Lesson 22: Finance

This lesson is divided into five parts - banking, loans, investments, taxes, and accounting. The first four parts contain vocabulary that is useful for everyone, even if you don't work in the financial sector - and the last part will have some terms that are specific to accounting.

Banking

Let's begin with banking, since going to the bank is part of everyday life.

There are three main types of bank accounts:

- **Checking accounts** are where you can keep your money and write checks to make payments. Checking accounts are usually used for day-to-day spending.
- **Savings accounts** are used to keep money for a long time - for example, saving money to buy a car or house, or pay for a vacation or your child's college tuition. Savings accounts usually earn **interest** (a small percentage of extra money that the bank gives you).
- **Investment accounts** let you put your money into the stock market. There is some risk, because you could earn more money - or you could lose the money you invested.

Every month, you receive a **bank statement** in the mail or online. A statement is a list of all the **transactions** (single financial activities) in your account for the past month. It also shows your **balance** - the current amount of money in your account.

You can put money into your account, or take money out. Putting money in is called **making a deposit**, and taking money out is called **making a withdrawal.**

Here are a few other things you can do at the bank:

- **Deposit a check** - Put the money from a check you received directly into your account
- **Cash a check** - Exchange a check you received for cash
- **Apply for a credit card**
- **Pay bills** - The money you need to pay for services like electricity, phone, water, heat, and internet.
- **Go through the drive-thru** - A service that lets you use the bank through a window, without leaving your car.

The employee of the bank who helps the customers is called the **teller.**

Now let's talk about a few financial problems. If you have $100 in your account and you withdraw $150 so that the balance of your account goes below zero, then your account is **overdrawn**. The bank will probably charge you a **fee** (extra money you pay as a penalty).

If you overdraw your account by writing a check - again, if you have $100 in your account, and you write a check for $150, then it is called a **"bounced check"** because there are insufficient funds (not enough money) to pay the check.

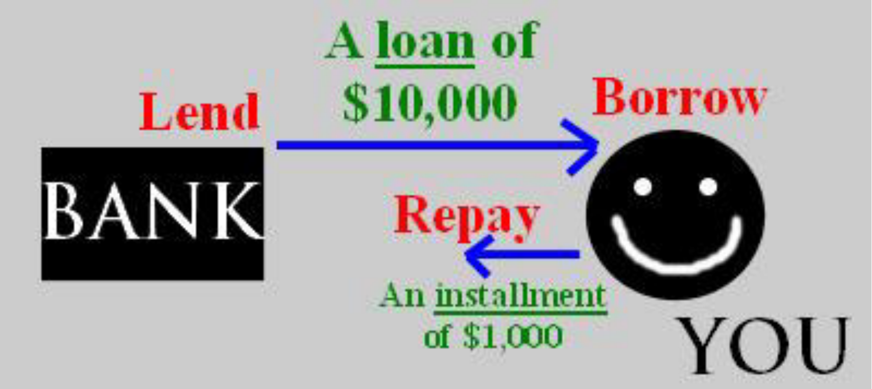
Loans

Another thing you can do at the bank is **take out a loan** - when the bank gives you a large amount of money, usually to buy a house or open a business – and you have to pay the money back to the bank over time.

Let me explain the difference between the words **"loan," "lend,"** and **"borrow,"** because they are commonly confused.

- The bank **lends** you money - and the amount of money is called a **loan**.
- You **borrow** the money from the bank.

Over time, you **repay** the loan to the bank in **installments** (monthly payments). You need to pay the original money (which is called the **principal**) plus **interest** (a small percentage of extra money).



Before a bank will lend you money, it will often check your **credit score/history** - that's your history of paying off credit cards and loans. If you always pay the correct amount on time, then you'll have a good credit score. If you miss repayments or make them late, then you'll have a bad credit score. The bank performs this check so that it can be sure you won't **default on the loan** - that means fail to repay it.

A loan that you take out for the specific purpose of buying a house is called a **mortgage.** If you don't pay back the loan, the bank can **repossess** (take) your house.

If a person (or company) has so many debts that it cannot repay them, it can **declare bankruptcy** (or **go bankrupt**) - bankruptcy is the legal status of not having enough money to pay for your obligations.

Investing

You can invest in the **stock market** - this is a network to buy and sell units of ownership of companies (these units are called **shares**). People make money in the stock market by buying shares of a company when the price is low and selling when the price is high (as the company grows in value).

The stock market can be **volatile** - that means it can go up and down very unpredictably. When the market is going up and people are making more investments because they are confident they will make money in the future, this is called a **"bull market."** When the stock market is going down and investors are more pessimistic, this is called a **"bear market."**

A person who likes to take risks in their investments is called an **aggressive investor.** Aggressive investors can make a lot of money - but they also run the risk of losing it all. Someone who prefers to invest carefully in more stable, reliable stocks is called a **conservative investor.**

Because of the unpredictable action of the stock market, a good piece of advice is to **diversify your portfolio.** This means to invest a little bit in many different companies and areas, and not to invest ALL your money in just one thing. Your **"portfolio"** is your collection of investments.

One way to diversify is by investing in **mutual funds** - these are groups that spread your money out among a large number of companies, like 50 or more. This way, if one of the companies loses money or goes bankrupt, it won't do too much damage to your investment.

If all of this investment talk makes your head spin (makes you confused) then you can hire a professional to handle your investments. This person is called a **stockbroker, investment adviser,** or **financial adviser.**

Taxes

The word **taxes** refers to the money you pay to the government, which is your responsibility as a working citizen of your country. The government then uses this money to pay for public infrastructure, national defense, and other projects to benefit everyone.

In the United States, and many other countries, a percentage of money is **withheld** (removed) from your salary every month, to pay taxes. Once a year, you need to **file your tax return** - that means you need to submit a document that shows how much in taxes you paid in the last year and compares it to how much you were required to pay.

People of different salary levels often need to pay different percentages of taxes. These categories are called **tax brackets.**

If your tax return shows that you paid more than you needed to, then you will receive money back from the government - this is called a **refund.**

The tax records of a person or company may be **audited** (investigated) by the government. If **fraud** (illegal activity) is discovered, the person may be convicted for the crime of **tax evasion**. The penalty may include paying **back taxes** (taxes from the past) and/or going to prison.

Accounting

Accountants are the professionals who take care of the financial records and financial administration of a person or company. Accountants work with three essential reports:

The **balance sheet** shows the company's **capital** (money provided by investors), **reserves** (money in savings), **debts** or **liabilities** (money the company needs to pay to others), and **assets** (economic resources such as buildings, equipment, inventory of products, and cash).

The second report is the **cash flow statement**. This shows the movement of money in and out of a company. It's essential for a business to have money available for **payroll** (payment of employee salaries) and payments to **suppliers** (other companies that provide the materials).

The final report is the **profit and loss statement (P&L).** This shows the company's **revenues** (money gained) from sales of products, as well as its **expenses** (money spent) for making the products and for **overhead** (operating expenses). The result is the company's **profit before tax.**

Accountants provide the information that helps the company create its **budget** - that's the plan of how to spend money in each different area - so that the company can operate **"in the black"** (with a positive amount of money) and not **"in the red"** (with a negative amount of money):

- In the black: **$500,000**
- In the red: **- $200,000**

For students who are working as accountants, you can find a great dictionary of accounting terms in English on the website of the New York State Society of Certified Public Accountants.