

Family Financial Planning

Preparing and Using Financial Statements

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As you develop financial plans and make financial decisions to reach family goals, such as buying a car or house, accumulating an emergency fund, educating children, or retirement—or to adjust to changes such as a new job, a pay raise, marriage, divorce, widowhood—you first need to know your current financial situation.

Two tools are used to review a family's current financial situation: the net worth statement and the income/expense statement. This publication includes directions for the preparation and use of these statements.

The Net Worth Statement

A net worth statement, also called a balance sheet, is a record of assets and liabilities; the difference between the two is net worth. Assets are the things you own with economic value. Liabilities are your debts, money you owe to others.

Your net worth statement tells you the fair market value of your assets today, and the balance of your debts today. If you prepare a net worth statement about the same time each year, you will see how your assets, liabilities, and net worth change from year to year.

Do you need one?

A net worth statement is a tool to measure progress toward meeting long-term financial goals, such as paying off major debts, financing your own or your children's education, saving for your own home, or saving for retirement. Before you formulate a plan to achieve goals, you need to know the resources you already have. A net worth statement visualizes your financial resources. Net worth statements are also useful as summaries of financial information. You may be asked for this financial information when you apply for credit, lease a car, or talk with a financial or estate planner.

Should everyone calculate net worth? Not necessarily. If you are struggling just to meet daily expenses, budgeting may be your first priority. Young families with few assets or debts may easily determine where they are financially without using a net worth sheet. However, before family members make decisions about investments, increasing debt, or purchasing insurance, they should know their present financial situation.

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How do you prepare the statement?

The easiest way to calculate your net worth is to use a preprinted listing of assets and liabilities (page 5). Other forms are available from financial institutions and in many financial publications. Once you have read several, you may develop your own form, one that is just right for your situation. Here are some places to find information about the value of assets and liabilities:

- Car values are published by the National Automobile Dealers' Association (N.A.D.A.) and by Kelley Blue Book. These are available in libraries, at car dealers, and at lending institutions.
- The cash value of whole life insurance policy can be found on a schedule in the policy. It is also available from your insurance agent. The cash value is the amount of money the insurance company would return to you if you terminated the policy today.
- Values of annuities are available in annual reports or periodic statements, or from your broker or insurance agent.
- Estimate the value of consumer goods by using information from second-hand shops and from classified ads. Use conservative estimates because it is difficult to sell used possessions.
- The balance owed on installment debts or credit cards is listed on monthly statements from creditors.
- The principal owed on a mortgage is usually available on the end-of-the-year statement from the mortgage holder.

How do you use the net worth statement?

You will use different parts of your statement to analyze different objectives. If your objective is to analyze your retirement plan, you will be interested in the present value of your pensions, IRA's, and investments, as well as their projected future values.

If your objective is to determine how much property insurance you need on your home and its contents, you would itemize the value and estimate the replacement cost of the house and everything in it.

After completing your net worth statement, look at your assets. What assets do you have that are very liquid—that is, those that you can convert into cash quickly and easily? Checking accounts, savings accounts, money market funds, and money market deposit accounts are very liquid.

You need some liquid assets for emergencies. How much you need will depend on many factors—the likelihood of loss of income through unemployment, layoff, or illness, and on the family's health and property insurance coverage. Some experts recommend that you keep an amount equal to 2 to 3 months income in liquid assets; others recommend 6 months income in liquid assets.

Will the value of your assets increase over time? Examples of assets that have the possibility of appreciating (growing in value) are mutual funds, stocks, and real estate. Some assets do not appreciate, but are income-producing assets. Examples are interest-bearing checking accounts, savings accounts, money market funds, money market deposit accounts, time deposits, and bonds. Are your income-producing assets producing what

you consider a satisfactory return? What kind of balance do you want between growth (appreciating) assets and income-producing assets?

Some assets depreciate; they decline in value over time because of wear and tear and obsolescence. Examples are automobiles, home furnishings, and appliances. When will you have to repair or replace these assets?

Also review your liabilities. Have you borrowed money to purchase items such as a car, a mobile home, or a home? If so, how does the amount you presently owe compare to the present value of the item? It's best not to owe more than the item is worth.

Families borrow money for items sometimes called investments in human capital. Investments in human capital are those things that increase an individual's knowledge, skills, and/or well-being. Education and medical and dental care are examples of investments in human capital. These do not show up as financial assets on the net worth statement. They do show up on the net worth statement as debts or as decreased savings. Even though they decrease financial net worth, they are important to the family and to the individual.

Borrowing money for day-to-day expenses should be done only in emergencies. If you charge day-to-day items such as clothing, gasoline, and meals and you pay the total bill when it arrives, you are not borrowing money. If you make only the minimum payment, you are borrowing money for day-to-day expenses. If you do this routinely, you are using credit to live beyond your means.

