

Checking/Savings Accounts Table of Contents

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Which Checking Account is Right for You?

You know you need a checking account to pay your bills and maintain a record of your expenses. You go to your financial institution to open one and are greeted with a whole line up of checking accounts. Which one is right for you?

There are five general types of checking accounts:

- *Basic checking*
- *Free checking*
- *Checking accounts that pay interest*
- *Club accounts*
- *Senior accounts*

Basic Checking

Basic checking accounts pay no interest, but usually allow you an unlimited number of checks per month. Usually you have to buy your checks, but you do get a free ATM card and you may qualify for a debit card.

Is the basic checking account right for me? Yes, if you are going to write many checks each month, use an ATM card, and will not be able to maintain enough of a balance to qualify for an interest bearing checking account. If you can maintain a high enough balance, you may not have to pay a monthly service charge.

What are the disadvantages of a basic checking account? You will probably have to pay for your checks, pay a monthly service charge on the account unless you maintain a high enough average balance to offset the service charge, and you will not earn interest on the money in your account.

Free Checking

Free checking accounts charge no monthly service charge and may provide free checks. Usually you have to pay a small annual fee for and ATM card and are limited to the number of checks you can write each month without imposing a substantial monthly fee upon your account.

Is the free checking account right for me? Yes, if you are only planning on writing a few checks each month, you will not be using an ATM card (or do not mind paying a small annual fee for your ATM card), and you will not be able to maintain enough of a balance to qualify for an interest bearing checking account.

What are the disadvantages of a free checking account? You are limited to the number of checks you can write each month, may have to pay for your ATM card, and will not earn interest on the money in your account. Free checks may come in a preset style.

Checking Account That Pays Interest

Interest bearing checking accounts pay a low rate of interest on the money in the account if you maintain their required minimum balance. You may get a free ATM card and can write an unlimited number of checks each month.

Is a checking account that pays interest right for me? Yes, if you can maintain the required balance (**financial institutions vary widely on the minimum amount required to earn interest. It pays to shop around!**) If you will be writing many checks on this account and want access to ATM's this account may be right for you.

What are the disadvantages of checking accounts that pay interest? You will tie up the required balance in this account and may be able to earn more on your money in another type of financial instrument. You will probably have to pay for your checks.

Club Accounts

Club Accounts are special types of checking accounts banks establishes for customers who want special features. Usually you pay a monthly club fee instead of a service charge, but you receive a number of benefits such as accidental death and disability insurance, free club checks, discounts at area merchants as well as discounts on travel and car rentals. Usually you get a free ATM card. There may or may not be a limit on the number of checks you can write each month.

Is a club account right for me? Yes, if you will be maintaining a low balance and would have to pay a service charge. The club fee would also entitle you to the club benefits as well as free club checks. If the merchant discounts are with local merchants that you frequent anyway, such as your dry cleaners or neighborhood restaurant, you may save enough each month with these merchants to offset your monthly club fee.

What are the disadvantages of club accounts? You do have to pay a monthly fee. If you might otherwise be able to qualify for a service charge free account by maintaining the required minimum balance and you would not use the benefits of the account, perhaps you would rather have a basic checking account.

Senior Accounts

Senior Accounts are available to customers who meet the age requirement and maintain the required minimum balance. The age to qualify for a senior account varies from bank to bank, from age 50 to age 62. Usually you pay no service charge, get a free ATM card, and have free checks if you use the club checks.

Is a senior account right for me? Yes, if you qualify. You need to meet the age requirement and when you reach the age of 50 it pays to shop for a bank that will offer a senior account that young. In addition to the service charge free account and free club checks, many accounts pay interest even on relatively low balances and offer a variety of other attractive services, such as free travelers cheques and a reduced rate on a safe deposit box.

What are the disadvantages to a senior account? Very few, if you age qualify. Other types of checking accounts may pay a higher rate of interest if you maintain a sufficiently high balance, but that balance could be put into another type of account. *Your financial institution will not automatically move your checking account into a senior account when you reach the qualifying age.* You need to go into the bank and move the account over into a senior account. You will probably need a new account number so you may want to wait until all your checks are used. When AARP contacts you it is a good time to think about moving your checking into a senior account.

Type and Ownership of Account: Just Whose Account is This Anyway?

The type of account opened by a customer/individual, joint partnership, corporate, or other determines the ownership of the account. The type determines the identification needed for the person opening the account, the rights, obligations, and liabilities of the parties to the account.

