



# Financial Literacy Inventory™

The Editors @ JIST

## Administrator's Guide

### Overview

Americans owe more than two trillion dollars in consumer debt, over 40 percent of families spend more than they earn each year, and the average household carries approximately \$8,000 in credit card debt. Financial analysts worry that Americans' spending and savings habits are negatively impacting their financial futures. Americans need to learn to manage their money better.

No one has a greater need for careful money management than those who are unemployed or underemployed. Job seekers, ex-offenders, and recent high school and college graduates all face serious financial hurdles as they search for work or try to start a career. With little income available until they land their next job, such individuals must be especially careful in managing their expenses and planning their financial futures. Unfortunately, studies have shown that Americans are seriously under-educated when it comes to financial literacy.

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The *Financial Literacy Inventory (FLI)* is designed to provide counselors, job coaches, instructors, and other professionals with a quick and reliable assessment of a student's or client's basic financial knowledge. The *FLI* gives test takers a benchmark, hopefully motivating them to revise their spending habits and learn more about their financial options. It also allows administrators the chance to step in and alleviate key financial hurdles that will stand in the way of their clients' success. The *FLI* can be used in educational, workforce development, and offender reintegration settings.

## Research and Background

Definitions of financial literacy vary, as do the standards for programs that seek to assess it. A distinction can be made between personal financial literacy, however, and a more complex professional or academic understanding of finance and economics. A research report released by the Institute for Socio Financial Studies (Vitt, Reichbach, Kent & Seigenthaler 2005) defines personal financial literacy as “the ability to read, analyze, manage, and communicate about the personal financial conditions that affect material well being. It includes the ability to discern financial choices; discuss money and financial issues without (or despite) discomfort; plan for the future; and respond competently to life events that affect everyday financial decisions, including events in the general economy.” The report elaborates, suggesting that a financially literate person possesses knowledge of banking, credit, money management, risk, insurance, savings, and investing. While any of these subjects can be studied in depth, there is a general assumption that a *basic* understanding of each of these financial topics is necessary to successfully navigate today's consumer and working worlds.

For the purposes of this guide, personal financial literacy may be defined as having a practical understanding of basic money management skills and topics as they relate to income, savings, investing, credit, debt, budgeting, banking, and risk management. The assessment also assumes that a basic level of financial literacy empowers individuals to make better financial decisions but does not guarantee that they will. It is up to the individuals to employ their knowledge and skills to plan their finances better.

## The Need for Financial Literacy

Though it only represents one of many financial barriers individuals face, researchers, educators, politicians, and parents all agree that financial literacy is a problem. This problem is compounded by changes in employment and public policy, a decrease in personal savings, and an increase in debt. It is further exacerbated by an increasingly complex financial market, which is more readily available (thanks to new technology) but not necessarily more comprehensible. In addition, the increasing shift in responsibility to individuals to manage and pay for their own health care and retirement have lead to an economic environment where financial literacy is all the more necessary.

More specifically, Americans today are faced with serious economic hardships—many of which are precipitated by their own lack of money management skills. The Federal Reserve reports that consumer debt (not including mortgages) currently exceeds \$2.03 trillion and is rising. Credit card debt exceeds \$742 billion. That means that every American household has an average of \$7,000 in credit card debt, amounting to \$60 billion in interest payments per year. These figures lead researchers such as Karen Gross, President of the Coalition for Consumer Bankruptcy Debtor Education, to

speculate that Americans are in over their heads: "Average obligations, as a percentage of household disposable income, currently exceed 100 percent—meaning we spend more than we make" (Gross 2005).

With the rising costs of health care and college and with Social Security unstable, careful financial planning is a must for most households. However, most Americans are not in a position to pay for the future. For the years 2005–2008, the personal savings rate (the amount of disposable income that isn't spent) has hovered below one percent, hitting lows that haven't been seen for nearly 75 years (Barr 2008).

