THEME: FINANCIAL INTEGRITY PART 1

By John W. Day

Editor's Note: This is the first of a three-part series dealing with money matters. The first article addresses a common way people can find themselves in an insidious financial nightmare. The second article, Financial Integrity Part 2, will discuss some methods and practices you can incorporate to help strengthen your financial code-of-ethics. The third article, Financial Integrity Part 3, will discuss some methods that help strengthen a non-destructive financial code-of-ethics.

ACCOUNTING TERM: Financial Code-Of-Ethics

Most people know that a "code-of-ethics" is a set of standards by which a person structures his/her behavior. As in, "I do not steal"; "I try to be as honest as I can"; "I am kind to animals", etc. A financial code of ethics is similar in that a person establishes "do's" and "don'ts" pertaining to financial matters. For example, "I do not impulse buy"; "I do not write checks if I don't have money in the bank"; "I do pay all my bills on time", and I don't borrow more money than I can afford to pay back", etc.

FEATURE ARTICLE: The "Easy Money" Trap

There are some who learned early-on the value of a dollar, began solid businesses that were financially successful, saved money, made good investments, and have never lived under the tyranny of barely having enough money to make ends meet. To many, this scenario sounds like a fairy tale. It is not, but, unfortunately, it is the exception.

So why is it that some people have money problems and others don't? The "arena" of money isn't any different than any other aspect of life? It's a question of "boundaries". Boundaries presuppose guidelines that help us navigate through the myriad of pitfalls lying in wait. Some people call using guidelines as "common sense", while others refer to it as, "being smart".

Financial Code-of-Ethics

Guidelines are the same as a "code-of-ethics". Gee whiz, if it were only as simple as saying, "I will" or "I won't". Maintaining financial integrity is a constant battle with many fronts. Attacks can come from any quarter seeking to exploit a weakness in your defense. The "easy-money trap" is one of the most common and insidious ways we can fool ourselves and end up with a financial nightmare on our hands. Here is what I mean:

Ah, Money! What a deep and complicated subject. Where shall I begin? Well, we do know that people approach their relationship with money according to the way they were raised, their economic environment and emotional needs, and so on. Two people coming out of the same circumstances may relate to money in completely different ways. Nonetheless, each person develops his/her own particular "financial code-of-ethics". The significant question is whether that code is helping or hurting the individual. The relevant problem is whether an individual is capable of overcoming the emotional needs and negative habits that contribute to his/her financial demise. Obviously, some people will never resolve their financial difficulties. For others who may be ready to change their behavior, the first step is to understand the nature of the trap. Once understood, the process of rebuilding a financial structure that supports and sustains can begin.

Many people never had a lot of money, and the money they acquired did not come easily. It used to be that people had no choice but to live within their means. During the last twenty-five years, the financial culture of most of the world has shifted dramatically. For the U.S., in 1975 an expensive house cost $30,000. Today, that house is probably selling for $300,000, or more, depending on where it is located. With this dramatic increase, banks have been in hot competition with each other to trade hard, cold cash for that equity. No one seemed to care much that our children's future was being mortgaged.   No one foresaw that this was going to force both the husband and wife to work in full-time, high-stress jobs that would tear apart the fabric of the family unit. How else could a young couple afford such a huge mortgage? We still have no idea what the true cost of this phenomenon is to society.

During the same time, easy and fast credit became available to almost anyone with a job, or, even for those who have the potential of getting a job, such as college students. With the advent of plastic money or credit cards, having equity in a home was no longer necessary to acquire easy money. Millions of individuals, who never had enough money to buy a new car or take a vacation to a foreign country, now could. Big blocks of money were available as never before. Therefore, it is not to hard to understand why spending this money was, for many people, like binge drinking. Easy money is truly a psychological and emotional drug. It does give one a temporary high, but as with other drugs, if not judiciously administered, it can exact a devastating price in the future.

For some reason, when we spend other people's money, or, even borrowed money, as with the equity or credit card loans, we can become very cavalier in our attitude. This happens a lot in business and it requires great discipline to resist the temptation. I refer to it as the "easy money trap". The following is a typical example:

I have this great idea for a business. It is exciting and really does sound plausible. It is such a good idea that I could get filthy rich. The only problem is I need venture capital to get it off the ground and I don't have the money. But, I'm a good talker and I sincerely believe in my idea. Of course I tell everybody I know about it until one day someone who has money to invest hears about it. With my energy and enthusiasm I am able to convince my amateur venture capitalist to invest. Naturally, I have to bring in a few of my out-of-work associates who are "seasoned" businessman who know exactly what to do. After all, we have to create a business structure to become operational.

We have a ton of money in the bank. It came from our investor. If we are going to be in business, we have to look like we are in business. We have to have an attractive office, with good-looking desks and furniture. We can't forget the good-looking receptionist either. In addition, since we are all "seasoned", successful businessmen we deserve to take a good salary. After all, we don't work for nothing. Life is good for the next few months. For some reason, we just can't seem to get the great idea off of paper and into reality. But, we know we will be able to very soon, if we can just surmount a few last hurdles.

