

PERSONAL FINANCIAL STATEMENTS



INCOME STATEMENT BALANCE SHEET

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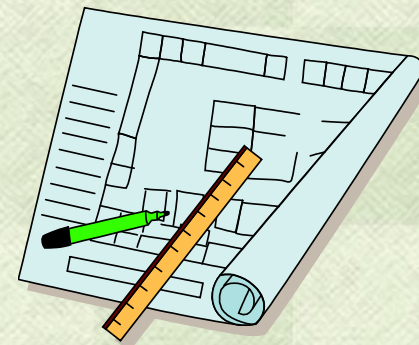


Developing Financial Statements

What are Financial Statements?

Compilations of personal financial data used to analyze financial situation

- Income statement –cash basis
- Net worth statement (balance sheet)

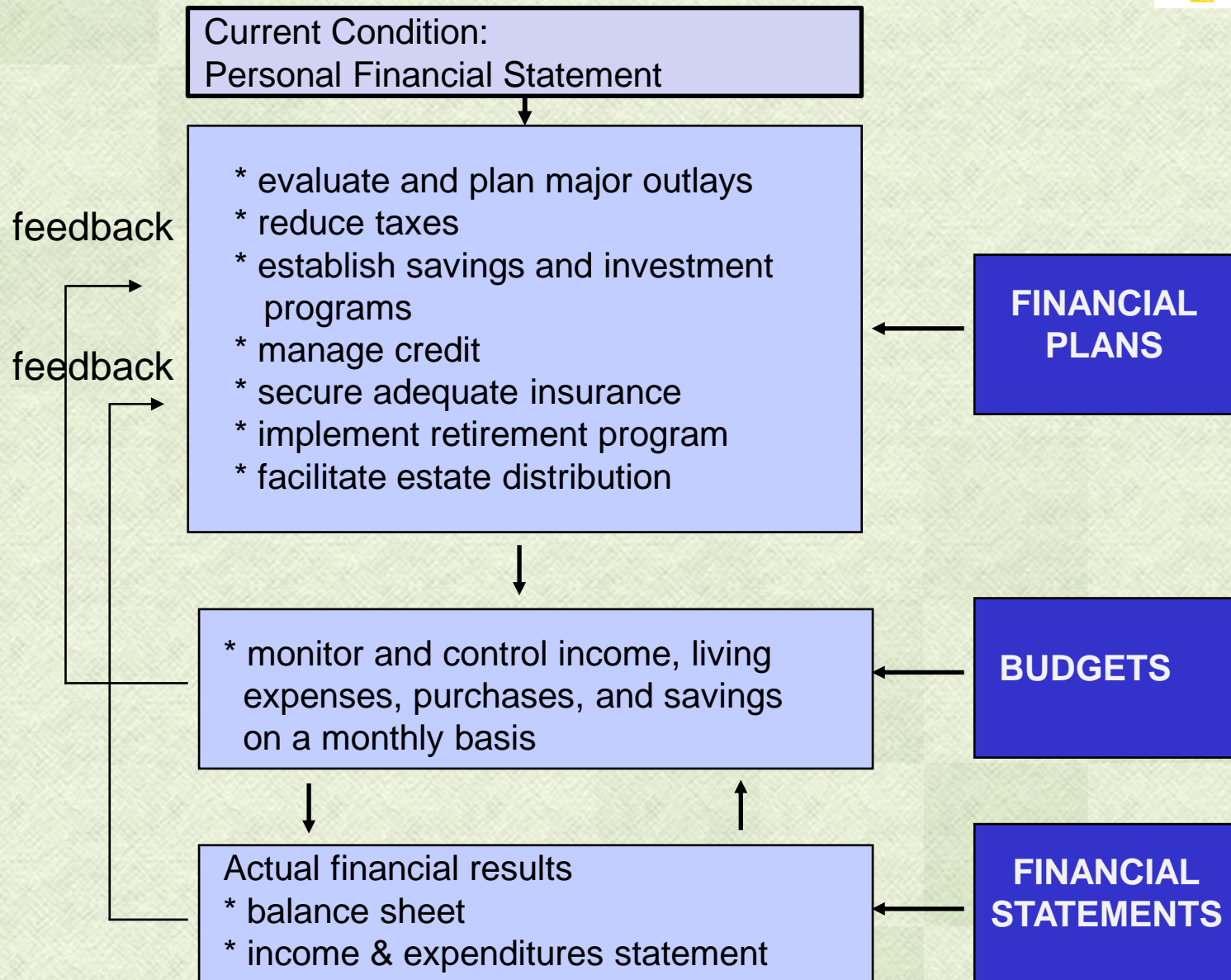




Financial Statements are Used:

- By person to know his/her financial position
- By person to set his/her financial direction
- By creditors & lenders to make decisions to extend, continue, or call indebtedness

The Interlocking Network of Financial Plans & Statements





PERSONAL INCOME STATEMENT



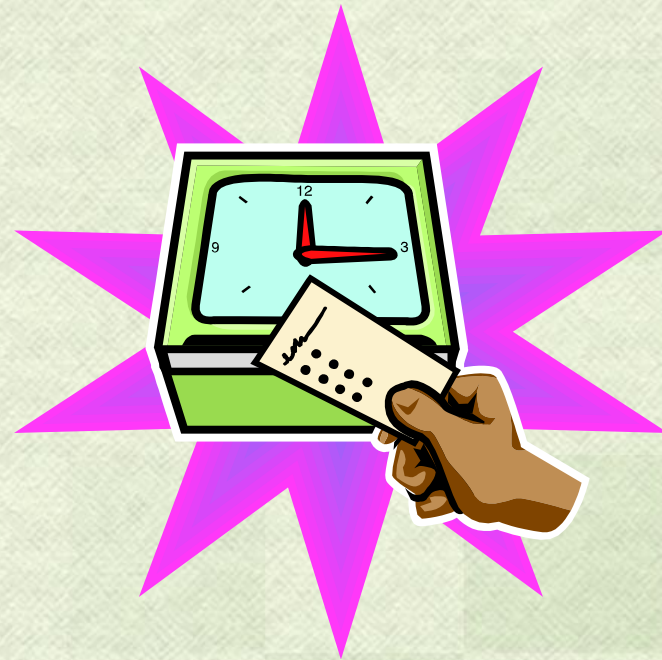
Personal Income Statement

- A financial statement that reports income and expenses over a period of time
- Many people don't have a clue about small expenses that add up.
- **Suggestion:** Track *your* income and expenses for the coming month!

Income



- Where are the income from?
- 3 sources of Income:
 1. Employment
 2. Investment
 3. Ownership of Business
- It includes:
 - Wages, salary, commision
 - Bonus
 - Interest
 - Dividends
 - Scholarships
 - Gifts
 - Other sources?





Expenses

Expenses:

Fixed Expenses:

- Usually paid in the same amount during each time period
 - They are often contractual
- Exp. House payment, Car payment, Insurance premium, etc.
- Most fixed expenses are variable over longer periods of time

- **Variable Expenses:**

- Expenditures you can control.
- Items/amounts differ from month to month.

Exp. Food, Utilities, gasoline

- **Occasional Expenses**

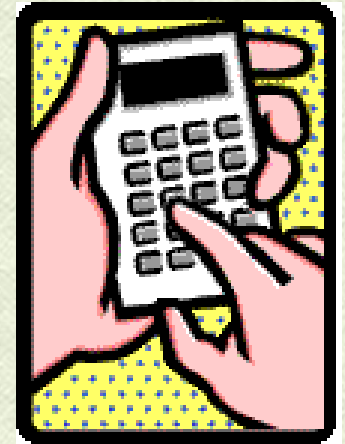
- Pay infrequently (e.g., quarterly)

Exp. Vacation/entertainment/gifts





Surplus (Loss)



- The surplus (loss)
 - shows the amount remaining after subtracting expenses from income.

- Surplus/deficit formula:

Surplus(deficit) = total income- total expenses

- **Surplus** = Positive
- **Deficit** = Negative



Step 1
For a set time period (such as a month), record your income from various sources, such as wages, salary, interest, or payments from the government.

Step 2
Develop categories and record cash payments for the time period covered by the cash flow statement.

Step 3
Subtract the total outflows from the total inflows. A positive number (surplus) represents the amount available for saving and investing. A negative number (deficit) represents the amount that must be taken out of savings or borrowed.