The Income/Expense Statement

An income/expense statement is a picture of your income and how you have spent your income for a given period in the past. This helps you compare income and expenditures to your goals and to what

you think is important. You want to use your money for those items and activities most important to you and your family.

Do you need one?

Some families need to control their spending to meet basic needs, and to accumulate funds for long-term goals. An income/expense statement is a tool to identify expenditures to decrease in order to increase saving. Income/expense statements are important during periods of transition. Each time there is an increase or decrease in income and each time there is an increase or decrease in expenses, a review of income and expenses identifies ways to adjust to the change.

An income/expense statement is not the same as a net worth statement. A net worth statement calculates your financial status at a point in time. An income/expense statement, in contrast, is a record of your income and outgo over a period of time in the past, usually 12 months. For example, a net worth statement lists the amount you owed on your car at the end of the year; an income/expense statement

tells you the total amount you paid in car payments in the past year.

An income/expense statement is not the same as a budget. A budget is a plan for future expenditures and income; it can also be a running record of expenditures and income—or it can be both. While income/expense statements summarize income and expenditures over a longer period of time, usually a year, and include future plans for a year, a budget usually controls spending for a shorter period, a week or a month. Therefore, a weekly or monthly budget can contain more detail about the nature of income and of expenditures.

An income/expense statement is primarily a record of past expenditures, but it can also incorporate future planning by including a column for future or “this year” projections.

How do you prepare the statement?

Some people calculate their income/expense statement around January 1, using figures from the previous calendar year. Others wait until they have completed their tax returns for the prior year and use income and expense calculations from the tax return. You can start and end an income/expense statement in any month and for periods other than a year.

You'll find an income/expense statement form on page 6. Begin by listing sources of income in the “Last year” column. The easiest way to obtain most of this information is to use your latest tax return. You also can use payroll stubs and listings of deposits in your checkbook. Remember to list all sources of income, including money from fellowships or scholarships, interest and dividends, and gifts.

The information about taxes is available on your tax return and on your paycheck stubs and wage statements. You probably have other deductions from your pay that fit into other categories.

Some expenses occur each month. These may be fixed: they are the same amount each month. Or they may be variable: they occur each month but the amount of the expense varies from month to month. Some examples of fixed expenses are rent or mortgage payments, car payments, alimony, and child support payments. Some examples of variable monthly expenses are food and gasoline.

The same expense category can be both fixed and variable. For example, in the category of utilities, a family might pay a set or fixed charge for local telephone service and a variable amount for long distance calls. The same expense might be variable for one family, fixed for another. The Smiths have a

set monthly local telephone rate (fixed), but the Browns have measured local service (variable).

Some expenses occur irregularly, perhaps only a few times in a year, and the amount may be fixed or variable. For example, car insurance is a fixed amount that may occur only twice a year. Clothing and vacation expenses are variable and occur irregularly throughout the year.

The most convenient source of information for fixed expenses is your checkbook record. Multiply the amount of the fixed payment times the number of times you paid it during a year and enter the amount in the "Last year" column.

For variable expenses, list on paper categories of variable expenses (clothing, gasoline, car repairs, hobbies, food, etc.). Then go through your check register and record the amount of each expenditure under the appropriate category. If you find that checks were made out to Mastercharge, Visa, or a department store for credit purchases, use the billing statement to determine how much was spent in which categories. If you had finance charges for your credit purchases, list them under "Interest paid."

For checks made out to cash, if you do not know what it was for, list the amount under the heading "Unaccounted-for cash." If this category is a high proportion of your past expenditures, try to reconstruct an estimate of where this cash went.

To make this estimate, keep track of your cash expenditures for 1 week. You might find that during this week you spent one-fourth of your cash on gas, one-half on lunches out and coffee breaks, and the other one-fourth on groceries you purchased on the way home from work. Use these same proportions to divide into the appropriate categories the total amount in the "Unaccounted for cash."

Add the expenditures in each category and enter the totals on your income/expense statement. Then add all the income and all the expenses.

If your total income is greater than your total expenses, the difference should be the balance in your checkbook and/or cash on hand. If you came out with a surplus on paper—but there's none in your checkbook—you probably underestimated your expenditures. On the other hand, if your expenses are greater than your income, you might have dipped into savings, taken out a loan, or underestimated your income.

The sample income/expense statement form is good for getting started, but after you've used it, you'll probably want to create your own categories to fit your family. You might want a category called "Meals out" or a special category just for "Sports equipment." And you might not need some of the categories listed on this form.

Likewise, families with different styles of financial management can use the statement in different ways. A couple who pool their incomes would probably fill out one sheet. A couple keeping separate accounts might fill out two—one for each person. Some couples with separate accounts may also fill out a third sheet for their joint income or joint expenses.

