DOLLARS & Sense

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Teaching Children about Money and Budgeting

As parents, we typically resent the notion of someone else telling us how to raise our kids. But when it comes to teaching our kids how to manage money wisely, most of us need all the help we can get.

The fact is, many adults and teens don't understand the most basic concepts about money. On the other hand, young people typically turn to their parents first for financial education and guidance. To help children learn money management skills, parents should first assess their own grasp of personal finance and gain the confidence to talk to their children about money matters.

Children need access to money

According to the Indiana Department of Financial Institutions, children and teenagers have more money to spend than previous generations and develop spending patterns at a younger age. Children's attitudes about money are most influenced by their parents, the media, their peers, and their own successes and failures in spending money. Their money management skills will develop from the ideas, attitudes, and spending habits they learn at home, school, and in the marketplace. Those who learn good money management skills are more likely to become adults who can make sound financial decisions, avoid excessive debt, and manage income and expenses to reach their financial goals.

Whether or not you pay your children an allowance, all kids need experience with money at a young age. Many parents feel an allowance represents a great opportunity for kids to learn about managing money through hands-on experience. An allowance is real money that kids can handle and manage now.

Giving children an allowance should begin when they can identify coins and cash, know how to count, and have spending opportunities. This often occurs around age five or six. If you decide to give your kids an allowance, remember it's important to pay it at regular intervals and to provide some general guidelines on how to spend and save it. Give them enough freedom to make their own decisions and mistakes.

Also, to help your children start learning how to save money, give them their allowance in denominations that make it easy to do so. For example, if the amount of the allowance is $5, give them five one-dollar bills and encourage that at least one dollar be set aside in savings. Saving $5 a week at 6% interest compounded quarterly will total about $266 after a year, $1,503 after five years, and $3,527 after ten years.

Give them the freedom to spend their money

If your kids receive an allowance or earn money through chores, a paper route, or helping with odd jobs around the house or yard, encourage them to bring some of their own money with them when you go grocery shopping. Then they can decide if they want that soda, Popsicle, bubble gum, or candy bar enough to spend their money on it. If your children don't have a source of income, allow them to manage money by letting them pay the grocer or the parking attendant.

Teach responsibility through activities

The following tips and activities provide useful insight for parents as they work to raise children who practice sound money management:

Take your child to the store. Let your child actually see a toy he or she saw advertised. Together, examine the toy and decide if it can really live up to the promises made in the advertisement. Children at this age are quite aware of television commercials and often sing the jingles they hear.

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Begin talking with them about the financial realities of the family and how choices are made.

Money jars. Help children divide their allowance or earnings into four jars—charity (10%), quick cash (30%), medium-term goals (30%), and long-term goals (30%).

Opportunities for extra chores. Give your children the chance to earn extra cash by doing jobs beyond their expected chores. Award jobs to the lowest bidder as part of a "Saturday Job Auction."

Paying bills. Have your high-school age children pay the family bills for one month (with the parents' money, of course). Use play money to recreate bill paying for younger kids. Help them see what you have, what you need to pay, and what will be left over for your discretionary spending.

Budgets and spending plans. Help teenagers who are earning money create and follow a budget. This is especially important before they leave for college, where they will have significant financial responsibility. Emphasize the freedom that comes when they plan their spending and saving.

Teach them to be charitable. Help your children experience the good feelings of sharing their income with others. Encourage your children to regularly contribute a portion of their income to a charity or help them buy treats for the family. "Adopt" a family through your church, synagogue, or community during the holidays or give your children the responsibility of buying or making birthday gifts for friends. Also, teach your kids to contribute in ways other than giving money by giving time, energy, and skills to help someone else.

Planning for vacations. Help children plan a family vacation. Involve them in the decision-making process for all aspects of the trip, such as food, travel, hotel, souvenirs, activities, etc.

Understanding compound interest.

Teach your children the benefits and penalties of compounding interest. Teach them they can earn interest by matching their savings 25 cents on the dollar or help them open a savings account or mutual fund. Teach them the drawbacks of paying interest when they borrow or purchase on credit.