Individual Accounts

An **individual account** is an account opened for and owned by one individual. The individual opening the account is the sole owner of the account, and no other person has any rights concerning the account. If it is a checking account, only this individual can write any checks against this account. If it is a savings account only this individual may make withdraws from this account. Only this individual has a right to have access to account information.

There are some situations in which a customer might want to give someone else access to account information or the authority to sign checks or make other decisions on the account.

A parent or other responsible adult may want to have access and control over the account of a minor child and would be authorized on the signature card. There are some cases where a customer may want to give another individual the authority to sign checks or make other decisions on his/her account. This can be accomplished through a *power of attorney*.

One requirement of participation in the IDA program is that the fiduciary agent, EOA, has access to your account statements. We cannot, however, make any deposits or withdraws from your account.

Joint Accounts

A **joint account** is an account opened in the names of and owned by two or more depositors. These accounts are normally held either as **joint tenancy** with full right of survivorship or as **tenants in common**.

Joint tenancy accounts with **full right of survivorship** are typically styled with an “or” in the title, and all the joint account holders are named. Joint accounts (usually held by husband and wife) may be styled as David Morgan or Susan Morgan with full

right of survivorship. In an account like this either David or Susan may make deposits, write checks, transfer funds, assign the account as collateral, stop payment on checks, close the account, or otherwise treat the account as his or her own.

Upon the death of one of the account holders, the proceeds remaining in the account typically pass to the surviving account holders in accordance with state law and without the need to establish an estate.

Accounts held as **tenants in common** are joint accounts that typically require the joint account holders to act together. The word “and” usually appears between the names of account holders and may be styled as Jane Lee and Christine Allen. Withdrawals from the account require the signatures of both Christine and Jane. Roommates might find this type of account the most convenient way to share expenses, requiring both to sign a check drawn on the household account.

Editorial note: My personal prejudice is for any competent adult to maintain a personal checking account. This can eliminate arguments about unrecorded checks, ATM withdrawals, and mathematical errors. If only one person has access to the account then only that person is responsible for any recording errors in the check register. Splitting expenses can easily be accomplished with separate accounts and a little communication.

Sole Proprietorship Accounts, Partnership Accounts, Corporate Accounts

These are accounts established to handle the financial needs of a business. A **sole proprietorship** is a business owned by an individual. The sole proprietor has the right to open the account, make deposits, stop payment, and conduct the account in any manner that he/she wishes. The proprietor may wish to add another individual as a signer on the account in the same way an individual another to sign on the account.

When two or more individuals enter into a business together they may choose to form a **partnership**. The principals to the partnership will determine who will have authority to conduct business on the account and will provide the financial institution with documents establishing that authority.

A **Corporation** is a legal entity or an artificial person created by state or national law. The person or persons authorized to conduct business for a corporation account are named in the **corporate resolution**.

Fiduciary Accounts

Fiduciary is a term that means one who acts for the benefit of another. A **fiduciary account** is an account opened by a representative for the benefit of another. Some common types of fiduciary accounts are *guardianships, conservatorships, trust accounts,* and *estate accounts.*

Adapted from material found in the textbook Principles of Banking

Choosing a financial Institution

Once you have decided which type of checking account is best for your needs you must decide which bank you want to use. Banks are not all the same, they charge different amounts for their services, pay different interest rates, and offer some services in package deals. Here is a chart to help you decide which bank is the best for you:

Name of Bank			
Address			
Federally Insured?			
Minimum to open an account			
Minimum daily balance required			
Monthly service charge			
Fee for writing checks			
ATM charges			
Direct deposit available			
Do they return checks or copies?			
Return of canceled checks fee			
Overdrawn account fee			
Overdraft protection available?			
Stop-payment fee			
Interest rate			
Traveler's check fee			
Cashier's check fee			
Safety-deposit box fee			
Transfers across accounts fee			
Others:			

Adapted from Planning Your Financial Future, second ed., by Louis E. Boone, David L. Kurtz, Douglas Hearth

Instructional Designer Sally Kahl

How to Write a Check

There are some important rules to follow when you write a check.