Lin Ye
Cash Flow Statement for the Month Ended September 30, 2012

Income (cash inflows)

Salary (gross income)		\$4,350	
Less deductions			
Federal income tax	\$810		
State income tax	108		
Social Security	<u>332</u>		
Total deductions		\$1,250	\$3,100
Interest earned on savings			34
Earnings from investments			<u>62</u>
Total income			<u>\$3,196</u>

Cash Outflows

Fixed Expenses

Rent	\$1,150	
Loan payment	216	
Cable television	52	
Monthly train ticket	196	
Life insurance	32	
Apartment insurance	<u>23</u>	
Total fixed outflows		\$1,669

Variable Expenses

Food at home	260	
Food away from home	168	
Clothing	150	
Telephone	52	
Electricity	48	
Personal care (dry cleaning, laundry, cosmetics)	66	
Medical expenses	85	
Recreation/entertainment	100	
Gifts	70	
Donations	<u>80</u>	

Total variable outflows		<u>1,079</u>
Total outflows		\$2,748
Cash surplus + (or deficit -)		<u>+\$448</u>

Allocation of Surplus

Emergency fund savings	168
Savings for short-term/intermediate financial goals	80
Savings/investing for long-term financial security	<u>200</u>
Total surplus	<u>\$448</u>



Income Statement for a College Student

Table 2.4 Cash-Flow Statement for a College Student—Bill Soshnik

January 1–December 31, 2005

	Dollars	Percent
INCOME		
Wages (after withholding)	\$4,650	39.71
Scholarship	1,750	14.94
Government grant	2,500	21.35
Government loan*	2,600	22.20
Tax refund	210	1.79
Total Income	\$11,710	100.00
EXPENSES		
Room rent (includes utilities)	\$1,500	12.81
Laundry	216	1.84
Food	1,346	11.49
Automobile loan payments	1,292	11.03
Automobile insurance	778	6.64
Books and supplies	932	7.96
Tuition	3,160	26.99
Telephone	282	2.41
Clothing	475	4.06
Gifts	300	2.56
Automobile expenses	600	5.12
Health insurance	102	0.87
Recreation and entertainment	360	3.07
Personal expenses	300	2.56
Total Expenses	\$ 11,643	99.43
Surplus (deficit)	\$ 67	0.57

*Technically, loans are not income. Bill plans to be a teacher and his loan will be forgiven should he go into teaching and remain in the profession for five years.

Factors That Affect Income Statements

- Factors affecting income:
 - Stage in your career path
 - Closely related to your stage in the life cycle — college, career, retirement
 - Type of job
 - Based on skill level and demand for those skills
 - Number of income earners in your household



Factors That Affect Income Statement

- Factors affecting expenses:
 - Size of family
 - Age
 - Personal consumption behavior
 - Some people spend all of their income and more while others spend mainly on necessities and concentrate on saving for the future





PERSONAL BALANCE SHEET



Personal Balance Sheet

- **Personal balance sheet:** a summary of your assets (what you own), your liabilities (what you owe), and your net worth (assets minus liabilities)
- A balance sheet reflects your financial position at a specific point in time



Balance Sheet

ASSETS

What you

own:

- Liquid Assets
- Personal
Used Assets
- Investment
Assets

LIABILITIES

What you owe:

- Short Term Liability
- Long Term Liability

NET WORTH



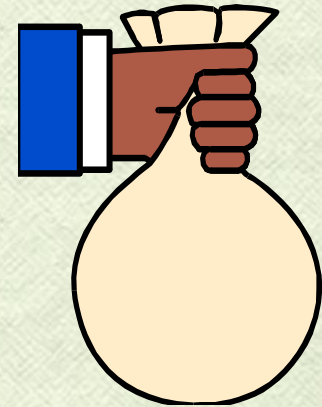
Net Worth—What Is Left

- Net Worth Formula:

Net worth = assets - liabilities

or

Net worth = what is owned - what is owed



Questions: What is YOUR net worth?

Is it a positive number?

How do you increase net worth?



Personal Balance Sheet

- **Assets**
 - **Liquid assets** are financial assets that can be easily sold without a loss in value
Cash, Savings.
 - **Personal Use Assets** are items normally owned by a household,
home, car, furniture, vacation home,
Jewelry
 - Long-lived assets
 - Used to maintain quality of life
 - You need to establish **market values** for these assets — the amount you would receive if you sold the asset today



Personal Balance Sheet

– Investments assets

assets that you own in anticipation of appreciation in value and/or receiving income as a result of ownership.

Retirement accounts, Securities

- **Bonds:** certificates issued by borrower, usually firms and government agencies, to raise funds; or
- **Stocks: certificates** representing partial ownership in a firm



Personal Balance Sheet

- **Mutual funds:** investment companies that sell shares and invest the proceeds in investment instruments
- **Rental property:** housing or commercial property that is rented out to others



Personal Balance Sheet

- **Liabilities**

- **Current liabilities:** debts that will be paid within a year.

- Exp. Current portion of mortgage, Utilities payable, Credit cards payable, Insurance premiums payable, Taxes due, Medical bills due; repair bills due.