Hogarth, Hilgert, and Schuchardt (2002) assessed the savings and spending practices of Americans. According to their research,

- Only 46 percent of Americans use a spending plan or budget.
- Only 49 percent of Americans save or invest money out of each paycheck.
- Only 36 percent of Americans plan and set goals for their financial future.
- Only 49 percent of Americans pay credit card balances in full each month.

While a lack of financial illiteracy is not the only culprit behind Americans' spending and savings habits, it can be argued that an increase in financial literacy would improve personal money management skills, which, in turn, could lead to an increase in savings and a decrease in consumer debt. It can be further argued that, faced with potentially debilitating financial barriers such as medical expenses, credit card debt, a ballooning mortgage, or a job loss, basic financial literacy is a survival tool. Individuals who are unemployed or underemployed especially would benefit from greater money management knowledge and skill.

Americans themselves realize their own shortcomings as it relates to personal finances. Polls conducted by the Pew Research Center uncovered several startling findings, including the following:

- Nearly two-thirds (63 percent) of Americans acknowledge they don't save enough.
- More than a third of Americans say that they spend more than they can afford.
- More than one-in-three (36 percent) Americans also say that they have at some point in their lives felt their financial situation was out of control.

The problems that stem from or are exacerbated by financial illiteracy are numerous and life-altering. Without a basic understanding of money management and financial options, individuals can and often do fall into debt, overpay for financial services such as cashing paychecks, ruin their credit, forego health insurance, avoid getting additional education or training, or become victims of fraud.

These general barriers can manifest into wider economic instability and uncertainty. The sub-prime mortgage crises of 2008 can be blamed, at least in part, on prospective homeowners who didn't fully understand the consequences of their borrowing decisions or who didn't read or understand the fine print on their lending agreements. While some politicians point to a need for greater oversight of institutions, greater foresight on the

part of educated American consumers is equally necessary to avoid the kind of economic problems faced by the country in recent years.

The statistics, research, and anecdotal evidence all point to a pressing need for a more financially literate America. However, the need for increased financial literacy has not been met. Every two years, the Jump\$tart Coalition surveys high school seniors from around the country to assess their basic financial literacy. The survey's results are a closely watched indicator of current financial literacy among young people. On the 2008 survey, students correctly answered less than half (48 percent) of the questions—a decrease in the mean score from 2006 (Jump\$tart 2008). These students—many of whom are college bound and therefore likely to be incurring substantial debt—struggle with basic money management concepts, a struggle that can easily produce greater financial hurdles in their adult lives.

The need for increased and ongoing financial education may best be summarized by the Financial Literacy and Education Commission's (2006) proposed national strategy for financial literacy:

Today's increasingly complex financial services market offers consumers a vast array of products, services, and providers to choose from to meet their financial needs. While this degree of choice provides consumers with a great number of options, it also requires that they be equipped with the information, knowledge, and skills to evaluate their options and identify those that best suit their needs and circumstances.

Comprehensive education can help provide individuals with the financial knowledge necessary to create household budgets, initiate savings plans, manage debt, and make strategic investment decisions for their retirement or their children's education. Having these basic financial planning skills can help families to meet their near-term obligations and to maximize their longer-term financial well being.

### **Need for the *FLI***

While the need for additional financial education is apparent, schools and other organizations often lack the time, tools, and other resources to help adults and youth achieve basic financial literacy. According to a 2007 survey commissioned by the National Council on Economic Education, only nine states require students to receive some form of personal financial education. In addition, according to a survey conducted by the Networks Financial Institute at Indiana State University (2007), the majority of teachers find that financial literacy skills are lacking among young people. Those same teachers strongly feel that students require more exposure to the basic financial skills they will need to function in society.