We have a lot of meetings and we are very busy. Finally, the money starts getting low. We can't quit now; we are so close to turning the corner. We had better bring our investor in and show him how close we really are and what a tragedy it would be to give up when we are so close. Our venture capitalist looks a little sick and worried when we give him the news, but he has been dreaming about all the endless wealth that is coming his way, so he ponies up again. Life is good again for the next few months. This story usually ends with everybody blaming everybody else and some ugly lawsuits. (Hint: If you are the investor, don't give carte blanche. Set up the rules as to how the money will be used and stay attuned. If it starts to smell bad, call your lawyer.)

The moral of the story is that it is a lot easier to spend someone else's money than it is to spend your own hard earned money. Easy come; easy go. When we are offered all this "easy money" through credit cards and home equity loans the temptation to spend can be overwhelming. The primary reason for this is because we do not have an established financial code-of-ethics to guide us. We don't realize that the accumulated debt payments are going to eat us alive. We want to be gratified NOW. Why? Because we think we damn well deserve it. We have worked long and hard all our lives and we say it's time for us to reap our rewards. Or, maybe we haven't worked that long, but we see all these other people presented to us in movies, advertisements, television - and we deserve what they have, don't we? Besides, if we don't take advantage of these opportunities now, time is going to pass us by and we will be too old to enjoy ourselves.

How can we avoid the siren call of easy money? First, we must understand who we are and what drives us, and, second we must educate our young people. This will be the topic of Financial Integrity Part 2's feature article.

QUESTION: Why Can Credit Card Companies Charge Such High Interest Rates?

With interest rates as low as they are today, how can these credit card companies charge such high interest rates? To charge almost 25% in today's market seems rather excessive, to say the least. Credit card companies are usually large financial institutions such as banks or stores. They say it is appropriate to charge high rates because they are issuing "unsecured credit" and they have to build in a cushion to make up for all the people who default on their loans. Make no mistake, these financial institutions are a powerful lobby and have many friends in high places. The credit card companies were becoming alarmed because over a million people a year were claiming bankruptcy. As a result, we now have new laws that make it more difficult to declare bankruptcy. It seems like they get to have it both ways. In other words, they are reducing their risk by charging the high rates and by making it more difficult to default on the loans.

The reason you are getting so many offers for credit cards today is because the credit card business is so lucrative. The financial institutions don't seem to mind that consumers are becoming so debt ridden that it threatens our entire economic system. There has been some real concern that if over one million people declare bankruptcy each year during an economic good-times, how many more are going to declare when there is a major downturn. Now that we are in a downturn, we may find out real soon. The fear is that some of these financial institutions may not be able to sustain the losses that could come when ten million people declare bankruptcy in one year. The makings for a huge economic catastrophe could be in the works.

Are we simply victims of these large financial organizations? Or, is it our responsibility to control ourselves? Most of us don't drink poison knowingly. No, but this is a case of that old jungle disease called the "creeping crud". We allow ourselves to be seduced by the "easy money" gradually. We fool ourselves into believing that we are going to make more money in the future and then we can afford to pay off the card/s. For many of us, our whole lives are invested in our business. When times are tough, we use the easy money to sustain us. There seems no other choice. Incredibly, some of us are able to acquire numerous cards and rack up $100,000 worth of debt before the institutions stop lending. We pay the minimum payments because that is all we can afford. To our dismay, even as our business succeeds and produces more money, we find that the extra money is going to pay the debts. If we have equity in our homes, we usually refinance and pay off the credit cards. It is temporary relief until the cycle begins again. Eventually, the equity in our home disappears, and we are back, owing a ton on our credit cards. It is a vicious cycle, if there ever was one.

TIP: Recording Credit Card Expenses On Your Books

Recording credit card purchases on your books can be confusing and messy if you don't do it right. This is especially true if you mix personal and business expenses together. It makes no sense to simply record a payment to some account called Miscellaneous Expense or Credit Card Expense. The business and personal charges must be broken out separately and allocated into their appropriate categories. The credit card usually has a finance fee element to it each month. Technically, you should not be able to charge the full amount of that fee as an expense if you have personal use activity mixed in.

It is always best to use the card exclusively for business if you can. Each month when you receive your statement from the credit card company you should code or categorize each charge item on the statement. Include the finance charge to an account called Interest Expense or Credit Card Fees. Using your general journal you should record the activity.

Here is an example:

DESCRIPTION	DEBIT	CREDIT
Office	43.78	
Meals & Entertainment	75.20	
Operating Supplies	64.90	
Education	97.00	
Personal Draw	50.00	
Credit Card Payable		330.88

Credit Card Payable is obviously a liability account on your balance sheet because you owe this money. If you were to make a payment on your credit card for $200, the transaction would look like this:

DESCRIPTION	DEBIT	CREDIT
Credit Card Payable	200.00	
Cash		200.00

However, since a payment would most likely be coming out of your check register, you would not have to write a general journal entry. The category called Credit Card Payable would simply be coded next to the check and entered via a cash disbursements journal into your computer, or, automatically entered if you use computer checks.

The beauty of this simple method it that the Credit Card Payable account balance should always equal the balance on your credit card statement. In addition, all the charges get allocated into the proper categories in their correct amounts.

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