- **Long-term liabilities:** debts that will be paid over a period longer than one year

- Exp. Primary residence mortgage, Auto loans, Student loans, Other loans

- **Net worth** is the difference between the value of your assets and the value of your liabilities



Personal Balance Sheet

- Creating a personal balance sheet
 - Allows you to determine your net worth
 - Update it periodically to monitor changes in your net worth over time



Personal Balance Sheet

		Present Situation
Assets		
Liquid Assets		
	Cash	500
	Checking Acct	3500
	Savings Acct	0
	Total liquid assets	4000
Household Assets		
	Home	0
	Car	1000
	Furniture	1000
	Total household assets	2000
Investment Assets		
	Stocks	3000
	Total investment assets	3000
	Total Assets	9000
Liabilities and Net Worth		
Current Liabilities		
	Credit card balance	2000
	Total current liabilities	2000
Long-Term Liabilities		
	Mortgage	0
	Car loan	0
	Total long-term liabilities	0
	Total Liabilities	2000
	Net Worth	7000



Step 1

Prepare a total of all items of value (assets). Include amounts in bank accounts, investments, and the cost (or estimated current value) of your possessions.

Step 2

List and total the amounts owed to others (liabilities). This list will include current debts, charge account/credit card balances, and amounts due on loans and mortgages.

Step 3

Subtract total liabilities from total assets to determine net worth. This amount indicates the current financial position of an individual or a household.

Rose and Edgar Gomez Personal Balance Sheet as of October 31, 2012

Assets

Liquid Assets

Checking account balance (Chap. 5).....	\$ 1,450
Savings/money market accounts (Chap. 5)	5,235
Cash value of life insurance (Chap. 12).....	<u>3,685</u>
Total liquid assets.....	\$ 10,370

Real Estate

Current market value of home (Chap. 9)	\$ 189,900
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Personal Possessions

Market value of automobile.....	8,000
Furniture and appliances.....	5,900
Stereo and video equipment	2,600
Home computer.....	1,400
Jewelry.....	<u>2,200</u>
Total household assets.....	\$ 20,100

Investment Assets (Chaps. 13–17)

Retirement accounts (Chap. 18).....	26,780
Mutual funds (Chap. 16).....	<u>11,890</u>
Total investment assets.....	38,670

Total assets \$ 259,040

Liabilities

Current Liabilities

Medical bills (Chap. 11).....	\$ 150
Charge account and credit card balances (Chaps. 6, 7)...	3,340
Balance due on auto loan.....	<u>1,750</u>
Total current liabilities.....	\$ 5,240

Long-Term Liabilities

Mortgage (Chap. 9).....	91,600
Home improvement loan (Chaps. 6, 7).....	1,760
Student loan.....	<u>1,200</u>
Total long-term liabilities.....	94,560

Total liabilities \$ 99,800

Net worth (assets minus liabilities) \$ 159,240



Balance Sheet for a College Student

Table 2.2 Balance Sheet for a College Student—Bill Soshnik, January 1, 2006

	Dollars	Percent
ASSETS		
Cash on hand	\$ 85	1.07
Checking account	335	4.21
Savings account	800	10.05
Personal property*	3140	39.45
Automobile	3600	45.23
Total Assets	\$7960	100.00
LIABILITIES		
Telephone bill past due	\$ 70	0.88
Bank loan—automobile	3130	39.32
College loan	1000	12.56
Government educational loan	4500	56.53
Total Liabilities	\$8700	109.30
Net Worth	(\$740)	—9.30
Total Liabilities and Net Worth	\$7960	100.00

*At fair market value, list includes clothing, \$400; dresser, \$50; television, \$150; chair, \$30; table, \$40; desk, \$120; cooking/dining items, \$50; and computer equipment, \$2300.



Personal Balance Sheet

- **Changes in the personal balance sheet**
 - Some changes will affect both your personal balance sheet and your net worth
 - Other changes will affect you personal balance sheet and leave your net worth unchanged