1. Always write checks in pen – never in pencil.
2. Write plainly. This makes it hard for anyone to change the check.
3. Write checks in their numbered order and enter them into your check register in numbered order. Avoid using more than one pad of pre-numbered checks at the same time. If you use checks in order, you can keep up with your balance more easily.
4. The payee is the person, company, or organization who receives the money. Write the payee's name after the printed words "Pay to the Order Of." Don't leave any space between words or initials. If you do, the payee or amount can be changed. If you do not use all the line, draw a wavy line to fill in the space.
5. Never make a check out to "Cash" unless you are writing the check at the bank to get cash. And some banks may not allow you to do it then. They may require that you write the check for cash to yourself. And if they do allow you to write it for "Cash", they will probably require you to endorse it at the time you receive the cash. A check made for "Cash" is a bearer instrument and if you lose it anyone who finds it may cash it.
6. Place the figures for the amount of the check close to the dollar sign. Write numbers close together so that no other number can be added.
7. Start writing out in words the amount as far to the left as possible. Draw a line to fill in the space between the written amount and the printed word "Dollars." Be sure the amount in words and the amount in figures are the same. If they are not the same, the written amount is the one that will be paid. Use the word "and" only once, between the dollar and cent figures: One Hundred Twenty-Nine and 39/100 **NOT** *One Hundred and Twenty-Nine and 39/100*.
8. Sign checks with the same signature you used on your signature card when you opened your account. For example, if you signed the signature card Stacy Ann See, do not sign your checks Stacy A. See. If you are a married woman, use your own legal name, Stacy Ann See, not Mrs. David See.
9. Write your name clearly. A simple, legible signature is hard to copy.
10. Never sign a blank check. If it is lost, the finder could fill it in for any amount you have in the bank and cash the check.
11. Once you have finished writing the check, look it over carefully. If you have made a mistake, tear it up. Start over with a new check.

Instructions for Student Practice Checkbook

1.	Balance brought forward	\$235.20
2.	Check #101 to Washington County Electric Company for July utility bill. Date the check July 3, 2000.	\$ 46.89
3.	Check #102 to GMAC for August car Payment. Date the check August 3, 2000.	\$184.60
4.	Deposit paycheck from full-time job. Date the deposit August 5, 2000.	\$410.00
5.	Check #103 to Heritage Property Management for August rent. Date the check August 5, 2000.	\$395.00
6.	Check #104 to EZ Mart for gas. Date the check August 5, 2000.	\$10.00
7.	Deposit check from part time job. Date the deposit August 8, 2000.	\$186.20
8.	Check #105 to WalMart for groceries. Date the check August 8, 2000.	\$65.10
9.	Check #106 to Heritage Cablevision for August cable service. Date the check August 10, 2000.	\$48.00
10.	Check #107 to EZ Mart for gas. Date the check August 12, 2000.	\$12.00
11.	Check #108 to Harps for groceries. Date the check August 19, 2000.	\$64.80
12.	Deposit pay check from full time job. Date the deposit August, 20, 2000.	\$410.00
13.	Check #109 to U. S. West for August Phone service. Date the check August 20, 2000.	\$34.80
14.	Service charge on checking account.	\$6.30

Instructions for Reconciling Your Checking Account	List Checks Outstanding			
	Check No.	Amount		
<p>Before you Start: In your checkbook make the following entries so that all transactions are recorded on both your records and the banks:</p> <p>Add Any deposits/Credits shown on this statement but not entered in your checkbook</p> <p>Subtract The following items shown on this statement but not entered in your checkbook: Service Charges Automatic Deductions Unrecorded Check/Debits</p> <p>Next: Using this statement mark off all items paid as well as deposits in your check register</p> <p>Then: List all outstanding checks in the column to the right (those you have written and recorded in your checkbook, but which have not been received and processed by us.) Add the dollar amounts and write the total on Line 4 below</p>				
		Total		

- Now:
- | | |
|---|----------|
| 1. Enter the current balance shown on this statement | \$ _____ |
| 2. Enter the total of the deposits made but not showing on this statement | + _____ |
| 3. Add Items 1 and 2 (Subtotal) | _____ |
| 4. Show the total of checks outstanding from the column to the right | - _____ |
| 5. This figure should agree with the balance shown in your checkbook | \$ _____ |

Checking/Savings

Pages 12, 13, 14 are the blank checks used for this activity. They do not transfer to this program with proper alignment. Please print three copies of the “checks” file when compiling this chapter.

