to wait for the customer to apply for a loan from their bank, they might never come back, or, once they have the idea in their head that they now want a new sofa, they may decide to go to a few more furniture stores before deciding which one to buy.

By offering the credit facility in store, the furniture retailer is more likely to make the sale. But it is not the furniture store that is actually providing the loan; rather, it is a bank. So for every loan that it is able to arrange, the store will earn commission from the bank as a reward for arranging new business for it.



Some shops – furniture stores in particular – offer deals that mean the customer does not even have to make any repayments on

the loan for the first few months, giving them time to rearrange their finances and budget for the monthly repayment. It is important to note that the customer is probably not getting ‘free’ credit during this time – the repayments, once they begin, are likely to be higher to compensate for the period during which no payments are made. Similarly, those shops that offer ‘interest-free credit’ may not be adding interest to the loan, but very few forms of credit are truly ‘free’, so they are probably charging more for the furniture in the first place.

Store cards

Some shops offer their own cards. These are called ‘store cards’ and can be used to purchase items only from that particular store. Interest rates on store cards are usually quite high. Having a store card for a particular shop encourages people to buy more things from that shop than they do from any other shop, because it means that they can still make purchases even if they do not have enough money at that time. They buy the things that they want on the store card and pay the money back later. This can be a very expensive option and a bad idea for people who are not very good at managing their money.

Supermarkets offer loans and credit cards too. Sometimes, it is a bank that is actually providing the credit under the supermarket’s name; sometimes, the supermarket has its own bank.

Payday loans

Another option is a payday loan, with Wonga being one of the best known providers of these. It is a relatively small loan (Wonga, for example, will lend up to £1,000 to existing customers) designed to be taken out over a short period of time. Typically, payday loans are advertised as a way to fund unexpected purchases that arise a few days before the end of the month, when you are short of cash and waiting for payday. Unlike traditional personal loans, they are arranged over days rather than years, so can be used as a 'stop gap' until your wages arrive.

While the APR figures quoted are huge, with Wonga quoting a representative APR of 1,509%, they are not necessarily more expensive than what your bank would charge for an unauthorised overdraft, provided they are repaid within the short term agreed at the outset. However, charges quickly mount if you miss the repayment or decide to extend or roll over the loan. What started as a small loan can grow rapidly once extra interest and fees start to be applied.

Concerns over payday loan charges led the Financial Conduct Authority, in 2015, to introduce rules that mean nobody will have to pay back more than double the amount they originally borrowed.

Illegal lenders

Any provider of borrowing products has to have legal permission to lend and, as we have already seen, must tell you the interest rate as an APR or EAR. Anyone lending money without legal permission is breaking the law. Such lenders are known as 'loan sharks' and they tend to charge very high interest rates.

You should avoid borrowing from loan sharks.





Review questions

1. Match each of the following loan providers with a type of credit product.

Providers			
1	Bank	A	re card
2	Family	B	'Interest-free' credit
3	Clothing shop	C	erdraft
4	Electrical shop (selling TVs, washing machines, etc)	D	IOU (that is, a written or verbal agreement to repay)

cts

2. What does 'APR' stand for and what does it mean?
3. Suppose that Frank wants to borrow a small amount of money for a few days. Should he ask his bank for an overdraft or a loan?
4. Suppose that Victor wants to borrow £3,000 over five years. Should he ask his bank for an overdraft or a loan?
5. What is the advantage of an authorised overdraft over an unauthorised one?
6. Do people pay interest on their full overdraft limit or only on the amount of money that they have borrowed?
7. Is Gillian borrowing money when she makes a purchase using her credit card?
8. Do credit cards charge interest on all of the money spent using the card during the month or only on the money that is not repaid at the end of the month?
9. Tom has a loan with a fixed interest rate. Will his repayment be the same amount every month?
10. Which types of provider offer personal loans?
11. Tammy is comparing the cost of borrowing using an overdraft or a credit card. She wants to borrow £200 for about eight days. Assuming that her next credit card statement will not arrive for another four weeks, which is the cheaper option?

12. What does 'EAR' stand for when talking about borrowing?
13. Why do you need to be careful borrowing from a payday loan company?
14. Why should people avoid borrowing from a loan shark?