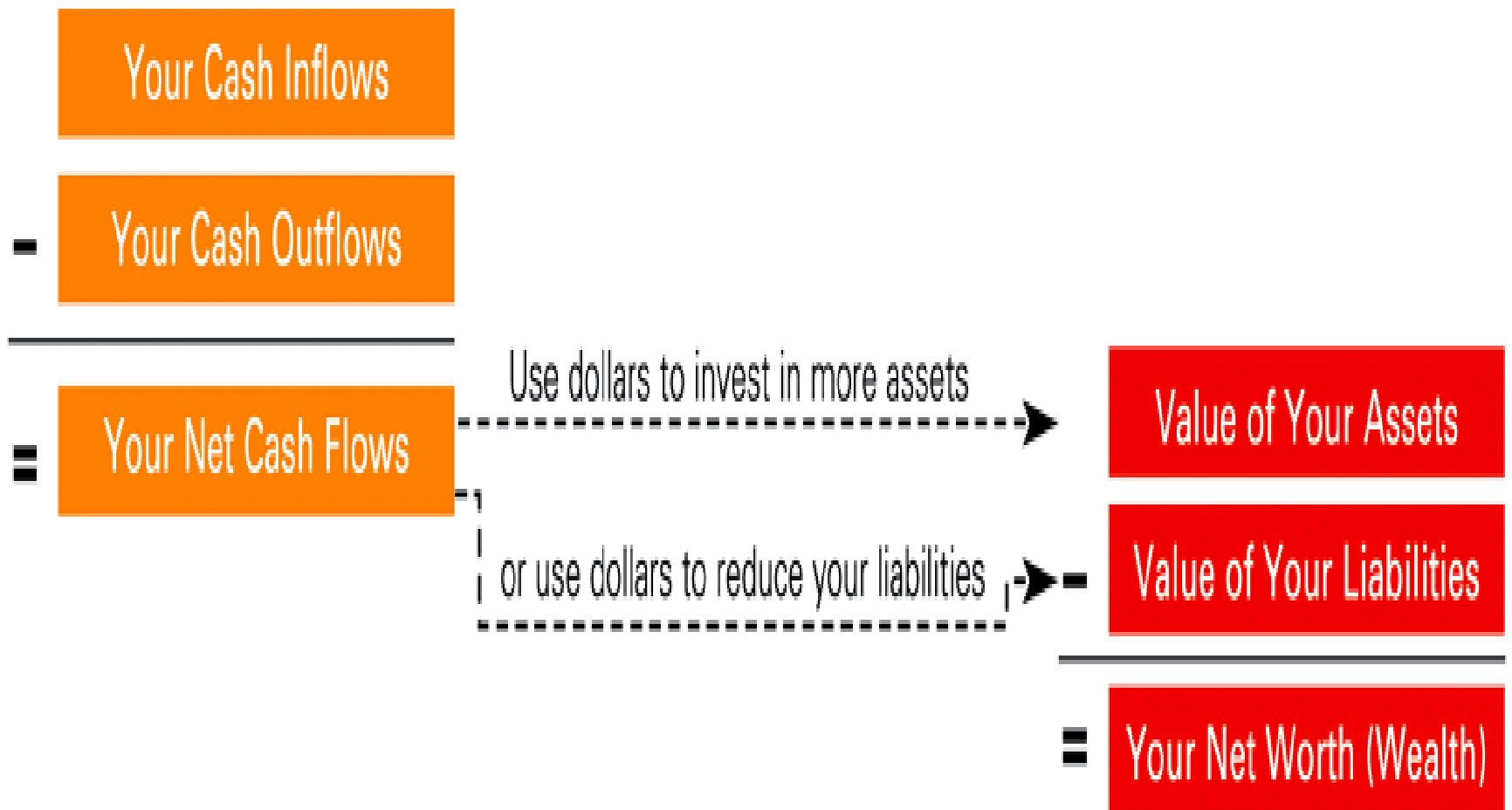


Relationship Between Income Statement and Wealth (Net Worth)

- Wealth is built by using surplus to invest in assets without increasing liabilities
- Surplus can be used to decrease liabilities which will increase net worth
- Net worth can change even if surplus are zero; for example, the value of an asset or investment increases or decreases



Relationship Between Surplus and Wealth



Information Sources to Prepare Personal Financial Statement

- Bank Statements
- Investment account statements
- Life insurance statements
- Real Estate purchase agreement
- Mortgage notes
- Car and other notes
- Credit card statements
- Employer benefit statements
- Appraisals



Financial Ratios Assess Your Financial Strength and Progress

Financial Ratios:

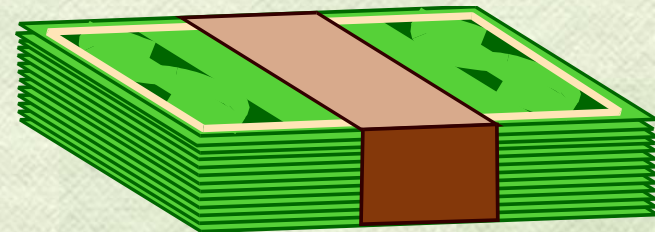
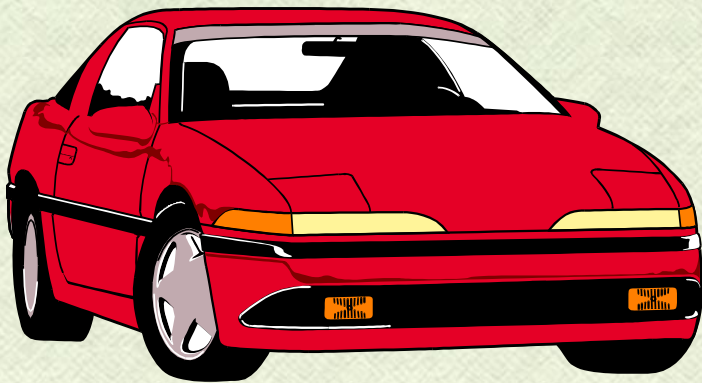
- Calculations based on information contained in financial statements.
- Simplify judgments regarding financial strength and condition.
 - Adequacy of emergency savings
 - Amount of household debt
- Often used by lenders, financial advisors





1. Basic Liquidity Ratio

Liquidity: The speed and ease with which an asset can be converted to cash.



Question:

What types of assets are liquid and what assets are not?



1. Basic Liquidity Ratio (Continued)

$$\text{Basic liquidity ratio} = \frac{\text{monetary (liquid) assets}}{\text{monthly expenses}}$$

- Tells how long you could meet monthly expenses with monetary assets after a loss of income.
- A higher number is better...Why?
- Three - Six months is a good cushion (emergency fund).
- More may be needed if income varies significantly from month to month.
- **Question 1:** Do you have adequate liquidity to meet emergencies?





2. Liquid Asset to Net Worth Ratio

- How much from net worth is in form of liquid assets
- **Liquid Assets/Net Worth**
- 15%
- **Question 1:** Do you have adequate liquidity to meet emergencies?





3. Savings Ratio

$$\text{Savings ratio} = \frac{\text{annual savings}}{\text{after - tax income}}$$

- Compares dollars saved to after-tax income.
- 10% or more is health
- A higher number is better...Why?
- **Question 2:** Are you saving as much as you think you are?





4. Debt-to-Asset Ratio



- The ability to pay debt
- **Total Debts/Total Assets**
- A lower number is better...Why?
- 50%
- Should decline as you get older
- **Question 3:** Do you have the ability to meet your debt obligations?



5. Debt Service-to-Income Ratio

Debt service - to - income ratio = $\frac{\text{annual debt repayments}}{\text{gross income}}$

- Provides a view of total debt burden
- Should be a ratio of .36 or lower
- 45% or more is too over
- A lower number is better...Why?
- Indicates ability to make payments
- **Question 3:** Do you have the ability to meet your debt obligations?





6. Debt Payments-to-Disposable Income Ratio

Disposable Personal Income: Take-home pay remaining after all deductions are withheld



Question: What are some common payroll deductions?



6. Debt Payments-to-Disposable Income Ratio (Continued)

Debt payments- to - disposable income ratio = $\frac{\text{monthly nonmortgage debt repayments}}{\text{disposable income}}$

- Indicates ability to handle monthly debt payments other than a mortgage.
- 20 percent or more is very high.
- 15% or lower is normal
- A lower number is better...Why?
- **Question 3:** Do you have the ability to meet your debt obligations?





7. Net Investment Assets to Total Net Worth Ratio

- Compares the value of investment assets to total net worth.
- **Investment Assets/Net Worth**
- A higher number is better...Why?
- Should increase as you get older.
 - Less than 20% in 20s
 - 50% or more in later life

Question 4: Are your investment enough?
your portfolio investments have properly
and return?





8. Solvency Ratio

- Reduction in net worth before **bankruptcy**

$$\frac{\text{Total net worth}}{\text{Total assets}}$$



- The larger this ratio, the greater the financial cushion to protect against insolvency.
- If: $SR = 280m/1,000m$
- This family could withstand a 28% decline in asset value before they would be insolvent.



Using Ratios: A Financial Thermometer

- **Question 1:** Do you have adequate liquidity to meet emergencies?
- **Question 2:** Do you have the ability to meet your debt obligations?
- **Question 3:** Are you saving as much as you think you are?
- **Question 4:** Are your investment enough? Do your portfolio investments have properly risk and return?
- **Question 5:** Have you prepared your pension fund?
- **Question 6:** Have you prepared your inherits? Do you know the taxation on your investment & net income?