Checking/Savings

Checking/Savings

Reconciling Your Checking Account

When you receive your periodic checking account statement, you need to reconcile or “balance” it with the figures in your check register. Follow these simple steps:

1. Arrange the cancelled checks in order by number or date. If you receive images of your checks instead of the cancelled checks, they should already be in order. You can reconcile a checking account statement without the checks in numbered order.
2. Subtract from your checkbook balance any service charge shown on your statement.
3. Add to your checkbook balance any interest earned shown on the bank’s statement.
4. Write the balance shown on your statement here. \$_____
5. Compare the cancelled checks with the check register. Note which checks have not yet been paid/returned by the bank. Also note if any ATM withdrawals or POS transactions have not been entered on this statement. Enter these “outstanding” checks, ATM withdrawals or POS transactions on the reconciliation sheet of your checking account statement and total them. Enter total here \$_____
6. Subtract the unpaid checks, ATM withdrawals, and POS transactions from the balance shown on your statement. \$_____
7. Enter the total of any deposits you have made by mail, in person, or through an ATM which are not shown on the bank’s statement. \$_____

If the adjusted balance on your checking account reconciliation sheet does not agree with your checkbook balance, here are some places to look for possible errors:

- \$ Double check all additions and subtractions in your checkbook.
- \$ Make sure you have carried forward any checks still outstanding from a previous statement. It is possible that some of your checks that are several months old still have not come into the bank. If so, add them to the outstanding checks total.
- \$ Compare the amounts on all your checks with the amounts you have listed in your check register. You may have made an error when entering them in your checkbook.
- \$ Be sure you carried forward the correct balance to each page in your check register.
- \$ Make sure you have not written a check, made a withdrawal from an ATM, or made a POS purchase and forgotten to enter it in your checkbook. You can discover this by comparing your checks, ATM receipts, and POS items on your checking account statement with your entries in your check register.
- \$ If you still find that there is a difference between the bank statement figure and your adjusted checkbook balance, call your bank and make an appointment to have a bank employee help you balance your checkbook. Be sure to take your checkbook and register, all cancelled checks and your statements to the bank with you. Some banks may charge a fee for this.

Checking Account Statement August, 2000

Beginning Balance \$ 235.20

	Date	
Deposits	8/5/00	\$ 410.00
	8/8/00	\$ 186.20

Checks

	101	8/5/00			\$ 46.89
	102	8/11/00			\$ 184.60
	103	8/6/00			\$ 395.00
	104	8/6/00			\$ 10.00
	105	8/9/00			\$ 65.10
	*				
	107	8/13/00			\$ 12.00
	108	8/21/00			\$ 64.80

Service Charge \$ 6.30

Ending Balance \$ 46.71

Am I Making My Account Work for Me?

Many of us never give the cost of our checking accounts another thought after we open them. We may notice the extra charge for using a different banks' ATM and make an effort to find our banks' ATMs, but beyond that we assume that things are fine. Well, that's not always the case. There could be a change in your personal spending habits or the bank could change its rates and fees.

I had an experience once with a bank that had gone through a merger. The rates and fee structure had changed. I received notice of the changes but I wasn't bank savvy enough to realize how the changes would affect my account. I was working at a temp agency and my paychecks varied greatly. I was very careful to keep \$100 in there at all times to avoid a service charge, then one month I discovered my regular service charge went up by \$2 and I had an additional charge of \$5 for not maintaining the minimum required balance. When I complained I was told that notices had been sent out. By the time I accumulated enough money to meet the new minimum I had paid the additional service charges two more times. Keep track of your charges and act immediately when you notice a change. Here is a chart to help you track the costs and/or benefits of your checking account:

Tracking Your Checking Account

Month				
Service Charge				
Average Monthly Balance				
Number of ATM Transactions				
ATM Fees				
Interest Earned				
Ending Balance				

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Instructional Designer Sally Kahl

Depositing Checks

When it is time to deposit checks into your savings or checking account, the bank has given you many ways to do it. You may make the deposit directly to a teller at the teller window, by mail, at an automatic teller machine, or at the night drop at your bank.

Whatever method you choose, you must complete several steps before you begin.

First you must complete the deposit slip. You will receive a supply of checking account deposit slips with your checks and can request savings account deposit slips at your bank or other financial institution.

The deposit slip must have the date and amount of deposit completed.

If you are depositing a check in person at the teller station, you may want to get some cash back. This is called a split deposit. 1. You enter the total amount of the check(s) on the top row. 2. Enter the amount of cash you want back on the next row. 3. Subtract the amount of the cash from the check(s) total. This becomes the deposit.

Once you have deposited the check(s), be sure to enter the amount of the deposit into your check register.

At the time you deposit a check you must endorse it. It is a good idea to never endorse a check ahead of the time you are going to cash or deposit it. A check with a blank endorsement becomes a bearer instrument and if you lose it and anyone finds it they may receive cash for your check. This endorsed check becomes the same as cash.

Kinds of Endorsements

1. *Blank Endorsement* Many people use the *blank endorsement* which is signing only their name. If the check is lost, the finder may cash it. Do not endorse a check in this way until you get to the bank.