Learning activities



Internet

- Visit www.moneyfacts.co.uk and under 'Banking' go to 'Banking Guides' then 'Loans', and select 'Personal loans – key factors to consider'. Read the guide that provides basic information to consider to ensure that you take out the right loan.
- Visit www.moneyfacts.co.uk and compare the costs of borrowing using a mortgage, overdraft, loan and credit card from different providers. Note that the introductory rates and the standard interest rates on cards can be very different. Next, visit the website of any high-street bank and compare its interest rates with the rates quoted on www.moneyfacts.co.uk. Think about why it is important to 'shop around' when looking for a borrowing product.
- Visit the websites of a range of high-street and internet banks, and find out what questions they ask when providing a quote for a personal loan. Think about why they might ask these questions.



Group

Suppose that your group works for a bank. You have £100,000 with which to make loans to customers. You want to earn the most money that you can for the bank. Think about and discuss the following questions.

- To what sort of customers do you want to lend?
- What questions will you ask customers on their application forms?
- Are you going to offer only one type of borrowing product, or will you offer several different ones (such as overdrafts and personal loans)?
- Look at the interest rates that you have discovered while working on various activities throughout this topic or at those quoted online at www.moneyfacts.co.uk. Decide what APRs and/or EARs you are going to charge on your products, giving reasons why you have chosen these rates.



Individual

- Look at advertisements and other information from providers to find the cheapest way of borrowing £800 to buy a car.
- Visit www.youtube.com, search for 'Credit made clearer', and select the clips entitled 'Understanding interest and APR' and 'Tips for using your credit card'.
- Imagine that you are about to leave home to live in a rented house with friends. At present, the house has furniture, but does not have items such as sheets, a telephone, a TV or stereo, light bulbs, cups and plates, etc. Think about what you will need to buy, how you will borrow the money that you need to buy these things and how you will ensure that you can pay this money back.



Key points for Topic 3

You should now understand:

- what 'credit' is;
- the main providers of lending;
- what 'APR', and 'fixed' and 'variable' APR, are;
- what 'EAR' is;
- how to complete simple interest calculations;
- what an 'overdraft' is, including the advantages and disadvantages of overdrafts;
- what a 'personal loan' is, including the advantages and disadvantages of personal loans;
- what a 'credit card' is;
- the features of a credit card statement;
- the credit limit and minimum repayment on a credit card;
- the advantages and disadvantages of credit cards;
- what a 'store card' is, including the advantages and disadvantages of store cards;
- what 'in-store credit' is, including the advantages and disadvantages of in-store credit;
- what a 'credit union' is, including the advantages and disadvantages of borrowing from a credit union;
- what a 'payday loan' is, including the advantages and disadvantages of taking one out; and
- what a 'loan shark' is and why you should not borrow from a loan shark.

Topic 6: Basic tools used to manage a personal financial budget and to make calculations

After completing this topic, you will be able to:

- explain how the following can help you to manage your finances – a bank statement, regular balance enquiries, online banking, telephone banking and a cash flow forecast;
- use calculations to manage a personal financial budget;
- calculate a personal financial budget, taking into account income and expenditure;
- keep track of your savings;
- understand the terms 'surplus' and 'deficit';
- budget for both short and long terms, and adjust for next time; and
- appreciate that plans may change over time and that budgets need to adapt.

What is a budget?



The word 'budget' comes from an old French word *bougette*, which means 'purse'.

A budget is an organised plan of all of the money that you are expecting to receive and all of the money that you expect to have to pay out over a period of time. A budget can cover a week, a month or a year, or even longer. Budgeting properly enables you to plan ahead, giving you an accurate picture of how much money you have left to spend on luxuries and treats, after all of your essential expenses are paid.



Sometimes, budgeting involves making an estimate of your living expenses by looking at previous bills. It also involves making other calculations so that you can accurately predict how much money you have to set aside for things such as bus fares, train fares, lunch money, etc, over a whole week or month.

If your income is not so regular, or it is a different amount each week or month, budgeting is even more important because you may have to take into account bills and other expenses that may fall due before you next receive any money.

Keeping track of your finances

In order to keep track of your finances, you need to know how much is in your bank account or your savings account at any one time. Without knowing what you have in your account, you cannot budget for the next week or month.

Of course, you could go into your bank and ask how much you have in your account, but this is not always convenient and you might want this information at a time when the bank is closed.