Savings and checking accounts and credit cards. When your kids are mature enough, help them open a checking and savings account and teach them how to balance a checkbook. If your teenager is financially mature enough to apply for a credit card, find one that allows you to set the spending limit and receive a monthly statement of your child's purchases. Review the monthly statements with your child and teach the importance of paying the balance each month.

Investments. Help children learn about the ups and downs of the stock market early in life. Then they will most likely be more comfortable with investing when they are adults. Give gifts of stock in companies your children are familiar with to encourage them to follow the stock market.

Tax returns. Taxes are a significant expense that few children consider. Have your child sign his or her tax return. If your child is employed, look at his or her pay-stub together and discuss how taxes work and why they are necessary.

Allow children to fail. Whether your children make wise or poor spending choices, they will learn from them. Encourage them to think through their spending options and use common sense when purchasing something. This encompasses doing some research beforehand, being patient for the right time to buy, and using what's known as the "spending-by-choice" technique. Help them determine at least three other things the money could be spent on by setting the money aside for one of those items, and then making a choice of which item to purchase.

Keep talking to children about family finances. Consider talking to your children about money when they reach age three. Use a piggy bank to teach them how to identify and count coins and cash. Between ages four and five, explain the importance of good savings habits. Help them understand that saving for a specific item and then buying it gives great satisfaction.

As your children grow, keep communicating with them about your values concerning money—how to save it, how to make it grow, and most importantly, how to spend it wisely. Help them come to understand the differences between needs, wants, and wishes. This will prepare them for making good spending decisions in the future.

Avoiding trends and brand-name labels.

When children enter adolescence, they are concerned about what their friends are doing and buying. Consequently, they tend to adopt the spending patterns of their peers, which often means becoming caught up in trends and brand-name labels. This is a good time to demonstrate the importance of comparison shopping when you buy goods and services.

During this time, many teens find jobs such as baby-sitting, lawn mowing, or snow shoveling. They can save the money they earn or spend it for extras such as clothing, accessories, and CDs. It is important that they have control of their money because their financial successes and failures will become valuable learning experiences.

If you establish what you as parents are responsible to pay for and what children will pay for, arguments and stress over brand name or higher priced items could be reduced. Let's say a child wants a pair of $80 shoes and you can afford $40. You could put your $40 toward the purchase, and they could come up with the rest. Another option that would discourage expensive purchases would be to set a limit on what you are willing to pay; say $20 towards a pair of shoes for example. The child would then need to make a responsible decision regarding how much he can put towards the purchase. Once "who pays what" is defined, be consistent. It's amazing how quickly a "must-have" item diminishes in importance when kids know it's their money they have to spend.

So what do you do if you don't like the way your teenager manages money? According to the University of New Hampshire Cooperative Extension, impressions about money are formed at an early age, so if you are concerned about your teenager's money management habits, you need to consider that child's history with money matters for clues. Money often plays a pivotal role in one's self-concept, self-esteem, and sense of intelligence. Consider what emotions might be motivating your child's money management decisions.

Learning to Say "No"

Parents can help children become good money managers and responsible consumers by teaching them money management skills from an early age. Financial education should be based on the needs, interests, and abilities of each child.

Children develop their financial attitudes and behaviors by what they see their parents do and not by what they're told. Actively encourage good values. Teach your children responsibility and the value of work. Teach them to save towards a goal of a new bike or video game; let them know that even you have things you want and cannot have.

Even parents who are able to buy their children everything need to be careful of overindulgence. By fulfilling every whim, you may deny your child of several things: appreciating things that cannot be bought; being motivated to work hard; persevering through obstacles and frustration; setting long-term strategies for savings, and achieving a hard-won goal. ■

Teach Your Teen How to Handle Credit Cards

The ancient Chinese philosopher Lao Tse said, "Give a man a fish and you feed him for day. Teach him how to fish and you feed him for a lifetime." The same principle applies to teens and credit cards. Teach them how to use credit responsibly, and chances are they'll enjoy a lifetime of wise money management free from nagging consumer debt.

Of course, teaching kids how to handle credit cards is easier said than done. Here are some proven tips you can adopt as is, or adapt to your particular needs and circumstances.