Example

2. *Special Endorsement* A *special endorsement* names the person to whom the check is to be paid and who must sign it before cashing it. This is a safeguard against loss or theft when the check is given to someone else. A blank endorsement can be changed to a special endorsement by the holder of the check by writing “Pay to the order of _____” (the person’s name) above the last endorsement. This is sometimes referred to as a “two-party check”. Some businesses will not accept this check.

Example

3. *Restrictive Endorsement* The *restrictive endorsement* may be used when you mail a check for deposit or if you send it by another person. This guarantees that the check cannot be cashed by someone else if it is lost. Usually you will write “for deposit only” with your endorsement. However, some banks may ask you to write “Pay to the order of _____ Bank” with your endorsement. If you are going to deposit by mail, at an ATM, or at the bank’s night deposit window, this is the type of endorsement you should use.

Example

or

Think about saving money.

- Did you have a savings account as a child?

- If your family saved, what did they save for?

- How did your family's saving or lack of saving affect your own opportunities?

- Have you saved money on a regular basis as an adult?

- What are the pros and cons of saving?

Pros

Cons

- What are the obstacles to saving?

Savings Accounts

Savings accounts differ from checking accounts in that you cannot write a check on this account to get use of your money. Instead you must go to an office of the bank to withdraw your funds. Some banks allow you to have a savings account tied to an ATM card and you can make withdrawals at an ATM machine. But most will allow that only if you have a checking account tied to the ATM card also. Savings accounts differ from checking accounts also in that you will earn interest on all the money you have in the account. Some banks may require a minimum balance in the savings account or they will charge a service charge on the account.

There is a special type of savings account called a timed savings account or more commonly known as a certificate of deposit. A certificate of deposit is purchased for a specified period of time and if you withdraw your money before that time is up you are subject to a substantial penalty. These time deposits, however, do pay a higher rate of interest than a regular savings account.

This unit, however, is going to be about regular savings accounts – not timed certificates of deposit. A regular savings account does not establish a maturity date; deposits and withdrawal may be made over a period of years. A financial institution can legally require a customer to give advance notice that he wants to make a withdrawal from a savings account. However, I do not know of any banks that impose that requirement and a customer may make a withdrawal from any savings account by simply going to the bank and completing a withdrawal slip. If there are sufficient funds in the account to cover the withdrawal, the customer may leave with the money – no matter how much or how little.

There are a number of special types of savings accounts such as Christmas, Hanukkah and Vacation Club accounts in which the customer makes regular deposits to have the money withdrawn at a specific time each year. But most of the savings account at a bank are regular savings accounts.

This is typically the first account a person ever opens and many of us had our first savings account at a bank when we were small children.

The IDA program is going to have participants open and use simple savings accounts at the participating financial institution. The program matched funds will be held in a savings account in owned by the program.

Choosing a financial Institution

Once you have decided which type of savings account is best for your needs you must decide which bank you want to use. Banks are not all the same, they charge different amounts for their services, pay different interest rates, and offer some services in package deals. Here is a chart to help you decide which bank is the best for you:

Name of Bank			
Address			
Federally Insured?			
Minimum to open an account			
Minimum daily balance required			
Monthly service charge			
How often are statements sent			
Fee for writing checks			
ATM charges			
Direct deposit available			
Overdrawn account fee			
Interest rate			
Traveler's check fee			
Cashier's check fee			
Safety-deposit box fee			
Transfers across accounts fee			
Others:			

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Instructional Designer Sally Kahl

Am I Making My Account Work for Me?

Many of us never give the cost of our savings accounts another thought after we open them. We may notice the extra charge for using a different banks' ATM and make an effort to find our banks' ATMs, but beyond that we assume that things are fine. Well, that's not always the case. There could be a change in your personal spending habits or the bank could change its rates and fees.

I was in this happy go lucky mode of thought about my savings account. One month I got a statement with a service charge. The charge was more than my quarterly interest, so I wasn't very happy. When I went to the bank to ask them what the charge was for, I was told that certain policies had changed with the recent merger. The minimum balance for my savings account had doubled and the fee for not meeting the new minimum balance was outrageous when compared to the interest they paid on that type of saving account. I knew I was moving out of the state soon so I put in enough money to meet the new requirements and left my money there for the three or four months I still lived in Arizona. I made sure that the bank I chose out here wasn't affiliated with them. In my experience banks here in Arkansas are more forthcoming about the changes, and you usually receive notice before the changes are instituted.