There are a number of ways in which you can check your balance without actually going into the bank itself, including:

- bank statements;
- getting a balance from the automated teller machine (ATM);
- online banking; and
- over the telephone.



What are bank statements?

Bank statements list all of the transactions that put money into and take money out of a bank account. The types of transaction that appear on a statement depend on the type of bank account to which it refers – for example, a current account or a savings account.

Information shown on a current account bank statement

A bank statement records the transactions on the account for a specified time period. Each line on the statement is a separate transaction. Statements are increasingly paperless due to online banking, instead available to view on a computer.

Let us look at an example.



Activity 6a

Teo has just received the statement for his current account with Big Bank plc. The top part of the statement is reproduced overleaf.

Use Teo's bank statement to answer the following questions.

- a)** *What is the number of the account that this statement is for?*

Current Account Statement

Account number: 71290439
 Statement number: 8
 Statement for 16 April to 15 May
 201X Page 1 of 1

Big Bank plc

12 The High
 Street Midtown
 MT4 17J
 Branch number: 91-20-07
 Telephone: 01632 960960

Mr Teo
 Szabo 28
 Oak Street
 Midtown
 MT51 6PN

Date 201X	Details	Payments	Receipts	Balance
15 Apr	Balance from statement 7			200.00
18 Apr	Cash machine wdl	30.00		170.00
21 Apr	Direct debit – Umbrella Insure Co	12.50		157.50

b) *Where is the branch located?*

c) *What is the sort code of the branch at which this account is held?*

d) *If Teo were to have a question about a transaction on this statement, what telephone number should he call?*

e) *How many pages are there for this bank statement?*

f) *What do you think 'wdl' means?*

g) *How much money was in Teo's bank account at the end of business on 18 April 201X?*

h) *How much did Teo pay the insurance company in April?*

Understanding current account statement entries

There is no standard format for bank statements. Each bank or building society can use a different layout and way of describing the information shown. They do, however, all tend to use five columns:

- one for the date;
- one showing a description of each entry;
- a column for amounts paid in;
- a column for amounts paid out; and
- a balance column.

The following table shows some of the entries that appear on statements and what they mean.

Balance	Statements usually start with the balance from the previous statement, ie the amount of money that the account holder had in the account on the last day of the last statement. Transactions are listed and each time that money is added to the account or taken out of the account, the total amount held or owed after this transaction (ie the balance) is also entered. A new balance is therefore entered after every transaction. Statements end with the balance at the statement date.
Cash machine	This details any money withdrawn from the account through a cash machine. Entries can also be described as 'ATM'.
Cheque	This will detail any money taken out of the account because the account holder has written a cheque to pay a person or an organisation. Statements show the number of the cheque, as well as the amount paid out.
Credit	This refers to money paid into the account.
Direct debit	Where a direct debit has been taken, it shows the name of the organisation that has collected the money and the amount taken.
Overdrawn	Where the account holder has spent more than they have in their account, the balance will be shown as a minus figure – eg '–£23.47' – or it might say '£23.47DR', meaning that the account is £23.47 into its overdraft.
Page number	The account holder may have made so many transactions on the account that the statement list runs to more than one page. Each page will be numbered.
Payments	This refers to money taken out of the account. This column can also be called 'Withdrawn' or 'Debits'.
Receipts	This refers to money put into the account. This column can also be called 'Paid in' or 'Credits'.
Standing order	This is a regular, automated payment from the account that is the same amount of money each time. This will show to whom the money was paid and how much.
Statement date	This is the date on which the statement was printed. Transactions made on the account after that date will appear on the next statement.
Statement number	The statements for an account are numbered from 1 upwards.



Activity 6b

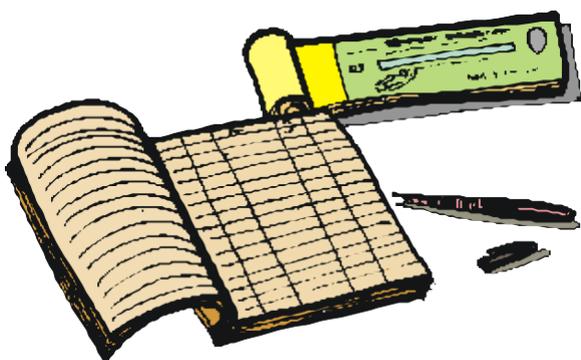
Some statements show descriptions for entries in full and some use abbreviations. Complete the table to show what you think these abbreviations might mean.