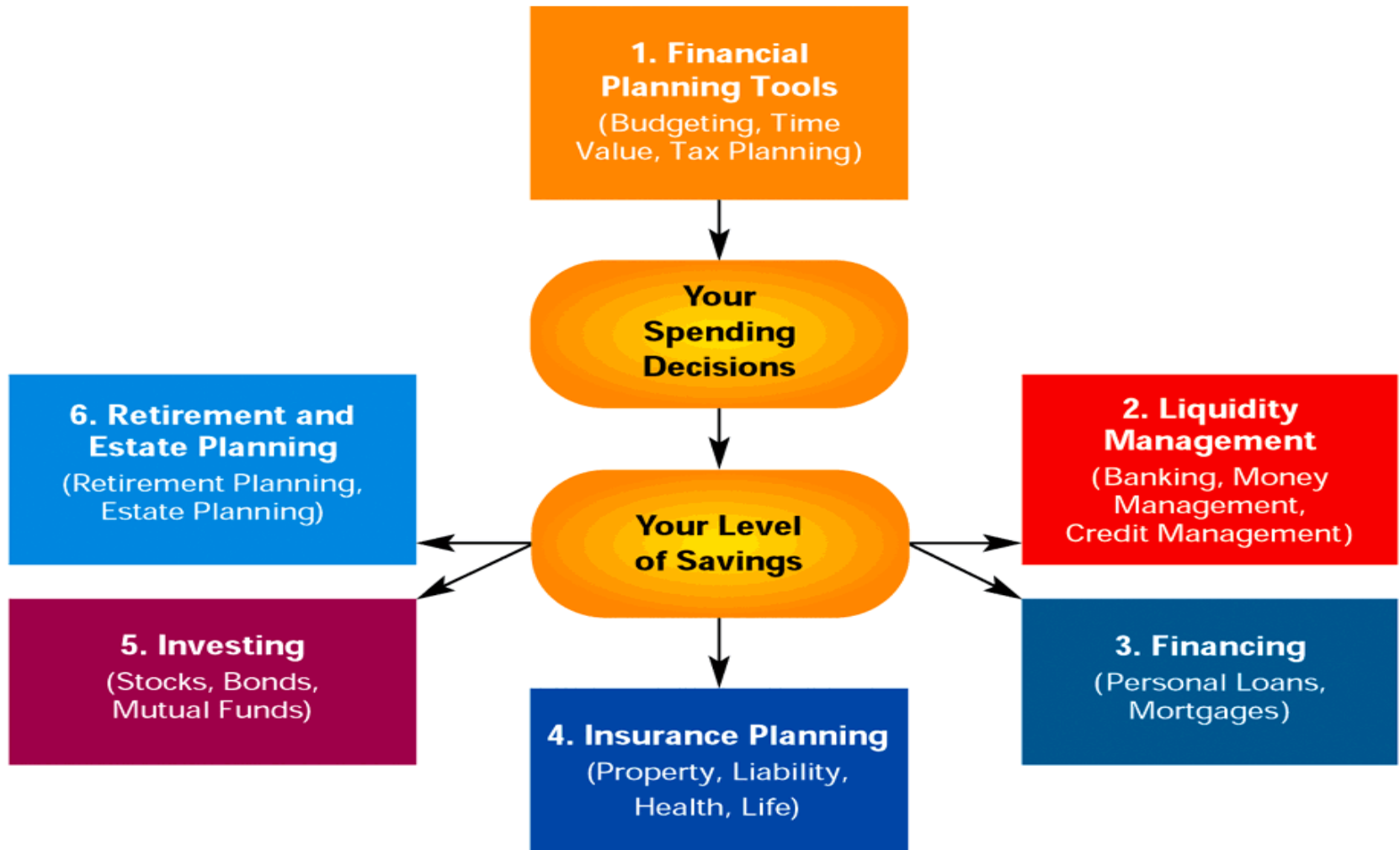


Golden Rules of Financial Planning

1. Develop a balance sheet; update annually
2. Develop income statements monthly or quarterly and compile into annual statement
3. Calculate financial ratios periodically and use them to assess financial progress
4. Develop a list of financial goals. Update and revise your goals annually
5. Start an uncomplicated personal financial record-keeping system to meet your needs



Integrating Key Concepts





Preparing & Using Budgets

Budget

- A short-term financial planning report that helps you achieve your short-term financial goals.
- Achieving your short-term goals then helps you achieve your longer-term goals.



Budgets help you to...