In their assessment of the current state of financial literacy in the U.S., Braunstein and Welch (2002) of the Federal Reserve Board's Division of Consumer and Community Affairs conclude that "in an ideal world, financial educators would analyze each individual's needs and provide customized training based on that assessment.... Knowledge of those needs, coupled with an assessment of the individual's motivation and confidence, could assist in providing relevant financial information at the appropriate time." Friedman (2005) concurs, stating, "the ultimate goal of [financial literacy] success

programs is to provide participants with the skills needed to effectively tackle personal financial matters and make positive financial choices.”

Financial literacy is considered integral to overall career success. Many schools connect financial literacy to employability or career planning skills, often teaching them under the rubric of family and consumer sciences. Moreover, workforce development and training programs are increasingly partnering with banks and other institutions to provide financial literacy training to clients, most of whom are currently unemployed and are in desperate need of financial assistance, knowledge, and planning. Jacob (2000) tells about a partnership established between the Chicago Commons Employment Training Center and LaSalle Bank. The Center's students were primarily women transitioning from welfare to work. The partnership proved to be a success: The program helped clients understand how to use banks, save money, and plan a budget. Job coaches and career counselors realize that helping their clients start to earn a paycheck isn't as valuable as it could be if those same people don't know how to manage those earnings.

The need to equip everyone with a basic understanding of personal finance has prompted the need for more tools and programs. However, given the time and budget constraints often faced by organizations with clients most in need of financial literacy, such resources must often be quick and cost effective. The *Financial Literacy Inventory* was born out of such a need. The *FLI* offers administrators a sense of the test takers' strengths and weaknesses as it pertains to personal finances, thereby helping administrators more efficiently allocate resources to assist those individuals how and where they need it most.

### **Description of the *FLI***

The *FLI* has been designed for ease of use. It is simple to take and can be easily scored and interpreted. It contains 60 statements about financial literacy, scoring directions, an interpretation guide complete with tips for becoming more money savvy, and a financial planning checklist and worksheet. The statements have been grouped into scales that are representative of the most basic principles of personal finance. The scales on the *FLI* include

- Income and Careers
- Money Management
- Credit and Debt
- Savings and Investing
- Rights and Risks

The *FLI* can be administered to individuals or to groups. It is written for individuals at or above the seventh-grade reading level. None of the items is race or gender specific, and the *FLI* is appropriate for a variety of populations.

Be aware: The *FLI* is a test of knowledge, not a psychological profile. Results do not indicate or predict an individual's habits, practices, or motivations with regards to personal finance. Researchers agree that an understanding of personal finance is not *necessarily* a predictor of financial success or effective money management. Effective

personal financial management requires the knowledge, skills, motive, and resources. While the *FLI* serves as an assessment of basic knowledge, it is ultimately the test taker's and administrator's responsibility to translate that knowledge into action.

Also, the *FLI* is intended only as an assessment of *basic* financial literacy. The items and scales are representative of the practical information required for attaining personal fiscal responsibility. As such, the *FLI* may not be useful for all audiences. It is intended primarily for use with individuals who lack education or training in personal finance or who struggle to manage their own finances.

## **Administering the *FLI***

The *FLI* is self-administered, and the inventory is consumable. A pencil or pen is the only other item necessary for administering, scoring, and interpreting the inventory. Each respondent should fill in the necessary information on the first page. Read the directions on the first page and for Step 1 while all respondents follow along. Test administrators should ensure that each respondent clearly understands the instructions and the response format. Respondents should be instructed to mark all of their responses directly on the inventory. The *FLI* requires approximately 20 minutes to complete.

## **Completing the *FLI***

The *FLI* uses a series of steps to guide the respondent through the administration of the inventory. Responses are marked in Step 1 of the inventory. Respondents are asked to read each statement and then mark whether they think the statement is true or false. If they think the statement is true, respondents are asked to circle the letter next to that statement in the "True" column. If they think the statement is false, respondents are asked to circle the letter next to the statement in the "False" column. Step 2 explains how respondents should total their score for each section. Step 3 helps respondents to better understand their scores. Step 4 allows respondents to review their answers and provides tips for improving their financial literacy. Step 5 encourages respondents to develop a plan for managing their personal finances.