1. Teach them first how to manage the cash they already have. As early as middle school age, kids can grasp budgeting and the concept of either spending all their allowance or cash for school clothes right away, or saving some of it to buy something later. Understanding spending limits is a key step in learning how to control credit spending. But remember to emphasize that once their money is spent, it's gone. Resist the temptation to slip them extra cash if they discover they missed out on some "must have" purchase. "Missing Out" – or said a better way, "going without" is a learned behavior critical to managing future finances successfully.

2. Help them "graduate" to a checking account. By the time your kids are in high school, help them open a checking account so they learn how to write checks, reconcile a bank statement, and avoid overdrafts and bank fees.

3. Introduce them to some "plastic training wheels." Once your kids master the checkbook a debit card allows them to withdraw funds from an ATM, but it can be used as a credit card. The good thing is that the charge is deducted directly from the account's balance, so there's no lingering credit balance that accrues exorbitant interest. So kids get the experience of using plastic while avoiding the potential pitfalls.

4. Ease into credit cards with the prepaid variety or a low-limit card. Keep in mind that a prepaid credit card like a Visa Secured Card lets you set spending limits and track where your kids are spending money, both through monthly statements, and through Internet accounts that show daily transactions. What's more, you can transfer money from your own checking account to the card for a minimal transaction fee, and the card can be used like any other credit card to make purchases.

5. Or, as an alternative, your child can apply for a real credit card where you co-sign for an account with a $200 to $300 limit. Such an approach makes more sense than adding a child to one of your own accounts. We all know that teenagers are prone to lose things, and you don't want to open yourself up to fraudulent charges on your own high-limit account by theft. ■

ARTICLES

TIPS & TRICKS

Questions to Ask Before You Jump Into a '529' Plan

For people saving for college, it is impossible to ignore the buzz around what are known as "529" plans. The problem is, these lucrative investments give new meaning to the term "state of confusion."

The plans, named for a Tax Code section, are soaring in popularity — there were $63.4 billion in them as of September, according to Financial Research Corp. That is because 529s currently let investors withdraw gains without paying federal taxes if they spend them on higher education, potentially saving well into the five figures.

But it can be very tough to pick a good plan. Every state offers at least one, and anyone can generally invest in any state's plan. Moreover, they all have unique fees, state-tax benefits, fund managers and investment options.

It is a situation tailor-made for the assistance of a knowledgeable adviser. But some of them have agendas that don't mesh with yours. Just last week the National Association of Securities Dealers announced that it had ordered Ameriprise Financial Inc. (American Express Co.'s former financial-planning unit) to pay $1.25 million for failing to adequately supervise sales of 529 plans.

Until October 2003, AmEx was putting all customers into a single Wisconsin plan; it stood to gain because it was one of Wisconsin's investment managers. That wasn't necessarily the best choice for investors: In early 2004, Morningstar criticized the state for also employing Strong Capital Management, a scandal-plagued fund company. (The state improved in Morningstar's 2005 rankings.) An Ameriprise spokesman says it has modified its procedures and is pleased that the matter is resolved.

The plans are almost certainly a winner if your six-figure income makes you ineligible for other tax-advantaged savings vehicles, or for financial aid in general.

Before you pick a plan, ask some questions: Does my state offer a tax deduction when I contribute to its plan (and only if I contribute to that plan)? What are the fees I'll pay? What are my investment options? Who's managing the money? And for your broker, if you use one: What commissions will he or she earn?

Three Web sites can answer most of these queries: savingforcollege.com, for state-specific 529 information; the 529 "Expense Analyzer" at www.nasd.com/investor in the "College Savings Center"; and the whiz-bang state-tax deduction deducer at scholarsedge529.com — click "Planning Tools," then "529 State Tax Calculator" to see how your state works.

So why does each state have its own savings plan? A few states already had created plans before federal tax benefits first became available in 1996. When the feds stepped in, they left the structure of the existing state plans alone, and every other state quickly set up its own.

Life would be easier if 529s worked more like IRAs and there weren't 50 states to shop. And it is something of a national embarrassment that four-year-olds need to be worried about being fleeced for their college money.

You can't solve those problems. But you can avoid them with some work, and the potential tax savings are definitely worth it. ■

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