

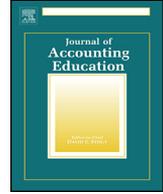


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Educational Case

The Personal Budget Project: A practical introduction to financial literacy

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ABSTRACT

Think a moment about your dream job. Do you know the beginning salary you are likely to make? Are you aware that your take-home pay is going to be only 60 to 75% of that amount? Have you given any thought as to how you might wisely allocate those after-tax dollars to provide for basic needs so that you will also have money to cover “wants” as well? The purpose of the Personal Budget Project is to give you an opportunity to envision your financial future and to understand and practice some important personal financial skills such as estimating income tax, preparing a budget, learning about debt, and recognizing the importance of beginning a savings program as soon as possible. In working through the project, you will discover foundational truths about personal finances that can help to foster sound decision-making as you become responsible for your own financial future. Hopefully your conclusion will echo that of others who have remarked that the Personal Budget Project is one of the most beneficial assignments they have completed throughout their college experience.

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1. Project overview

The purpose of this project is to introduce some important financial concepts that will help you make sound decisions both now and after graduation. The project has several areas of focus that demonstrate the importance of the underlying foundational financial principle of *living within your means*. First, you will *identify your means* by researching the job you would like to have after graduation. Next,

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you will calculate taxes to understand how much of your means will be claimed by taxing authorities. You will prepare a budget to demonstrate how to *live within your means* and calculate the impact of debt repayment on your budget to emphasize *the cost of living above your means*. You will also calculate various savings scenarios to recognize *the benefit of living below your means* today, in order to save for the future. By working through this project, you will lay the foundation for developing a personal budget that will help you differentiate between needs and wants, focus on the most important goals, and avoid the pitfalls of excessive debt. Moreover, you will see the benefit of beginning savings plans sooner rather than later. This is certainly a project that follows the adage “the more you put into it, the more you will benefit.”

This project has three distinct parts: Income and Taxes, Budgeting and Repaying Debt, and Long-Term Savings. In addition to the case, there is an Excel workbook for each part to facilitate your understanding of the content and to use to report your calculations and answers.¹ Also, [Appendix A](#) lists the web sites used in this project as well as other useful resources.

2. Income and taxes

What do you plan on doing when you complete your undergraduate or graduate degree? What is a reasonable starting salary for someone in this career? The key element in any financial plan is the amount of income that one has to allocate to various categories. Although your salary will be the beginning point, the income available to you for budgeting will be the amount remaining after deducting payroll and income taxes.

2.1. Identify your means – Career goals and salary

Several sources provide salary-related information for career paths you may wish to explore. These include salary reports by industry groups, placement services, human resources departments, and web sites (see [Appendix A](#)). Many companies have information on their web sites about how to contact the human resources department. Even if a particular company is not advertising the type of job you desire, someone in the department may be willing to speak to you for a few minutes or answer a respectful email in which you explain that you are seeking an appropriate starting salary for a hypothetical person in a specific position for that industry. When conducting salary-related research, be realistic! Do not assume that you can begin as an investment banker and earn a million dollars the first year. Also, realize that an average salary for a particular job title may not be accurate for an entry-level person.

2.2. Payroll taxes

The federal government requires employers to deduct payroll taxes from an employee's salary before paying the employee. The government uses these taxes to fund both Social Security and Medicare. Because they are mandated by the Federal Insurance Contributions Act, these taxes are often referred to collectively as “FICA” taxes. The Social Security (also referred to as Old Age and Survivors Disability – OASDI) portion is 6.20 percent of all dollars earned up to an established limit that usually increases every year. The Medicare portion is 1.45 percent of all dollars earned, regardless of amount. Accordingly, unless you earn more than the Social Security limit, your share of the FICA tax will be 7.65 percent of all dollars earned.

¹ The workbook titles correspond to the case sections: Income and Taxes, Budgeting and Repaying Debt, and Long-Term Savings. Your instructor will make these available via your course management system or some other means.

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