## **Calculating Scores for the *FLI***

The *FLI* was designed to be scored by hand. All scoring is completed on the consumable inventory. No other materials are needed to score or interpret the instrument, thus providing immediate results for the test taker.

In Step 2, respondents are asked to total their circled B and C answers in each of the five scales and put that total in the space provided. These scores will range from 0 to 12 for each of the sections. Respondents then will put that number in the blank box in the TOTAL column for each section on the *FLI*. Respondents should then add up their totals for all five scales to ascertain their overall financial literacy score.

Administrators should note that B and C are the *correct* answers for all items. Administrators should also note that while the overall score acts as a reasonable indicator of an individual's need for financial literacy training, scores on individual scales can more accurately pinpoint the specific subjects and skills individuals are lacking. Thus

administrators can more effectively allocate resources to deal with specific knowledge and skills gaps rather than addressing the whole range of financial concerns.

## Interpreting Scores

The *FLI* yields content-referenced scores in the form of raw scores. A raw score, in this case, is the total number of correct responses to each of the statements. Scores between 0 and 4 indicate that the respondent has little understanding of that particular aspect of financial literacy. Scores between 5 and 8 indicate that the respondent has some understanding of that financial literacy topic but needs to learn more. Scores between 9 and 12 indicate that the respondent has an adequate understanding of that particular financial literacy topic.

In addition, respondents are asked to total their scores for all five scales. This provides both respondents and administrators with a base score that can be used to determine if additional resources or training is necessary. In general, scores between 0 and 40 suggest a need for additional financial literacy training.

Respondents generally have one or more areas in which they score in the low or moderate range. These are the areas respondents should concentrate on. Step 4 provides information and tips for each of the five subject areas addressed by the *FLI*. Respondents should refer to those sections on which they scored the lowest and review the information provided. Be aware that the numbers at the end of statements refer to items in the inventory itself. Therefore, statements that respondents marked incorrectly can be specifically reviewed and discussed.

The checklist in Step 5 is designed to help respondents assess their own personal finance practices. They can then combine that information with the knowledge gained from completing the inventory to outline short- and long-range goals for becoming more financially knowledgeable and responsible.

## Improving Financial Literacy

Because the primary objective of this instrument is to help individuals assess and then improve their financial literacy, the *FLI* is organized so that it contains five scales representing the most basic financial literacy concepts needed to function in today's economic environment. Following are descriptions of the five basic scales on the *FLI*:

**Section 1: Income and Careers.** This section helps people to understand where their money comes from. That means understanding expenses, taxes, and other deductions; understanding what constitutes a "fair wage"; and understanding how career choices affect income and future opportunities.

**Section 2: Banking and Budgeting.** This section helps people to understand how to manage their money on a daily, weekly, and monthly basis. That means understanding the difference between needs and wants, using checking and savings accounts to stay in control of finances and pay bills, and learning how to make and stick to a budget.

**Section 3: Credit and Debt.** This section helps people to understand the uses and potential abuses of credit. That means understanding what credit is used for, what a credit score is, how to manage one's credit, and how to avoid or manage debt.

**Section 4: Savings and Investing.** This section helps people to understand the value of saving and investing. This means understanding the options available and the risks associated with each one. This includes basic financial instruments (such as savings accounts, CDs, money market accounts, stocks, and bonds). It also includes planning for the future and understanding the role investing plays in retirement, college, and home ownership.

**Section 5: Rights and Risks.** This section helps people to understand their rights as consumers and how they can use insurance to help prevent loss and manage risk. It primarily focuses on the value of and need for health, automobile, homeowner's/renter's, and life insurance.