Abbreviation	Meaning
CHG	
CHQ	
D/D	
INT	
O/D	
S/O	
TRF	

Checking current account statements

When you receive a bank statement, it is very important that you check the entries to be sure that there are no mistakes or missing items.

How to check statements



You must always keep the following documents to be able to check your current account statement:

- ATM receipts;
- withdrawal slips from transactions completed at the bank;
- paying-in slips; and
- debit card vouchers.

Paying-in book stubs and chequebook stubs are also important.

You will need to check the following when you are trying to make sure that there are no mistakes in your statement.

- ATM withdrawals listed on the statement should match up with your ATM receipts (that is, the date of the withdrawal and the amount should be the same).
- Withdrawals listed on the statement should match up with the withdrawal slips that you kept when you withdrew the money.

- Credits listed on the statement should match up with your counter receipts and paying-in book stubs showing money that was paid into the account at a branch on that day.
- Payments listed on the statement showing as debit card transactions should be the same as the debit card vouchers that you kept from the shop.
- Cheques paid should match with the information on your chequebook stub (that is, the date, amount and cheque number should all be the same).
- Automated payments, such as direct debits and standing orders, should be for the amounts expected.
- Payslips from employers should detail the same amount as that shown as a direct credit on your bank statement.
- Your bank will already have advised you of any bank charges or interest due on your account and you should check that the figures on the statement agree with the advice.

What to do if you find a mistake

If you find a mistake on a bank statement, you should contact the bank branch immediately. Banks can make mistakes and they will always correct them.

There may also be a transaction that you do not recognise and, if this is the case, you should tell your bank about it straight away. It might be that someone has accessed the money in your account and made a fraudulent transaction. This is rare, but if you tell the bank immediately and if it is definitely not a transaction that you, the account holder, have authorised, you will get your money back. This is why it is important to keep all of your receipts and slips, and to check your statements carefully.

Did you know?

It might be that the mistake you find on your statement is a credit of which you are not aware - that is, that some extra money has been put into your account by mistake. No matter how tempting it is to keep the money and say nothing, you should always tell the bank **always**.

Keeping the money could lead to criminal charges against you for the offence of 'retaining wrongful credit'.



Activity 6c

The below is a statement that Maria has received from her bank.

Statement of Account				
Current Account: 22187655 Overdraft limit: £100 1 July to 31 July 201X				
Ms Maria Dane Flat 4A, Apartment Heights 17 Chestnut Road Anytown				
Date	Details	Payments	Receipts	Balance
	Balance from Statement 42			56.00
3 July	Bank Credit PEABODY LTD ^A		600.00	656.00
4 July	ATM Withdrawal	30.00		626.00
7 July	Cheque 102234	200.00		426.00
12 July	Standing Order BARNADOS ^B	3.00		423.00
14 July	Cheque 102235	45.50		377.50
14 July	ATM Withdrawal	30.00		347.50
17 July	Direct Debit HOPE INS CO ^C	12.00		335.50
18 July	Debit Card Cinema Now ^D	14.95		320.55
21 July	ATM Withdrawal	130.00		190.55
24 July	Debit Card Food Store	66.21		124.34
28 July	Counter Credit 12-34-56 ^E		44.14	168.48
28 July	ATM Withdrawal	30.00		138.48

Can you identify what each of the items marked ^{A-E} represents?

Bank statements are received regularly, but they do not give you an up-to-date balance. They show only the balance on the last day of the period that the statement represents.

Balances

We have already seen in previous topics that it is very easy to make a mistake by not budgeting correctly for all payments that are due out of your account. You need to look at the balance at the end of the statement period and then work out what payments may have been deducted, or are about to be deducted, from your account since that day to give you a more accurate picture – that is, to give you an up-to-date balance on your account.



There are a number of ways in which you can get a more up-to-date balance on your account, including:

- visiting the branch;
- getting a balance from the ATM;
- checking your account using online banking;
- checking the balance over the telephone; and
- keeping your own record of how much you have spent.



What do you think might happen if you were to use the ATM after the statement date?

Case study

Mollie got her bank statement on Tuesday in the post. It was dated Friday 20 February and showed a balance of £47. On Monday evening, she checked her balance on the ATM and it said that her balance was £22.

This is because Molly drew out £25 cash over the weekend.