Here is a chart to help you track the costs and/or benefits of your checking account:

Tracking Your Checking Account

Month				
Service Charge				
Average Monthly Balance				
Number of ATM Transactions				
ATM Fees				
Total Deposits				
Interest Earned				
Ending Balance				

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Instructional Designer Sally Kahl

The Magic of Compound Interest

1. If you diligently save \$25.00 each month for two years and stick your savings in an old sweat sock and hide it clear in the back of your sock drawer and never take any money out of your old sweat sock, how much money will you have in two years?
A. \$600 B. \$615.88 C. \$625.65
2. Now if you take that same \$25.00 each month to the bank and deposit it into a savings account that is paying you 2.5% interest, how much money will you have in two years?
A. \$600 B. \$615.88 C. \$625.64
3. Now you find a financial institution that will pay you 4% interest on your savings account. You dutifully take your \$25.00 each month to that bank and deposit it and never make a withdrawal. How much money will you have in two years?
A. \$600 B. \$615.88 C. \$625.65

* If your answers were: 1.A, 2.B, 3.C you were right.

Now, earning \$25.64 over a two year period (and having your old sweat sock free to use to dust the T.V.) is not bad, but let's make that savings habit last for 10 years instead of 2. And instead of putting \$25.00 into your savings account each month, put \$50.00 into your savings account each month.

4. You deposit \$50.00 a month each month for 10 years into a savings account that pays you 2.5% interest. How much money would you have at the end of those 10 years.
A. \$6,000 B. \$6,822.78 C. \$7,387.03
5. Now deposit that same \$50.00 a month each month for 10 years into a savings account that pays you 4% interest. Now what do you have?
A. \$6,000 B. \$6,822.78 C. \$7,387.03

* If your answers were: 4.B, and 5.C you were right.

So, in that 10 years you made \$1,387.03 on your money just by taking it to the bank each month and shopping around for a better interest rate. **This is the magic of compound interest!**

Check with your employer. You may not even have to go to the trouble of walking to the bank. You may be able to make a direct deposit to a savings account at your company credit union or a bank from each paycheck. Or you may purchase Government Bonds with a payroll deduction. **Let your money work for you!**

What is an IRA?

An *Individual Retirement Account* is a special type of savings account where you can make pre-tax contributions to your account. That means the money you deposit into your IRA account is deducted from your income before your income taxes are figured. Also, you do not pay tax on the interest you earn on your IRA account.

Then when you retire and start to take the money out of your IRA, or as they say “take distribution”, you pay the tax. That tax has been deferred. The idea is that when you are retired your income will be lower and you will pay a lower rate of income tax. In addition, you will get to use the money you have not paid in taxes and earn interest on it.

There are some restrictions on an IRA account.

1. You can only deposit \$2,000 per year into your account.
2. The money you use to deposit into your account must be *earned* income. That is it must be money paid to you from a job or work that you do. You cannot deposit into an IRA from money that you earned in interest or was given to you.
3. You cannot take any withdrawal from your IRA until you are 59 ½ without paying a substantial penalty.
4. You must begin to take distribution from your IRA by the time you are 70 ½.
5. If a married couple purchases an IRA and one partner does not work, they may purchase a larger IRA than an individual. They may purchase what is called a spousal IRA worth \$2,250.
6. If both persons in a marriage work, they would probably prefer to each purchase an IRA. That way they could save up to \$4,000.
7. If your employer provides you with a pension or a 401(k) plan, the deposit into your IRA may not be tax deferred. That depends upon your total income. However, the interest on your IRA is deferred.

What are the Advantages of an IRA?

What should you invest in an IRA instead of something else? Let us look at the advantages to you.

Let's say you earn \$30,000 per year. To make this illustration simple, we are going to say you pay 20% of your income out in taxes. If you put the \$2,000 into a certificate of deposit or use the \$2,000 to buy WalMart stock what would your total income look like?

Income	\$30,000
Less 20% taxes	<u>6,000</u>
	\$24,000
Less \$2,000 for stock purchases	<u>(2,000)</u>
Money left over for everything else	\$22,000

Now let's take that same \$2,000 and invest it into an IRA. (You could still buy that Certificate of Deposit or that WalMart stock through your IRA, but that is a topic for another whole class.)

Income	\$30,000
Less IRA deposit	<u>2,000</u>
	\$28,000
Less 20% taxes	<u>5,600</u>
Money left over for everything else	\$22,400

See the advantage. You have \$400 more to spend on the rest of your life? In addition you will have money waiting for you when you decide to retire.

What are the Disadvantages of an IRA Account?

How can there be any disadvantages? You just saved \$400!

Well, you may need the \$2,000 before you turn 59 ½. If you are trying to set up an emergency fund, or if you are saving for a goal other than retirement, the IRA may not meet your savings goals.