After you have estimates for last year, think about your income and expenditures for next year. You will be able to predict some items fairly accurately. Others will be estimates. Do the best you can. The better you estimate, the fewer financial surprises you will have during the year.

If your income is uncertain, estimate the highest and lowest income you expect for the year. Have an idea what expenses you will adjust if income is the lowest rather than the highest estimate.

How do you use the income/expense statement?

After completing the income/expense statement, review your income. If income is increasing, how has the increase been allocated? If income is decreasing, give thought to expenditures you are most willing and able to decrease. Are there ways to get additional income?

Review the expenditures. Are there expenditures you think ought to be increased? decreased? Are there debts that will be completely paid in the near future? If so, how will the money that was being used to pay the debt be reallocated? Can part of this be used toward a financial goal such as an emergency fund?

How will you monitor your finances to see how close your actual expenses and income are to your estimated expenses and income? An income/expense plan is no help unless you use it to help you control your spending.

Record the amounts you actually spend and compare actual and planned expenditures. Compare actual income to planned income. If actual income and expenses are not the same as planned income and expenses, rework your plan to fit the reality of your income and expenses.

Net Worth Statement

Name _____ Date _____

Assets

Cash and cash equivalents

Cash on hand \$ _____
 Checking account(s) _____
 Savings account(s) _____
 Money market funds/Money market deposit accounts _____
 Time deposits _____
 Savings bonds _____

Investment assets

Stocks _____
 Bonds _____
 Mutual funds _____
 Real estate _____
 Home _____
 Other _____
 Cash value of life insurance/annuities _____
 Partnership and business interest _____

Retirement assets

IRA/Keogh account _____
 Employee retirement fund _____
 Other _____

Consumption assets

Home furnishings/appliances _____
 Sports and hobby equipment _____
 Antiques, art, collections _____
 Jewelry, furs, etc. _____
 Automobiles/vehicles _____

Other

_____ _____
 _____ _____
 _____ _____

Total assets \$ _____

Liabilities

Past due bills for services, rent, etc. \$ _____
 Credit cards/charge accounts _____

Consumer installment debt

Automobile _____
 Other _____
 Real estate debt _____
 Home _____
 Other _____

Taxes _____
 Pledges: charities, churches, etc. _____
 Other _____

Total liabilities \$ _____

Total assets _____

Less total liabilities _____

Net worth \$ _____

Income/Expense Statement

From _____, 19____ to _____, 19____

	Last year	Estimates for this year
Income		
Salaries (before deductions)	\$ _____	\$ _____
You	_____	_____
Your spouse	_____	_____
Others	_____	_____
Commissions, tips, bonuses	_____	_____
Investment income	_____	_____
Interest/dividends	_____	_____
Profit from rental property	_____	_____
Profit from sale of assets	_____	_____
Other investment income	_____	_____
Alimony/child support	_____	_____
Cash gifts	_____	_____
Other income	_____	_____

Total income \$ _____ \$ _____

Expenses		
Taxes	\$ _____	\$ _____
Federal income	_____	_____
Social Security (F.I.C.A.)	_____	_____
State income	_____	_____
Property	_____	_____
Other	_____	_____
Housing		
Rent/mortgage payment	_____	_____
Utilities	_____	_____
Property/liability insurance	_____	_____
Furniture/other durables	_____	_____
Household maintenance	_____	_____
Other	_____	_____
Savings		
Savings account	_____	_____
Investments	_____	_____
Pension contributions	_____	_____

Expenses (continued)

	Last year	Estimates for this year
Transportation	_____	_____
Car payment	_____	_____
Gasoline, repairs, tires	_____	_____
Insurance, licenses	_____	_____
Food	_____	_____
Clothing, clothing care	_____	_____
Recreation, hobbies	_____	_____
Personal care	_____	_____
Health care	_____	_____
Services/medications	_____	_____
Health insurance	_____	_____
Education, publications	_____	_____
Life/disability insurance	_____	_____
Debts	_____	_____
Bank loans	_____	_____
Charge accounts/credit cards	_____	_____
Child care	_____	_____
Family allowances	_____	_____
Charitable contributions	_____	_____
Gifts	_____	_____
Child support/alimony	_____	_____
Business/professional expenses	_____	_____
Unaccounted for expenses	_____	_____

Total expenses \$ _____ \$ _____

Year _____ Estimates for Year _____
Total income \$ _____ \$ _____
Less total expenses _____ _____
Difference \$ _____ \$ _____

Another Publication on Financial Planning

Another financial planning publication is available from Oregon State University. To order a copy, send the following form to: Agricultural Communications, Publications Orders, Administrative Services Bldg. 422, Oregon State University, Corvallis, OR 97331-2119. If you'd like more than one copy, please call us at (503) 737-2513 for a price quote.

Please send one copy of the following publication:
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