Activity 6d

Antonio goes to the ATM on Thursday and sees that his balance was £77. On Monday, his bank statement shows that his balance is £145. On his mobile, he has a reminder that he is expected to pay his phone bill of £35 on Tuesday and his chequebook shows he has issued a cheque for £33 that has not yet shown on his bank statement.

Can you complete a simple calculation to show that the ATM balance is correct?



Activity 6e

Pierre checked his balance by logging onto the bank's website and using online banking. His balance is shown as £117, but he knows that there are a few transactions that he has carried out that are not yet showing on his account.

What documents will he use to work out how much he really has left to spend?

Keeping track of expenditure

We have seen what happens if you fail to keep a record of the money that you spend or the money that is paid regularly out of your account. If you do not keep track of your transactions, the consequences can include:

- being unable to get cash out of an ATM, because you have no money left in your account;
- being unable to buy something for which you have saved up, because you have spent the money on something else; and
- bank charges, because the bank has either given you an unauthorised overdraft or has not been able to make a payment.



Activity 6f

- a) List some of the ways in which you might make sure that you keep track of your money.

b) Which one of these do you think is the best?



Activity 6g

Maria knows that her bank balance is £67. Her notebook looks something like this:

	Expense	Balance
		£67
Monday		
ATM	£10	£57
Tuesday		
New bus pass	£15	£42
ATM	£10	£32
Friday		
Cinema	£7.50	_____
Cash	£12	_____

Fill in the balance boxes for Friday to show how much Maria has left.



Activity 6h

Sercan has made the following notes in his diary about his money. He had £54 in his bank account on Wednesday.

Thursday: had to get a new T-shirt – set me back £15

Friday: big night out – cash £20 and pizza £15

How much does Sercan have left to spend on Saturday?

We are now going to look at how a student might manage their spending.



Activity 6i

Abbas is in his first term at university. He is living in halls of residence, so all accommodation costs and bills have already been paid. Below is a record of Abbas' spending during his first ten weeks.

	Expens e s	Balanc e s
Student expenditure for a term of ten weeks		
Allowance		1,000
Week1		
Freshers' Week (lots of money, but everyone spends loads that week)	200	
Food (including all of the stuff you forget to bring from home)	50	
At end of week		750
Week 2		
Books	60	
Food	35	
Going out	50	
At end of week		605

Week 3	
Food	35
Going out with mates for someone's birthday	50
Toiletries	20
At end of week	500
Week 4	
Food	35
Cleaning stuff (flat inspection)	10
Mobile contract	30
Last-minute gig	15
At end of week	410

a) *Can you work out how much Abbas has spent during his first four weeks at university?*

b) *How much does he have left to spend during the remaining six weeks of term?*

c) *Can you see what is going to happen here?*

- d)** *Discuss how Abbas might plan to get through the next six weeks. What would you do if you were Abbas? (You should include in your discussion the ideas about essential and non-essential expenditure that we met in the previous topic.)*

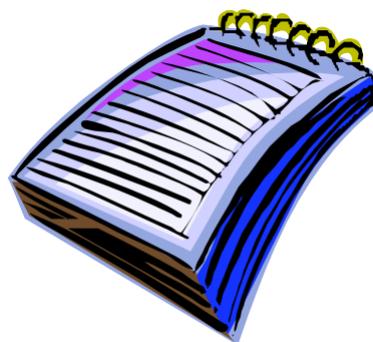
Surplus and deficit

There are two words that are often used when talking about budgeting, as follows.

- **Surplus** means that you have money left over. When you make a budget and stick to it, you usually have a surplus at the end of the week or month.
- **Deficit** means that you have spent more than you should. An example of when a deficit occurs is when you spend everything in your current account and you go overdrawn.

In the previous example, Abbas spent more than half of his allowance in his first four weeks of term – but he still had six weeks to go. If he were to continue to spend at the same rate, he would have a deficit. He might have to borrow in order to meet his essential needs.

This is why it is important to make a budget and stick to it. Abbas should have made a list of the things that he *has* to buy before he started and, if he had done this, maybe he would have spent less during Freshers' Week!