If you are interested in learning more about IRA accounts, talk to your banker, insurance agent, or stock broker.

IRAs and the Economic Growth and Tax Relief Reconciliation Act of 2001

Traditional, Roth and Education IRAs are excellent savings tools that provide stability in your investment portfolio. These tools are going to be impacted by the 2001 Tax Relief Act.

Education IRA Change

- \$ Instead of the current contribution limit of \$500 per child per year, the limit will increase to \$2,000 per child per year beginning with the 2002 tax year.
- \$ The phase-out range of adjusted gross income for being able to make an Education IRA contribution has increased from \$150,000-\$160,000 to \$190,000-\$220,000.

Traditional and Roth IRA Changes

- \$ The contribution limit will increase over a seven year span to \$5,000.

Tax Year	Current Law	Relief Act of 2001
2002-2004	\$2,000	\$3,000
2005-2007	\$2,000	\$4,000
2008-2010	\$2,000	\$5,000

- \$ Individuals who are age 50 or older will be eligible to make catch-up contributions.

Tax Year	Contribution Limit for Individuals 50 & Older
2002-2004	\$3,500
2005	\$4,500
2006-2007	\$5,000
2008-2010	\$6,000

Adapted from materials in First Edition of 1st National Bank, Ames, Iowa

More on IRAs

When is the best time to open my first IRA? Now. Yesterday. If you have taxable earned income that equals or exceeds \$2,000 you are eligible for an IRA. If you have a qualified retirement plan where you work, the contributions to the IRA may not be tax deductible. The interest earned will be. But in either case, you will enjoy the benefits of having your money work for you as you save for retirement.

How old do I have to be to open an IRA? There is no minimum age, but you must have taxable earned income that equals or exceeds \$2,000. An IRA is a contract. In most states you must be 18 to enter into a contract. If you are under age 18 but have earned income, ask your banker if you can set up an account in a way you can qualify.

I won't be old enough to retire for more than 40 years. It is too soon for me to even bother with a retirement account now. Right? Wrong! Read through the following illustration.

Brother A, let's call him Al opened an IRA when he was 20. He put the maximum \$2,000 each year into his account for 10 years until he was 30. Then he did not ever deposit another dollar into this account, but left the IRA active and growing until he retired at age 65. Al's IRA was earning a modest 5% per year in an FDIC insured certificate of deposit at a bank.

By age 65 Al had \$145,697.68* in his IRA. He only deposited a total of \$20,000.

Brother B, let's call him Bud opened an IRA when he was 30. He put the maximum \$2,000 each year into his account for 10 years until he was 40. Then he did not ever deposit another dollar into this account, but left the IRA active and growing until he retired at age 65. Like brother Al, he placed his IRA into an FDIC insured certificate of deposit at a bank and earned a modest 5% per year interest.

By age 65, Bud had \$89,445.74* in his IRA. He too deposited a total of \$20,000.

Let's head back up to brother Al. He decided to continue to his annual IRA contribution to age 65. He contributed to his retirement plan for a total of 45 years – making a total of \$90,000 in contributions himself.

By age 65, Al had \$335,370.33* in his IRA.

Brother Bud realized by age 40 that he had to play catch up. He could not quit contributing to his IRA then because he knew he would need more than \$89,445.74 in his retirement account. So he too continued to contribute to his IRA until he was age 65. He contributed for a total of 35 years – making a total of \$70,000 in contributions himself.

By age 65, Bud had \$189,672.65* in his IRA.

Pretty amazing isn't it. Even though Al contributed \$20,000 more into his account over a lifetime he made \$245,370.33 on his investment. Bud made \$119,672.65 on his investment. That's the power of compound interest!

Maybe you are over age 20 and you think you missed the boat. You did not. Look how well Bud did starting at age 30. Really, \$119,672.65 is a respectable amount of money and will enable Bud to have a more comfortable retirement.

But, I'm afraid I'm going to pick on Bud just one more time.

Each brother at age 65 decided to invest his entire IRA in an investment product that paid 8%. During his early retirement years each spent the earnings only for leisure time activities. The principal of each IRA was available for each brother to meet high medical expenses or nursing home expenses that come with old age, or the principal of each IRA became part of each brother's estate.

Al had \$26,829.63* per year to spend on leisure time retirement activities.

Bud had \$15,173.81* per year to spend on leisure time retirement activities.

Whose leisure time retirement partner do you want to be?

Also remember, Al had over \$335,000 to apply toward his nursing home expenses. Bud had less than \$190,000. Who got the classy room at Golden Life Manor?