In reviewing scores with test takers, it is recommended that administrators stress that financial literacy and financial responsibility are not the same. Scores on the *FLI* are not an indicator of personal financial history or habits. However, administrators are encouraged to use results from the *FLI* as a starting point for assessing potential problem areas. The assessment can help to uncover barriers to job search, job retention, and career management efforts. Administrators are also encouraged to have resources readily available for individuals interested in increasing their financial literacy. Several Web-based resources are listed on the assessment in Step 4 as well.

## Research and Development

This section outlines the stages involved in the development of the *FLI*, including guidelines for development, item construction and selection, and plans for future research.

### Guidelines for Development

The *FLI* was developed to fill the need for a quick, reliable instrument to determine an individual's basic financial literacy and identify those areas of personal finance requiring additional training and education. The inventory consists of a series of statements representing basic facts of personal finance that the average American should know. The *FLI* was developed to meet the following guidelines:

1. The instrument should measure basic financial literacy concepts. Items and scales on the *FLI* were derived from research and standards developed for high school students and adults engaged in basic financial literacy courses and programs.
2. The instrument should utilize a user-friendly format. The *FLI* uses a True/False question-answer format that allows respondents to quickly determine their financial literacy strengths and weaknesses.
3. The instrument should be easy to administer, score, and interpret. The *FLI* utilizes a consumable format that guides the test taker through the five steps.

4. The instrument should contain items that are applicable to people of all ages, genders, and backgrounds. Items have been screened to eliminate any that are age, gender, or culture specific.

### Item Construction

To ensure that the inventory content was valid, the authors conducted a review of the literature related to financial literacy and the programs designed to promote it. The authors also consulted with individuals providing counseling services in high schools, colleges, and government-funded training programs. From this research, five scales were identified as most representative of the basic information that most people should know. Those scales were correlated to a wide variety of financial literacy standards and curricula from across the country.

Table 1 shows how the five scales of the *FLI* correlate to national standards developed by the Jump\$tart Coalition for Personal Financial Literacy, the Institute for Adult Financial Literacy, the FDIC's *Money Smart* program, and the Indiana Financial Literacy Education standards for high school seniors.

<b>Table 1: Correlation of <i>FLI</i> Scales to National Standards</b>				
<b>Financial Literacy Inventory</b>	<b>Jump\$tart Coalition</b>	<b>Institute for Financial Literacy</b>	<b>Money Smart</b>	<b>Indiana FLE</b>
Income and Careers	Income and Careers			Relating Income and Careers
Banking and Budgeting	Planning and Money Management Financial Responsibility and Decision Making	Money Management	Bank On It Check It Out	Financial Responsibility and Decision Making Planning and Money Management
Credit and Debt	Credit and Debt	Credit Debt Management	Borrowing Basics To Your Credit Charge It Right Loan to Own Your Own Home	Managing Credit and Debt
Rights and Risks	Risk Management and Insurance	Risk Management	Keep It Safe	Risk Management and Insurance
Saving and Investing	Saving and Investing	Investing and Retirement Planning	Pay Yourself First	Savings and Investing

A pool of items representing a wide range of financial literacy concepts and skills was then created and later revised to reflect basic knowledge in these five areas. This enabled the elimination of items that did not correlate well. After the items were developed, they were reviewed and edited for clarity, style, and appropriateness.

Draft forms of the *FLI* were tested on an adult population. This initial research yielded information about the appropriateness of items for each of the scales; reactions of respondents concerning the inventory format and content; and reactions of respondents concerning the ease of administration, scoring, and interpreting. From this research, a final pool was chosen of 60 items that best represent the five topics addressed in the assessment. The items accepted for the final form of the *FLI* were again reviewed for content, clarity, and style and screened for bias.

Validity and reliability studies of the *Financial Literacy Inventory* are currently in progress. If you are interested in being a part of these studies or doing research that uses the *FLI*, please contact Dave Anderson at [jistassessments@yahoo.com](mailto:jistassessments@yahoo.com). Free copies of the *FLI* are available to approved administrators with the understanding that JIST will be provided with a copy of the results. You can also e-mail any comments or questions about the *FLI* to the above address.

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