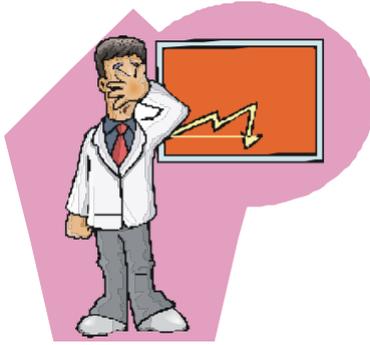


Plans for the short and long terms

We have looked at plans and expenditure for short periods of time, such as a few weeks. This is the type of planning that you are more likely to do, because your allowances and wages will be paid weekly or monthly.

As we saw with Abbas, however, things get harder if you get an allowance for a term of ten weeks. This will demand longer-term planning.

Long-term planning is also needed once you move into your own home or if you have decided to borrow using personal loan for a car, for example.



Cash flow forecasts

A cash flow forecast is a calculation undertaken to work out what will happen in the future. It is a plan for the money going into and coming out of a bank account.

It is always a good idea to prepare a cash flow forecast, because this will help you to decide which non-essential items you can afford to buy and which ones you cannot afford just yet.



Case Study

Abbas has a number of ways in which he might solve his budget problem. You have discussed ideas about how Abbas might get through the next six weeks. The following is he might prepare his cash flow forecast:

Cash flow	Week 5	Week 6	Week 7	Week 8	Week 9	Week 10
Balance	£410	£355	£300	£245	£160	£105
Food	£35	£35	£35	£35	£35	£35
Phone			£30			
Going out	£20	£20	£20	£20	£20	£20
	£355	£300	£245	£160	£105	£50

Abbas knows that he has £50 left to spend on his birthday, or clothes, or a treat, during the next 6 weeks.

Adapting your budget when things change

Although it is important to stick to a budget once you have taken the trouble to create one, it is equally important to adapt it if your circumstances change.

A change in financial circumstances can either result from an increase in expenses, or a reduction in income. Even if the change is only small (such as an increase in the cost of electricity, or an increase in the cost of petrol), it is still important to update your budget so that it continues to reflect an accurate picture of your finances.

For example, for someone who does not earn very much, an increase of £20 on their electricity bill could mean that they have to go without something else to pay for it.

If one of the household income earners loses their job, the household budget will have to be changed quite dramatically in order that the family can continue to afford necessary items. It may mean fewer trips to the cinema or fewer meals out until they find another job; even then, their wages might be lower than before, so the budget will have to be adapted to reflect this.

If a person changes their job from one that paid monthly to one that pays weekly, this too will require some additional budgeting, so that they set aside some money each week to put towards the bills that fall monthly.



Review questions

1. What is a budget?
2. How old should you be before you should start budgeting?
3. Name three ways in which you can obtain an up-to-date bank balance.
4. Why do you think bank statements use abbreviations, such as 'WDL' instead of 'withdrawal', or 'D/D' instead of 'direct debit'?
5. Why is it important to complete a chequebook stub?
6. What should you check against your bank statement and for what are you looking?
7. Why can you not rely on an ATM balance as a true indication of the balance of your account?
8. What does 'surplus' mean when talking about budgeting?
9. What does 'deficit' mean when talking about budgeting?
10. Why is it important to update your budget if your circumstances change?
11. What can happen if you do not budget your finances properly?

Learning activities



Internet

- Visit <http://moneysense.natwest.com/schools/students/>. Choose 'Managing your money' and then 'Budgeting'. Under 'Planning tools', choose 'Weekly budget', then choose 'Budgeting for a holiday', followed by 'Case study: a personal budget'.
- Visit www.nidirect.gov.uk and select 'Young people', then 'Money' and 'Managing your money'. Look at the advice given for managing your money and keeping your finances under control.



Group

If you have any iPhones or Android phones in your class, look at the list of free finance apps and download a couple. Use the apps to record someone's spending and see how easy they are to use.



Individual

- Talk to family and friends about how they manage their money. What mistakes have they made? What do they think works for them?
- If you have an iPhone or Android phone, download a finance app and try to record your expenditure.



Key points for Topic 6

You should now understand:

- what a 'bank statement' is;
- methods of checking your balance;
- how to calculate the balance of your account;
- why an ATM balance might not be correct and be able to give an example;
- how to calculate how much you have got left to spend;
- what 'surplus' and 'budget' mean;
- the difference between short-term and long-term planning;
- what a 'cash flow forecast' is and for what it is used;
- why keeping a record of expenditure might help you to plan for next time.