*Figures are estimates

The Rule of 72

Return	Years to Double
1%	72
2%	36
4%	18
6%	12
8%	9
10%	7.2
12%	6
15%	4.8
18%	4
24%	3

Appendix A

Federal Reserve Banks

The United States is divided into 12 Federal Reserve Districts. Each district has a Federal Reserve Bank in a principal city. Each bank also has branch activities check taking place in branch cities. The 12 Federal Reserve cities and their branch cities are:

1. Boston
2. New York City - Branch cities: Buffalo
3. Philadelphia
4. Cleveland - Branch cities: Pittsburg, Cincinnati
5. Richmond - Branch cities: Culpepper, Charlotte
6. Atlanta - Branch cities: Nashville, Birmingham, Jacksonville, Miami, New Orleans
7. Chicago - Branch cities: Detroit
8. St. Louis - Branch cities: Louisville, Memphis, Little Rock
9. Minneapolis - Branch cities: Helena
10. Kansas City - Branch cities: Omaha, Denver, Oklahoma City
11. Dallas - Branch cities: El Paso, Houston, San Antonio
12. San Francisco - Branch cities: Los Angeles, Portland, Seattle, Salt Lake City

In addition there are Regional Check Processing Centers (RCPC's) in cities scattered throughout the United States that process checks for their region and send these checks on to the Federal Reserve Bank with which they are affiliated. (Des Moines has a Regional Check Processing Center for the Chicago Federal Reserve Bank.)

The number of the Federal Reserve Bank is the first number of the MICR encoding at the bottom of your check. If you live and bank in Arkansas, the first MICR number on your check will probably be 08 – the St. Louis Federal Reserve Bank.

Adapted from Principles of Banking, G. Jay Francis, Norman F. Hecht, Susan M. Siegel

Appendix B

Functions of the Federal Reserve Banks

- Propose discount rates
- Hold reserve balances for depository institutions
- Lend at the discount rate to member banks
- Furnish currency
- Collect and clear checks
- Transfer funds for depository institutions
- Handle U.S. government debit and credit balances

Quoting directly from Principles of Banking, 6th Edition:

One of the original purposes of the Federal Reserve System was to provide basic banking services to member banks. From its inception until 1980, the Fed provided almost all its services for free (lending money was the exceptions) but only to member banks. In 1980, Congress, through the Monetary Control Act of 1980, mandated the Fed to charge for its services, including float (the time it takes a check to go through the system from the time it is written until the time the money is taken out of the account). Fed services that must carry a fee are:

- *Coin and currency*
- *Check clearing and collection*
- *Wire transfer*
- *Automated clearing house*
- *Settlement*
- *Securities safekeeping*

At the inception of the check clearing and collection system, and even past 1980, the check clearing process took several days – even up to a week. A check written on a bank in Fayetteville, Arkansas and mailed to Eddie Bauer in Seattle to purchase a pair of pants would first be deposited into a bank in Seattle. Then it would clear through the San Francisco Federal Reserve Bank. Then it would travel to the St. Louis Federal Reserve Bank. From there it would come back to the bank in Fayetteville to be subtracted from the customer's account. It could easily have stops in the Federal Reserve Branch Office in Seattle and again at the Federal Reserve Branch Office in Little Rock. The entire process was speedy for the technology of the time, but still took several days.

The banking industry, like all others, in taking advantage of the improvements in technology and one area where change is very apparent is

the check clearing system. Quoting directly from Principles of Banking, 6th Edition again:

Check processing is one area that is changing significantly because of technology. The check clearing process is currently very labor intensive, requiring that paper checks be moved from point to point. Movement of physical check is a barrier to speeding up the check collection process. Through technology, some banks are speeding up this process by transmitting the MICR data electronically to the paying bank, followed by the physical checks.

And still quoting directly from Principles of Banking 6th Edition - predictions for the future of check clearing:

The next step in the process is to eliminate the need to transport the physical check. Advances in image technology may someday lead to truncation of checks at the depository bank or at the merchant level. An image of the check will be transmitted to the paying bank. The merchant or the depository bank will also retain an image and will destroy the physical check.

Adapted from Principles of Banking, G. Jay Francis, Norman F. Hecht, Susan M. Siegel

Note from 2004 update. The future is here! This document was written less than five years ago, but check processing has evolved to the point that many checks do not ever physically pass through the Federal Reserve system. Your check is “debited” against your checking account at the moment you write it and it is accepted by the merchant and entered into the merchant’s computerized cash register or funds received system.