Pre-College Conversations: How Should Your Kids Handle Their Money?

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In part two of our three-part series on pre-college conversations to have with your soon-to-be undergrad, we examine ways to navigate two tricky issues: how to give kids the funds they need, and how to give them some spending discipline.

If you've been in the habit of handing your high school-age kids cash from time to time, you'll need to develop a new method of transferring money to them for daily expenses once they're away at school. Among the obvious options: a credit card, a checking account, a prepaid card, or some combination of all three. But which one is best for you will depend, in part, on the fiscal discipline your child has demonstrated during high school.

"So many college kids graduate with debt, not only student loans, but also credit card debt they take on while in school," says Jeffrey Cutter, a certified public accountant and owner of Cutter Financial Group in Falmouth, Mass. "This is a time to closely evaluate your child's spending habits and financial responsibility."

Money Choices

There are pros and cons to each method of transferring funds to your kids, says Jonathan Clements, director of financial education at Citi Personal Wealth Management in New York City. "You know your kid best, so you have to decide whether it's more important to build good financial habits or to limit the damage that they might do," says Clements.

Separate credit card: Clements says that the best and safest way for students and parents to handle spending money is to open a joint credit card account with a low credit limit.The parents can choose to pay the bills themselves or tell the student to make the payments, with savings from a summer job or part-time job during the school year.

"This is a low-risk option since only so much money can be spent on the credit card," says Clements. "The only potential problem is that the bills might not get paid, but if the bills come to your home, you can keep up with them." Clements recommends teaching your student to deduct every credit card charge from a checkbook register to make sure the money will be available to pay the bill when it arrives.

Andrew V. Tignanelli, a certified financial planner and president of The Financial Consulate in Hunt Valley, Md., says that opening a credit card with a low limit, and teaching your offspring to pay the bill in full at the end of every month, can be a good method to start them on the path of establishing credit. "It's critical the student pays the bill and learns to stay on budget," says Tignanelli.

Authorized user on your credit card: Cutter says that if your college-aged kid doesn't have the funds or the discipline to keep up with credit card payments, another option is to add them as an authorized user on your account.

"This choice must come with strict guidelines as to what may be charged, and what the limit is," says Cutter. "For example, can they only charge school supplies? Can they charge clothing? Can they charge entertainment?"

While it can be an advantage to keep track of your student's spending, you run the risk of them using your credit card recklessly.

"Adding your kid as an authorized user gives him or her the potential to do more financial damage," says Clements. "The other downside is that your student may not necessarily be building a credit history. You need to check with your credit card company to see if your credit card history will be reported as an authorized user's credit history."

If your credit card provider does report your history as an authorized user's history, however, and you have a good credit history, your child can benefit, getting a head start on building a good credit history of their own.

Prepaid card: For the student who has little regard for budgets or money, the best option may be a prepaid card, says Cutter. This guarantees that your student can't spend more than what's in the budget.

"While a prepaid card can be good because it puts a cap on your student's spending, the bad news is that prepaid cards have a lot of fees, and they don't help your student build a credit profile," says Clements. "A prepaid account is best, though, for a kid you can't trust."

Checking account: A checking account can be a good tool to teach your kids that the account needs to be balanced at the end of the month, and monitored daily, says Tignanelli.

"Mint.com and Quicken are two great ways to teach a child about budgeting, cash flow, and monitoring your balances," says Tignanelli. "I would always set up a separate checking account just for the child. It's critical that the student monitor and balance the checking account."

Clements warns that if you open a checking account, and deposit a large sum at the beginning of the semester, your student could spend too much initially. Cutter says you should only deposit a larger sum of money in a checking account if your student has already demonstrated fiscal restraint and responsibility during high school.

"If your student opens a checking account, you'll need to find out the overdraft policy," says Clements. "I'd recommend signing up for low-balance alerts, and to link to another account to avoid overdraft fees."

You can always start out with one method of transferring funds to your kids, and then switch depending on their financial behavior, suggests Clements. Start with a prepaid card if you're not sure of your student's ability to keep track of money, and then move to more freedom as your student matures.

Read More: Part 1: Pre-College Conversations to Have With Your Kids: Who Pays for What?

Michele Lerner is a contributing writer to The Motley Fool. Try any of our Foolish newsletter services free for 30 days.

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