- **Monitor** and **control** finances.
- **Allocate** income to reach goals.
- **Implement** system of disciplined spending.
- **Reduce** needless spending.
- **Achieve** long-term financial goals.



The Budgeting Process

- Estimate income
- Estimate expenses
- Finalize the income statement budget
- Deal with deficits

Use of
Budgets



What should you do if you have monthly deficits?

- Shift expenses from months with deficits to months with surpluses.
- Use savings, investments, or borrowing to cover temporary deficits.
- Decrease spending.
- Increase income.



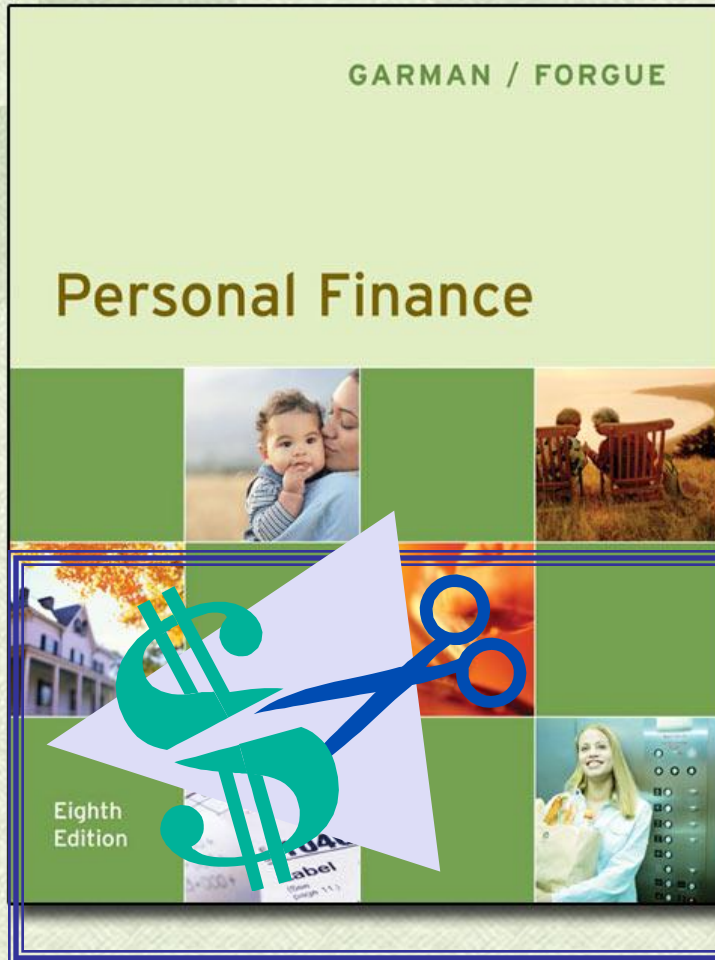


What should you do if you end the year in a deficit?

- Liquidate savings/investments
- Borrow to cover the deficit
- Cut low priority expenses; alter spending habits
- Increase income



Deficit spending causes you to ...



Deplete an existing asset,

Incur more debt –

Or both!

Deficit spending
DECREASES
your Net Worth!



Things to remember about a budget



- Use a Budget Control Schedule to compare your budgeted figures to your actual figures and determine the variances.
- Continually update your budget based upon the actual figures.
- Always try to keep your budget balanced or, even better, at a surplus.

Use of
Budgets



Microsoft Excel

File Edit View Insert Format Tools Data Window Help Acrobat

O1 = Annual Totals

	A	B	C	D	E	F	G	H	I	J	K	L	M	N	O	P
1	Actual Spending (cash outflows)														Annual Totals	
2	Item	Monthly Budget	Jan.	Feb.	Mar	Apr	May	June	July	Aug.	Sept.	Oct	Nov.	Dec.	Actual	Budgeted*
3	Income	2,730	2,730	2,730	2,730	2,940	2,730	2,730	2,730	2,730	2,850	2,850	2,850	2,850	33,450	32,760
4	Savings	150	150	150	200	150	90	50	30	100	250	250	150	40	1,610	1,800
5	Mortgage/Rent	826	826	826	826	826	826	826	826	826	826	826	826	826	9,912	9,912
6	Housing Costs (insurance, utilities)	190	214	238	187	176	185	188	146	178	198	177	201	195	2,283	2,280
7	Telephone	50	43	45	67	56	54	52	65	45	43	52	49	47	618	600
8	Food (at home)	280	287	277	245	234	278	267	298	320	301	298	278	324	3,407	3,360
9	Food (away from home)	80	67	78	84	87	123	109	89	83	67	76	83	143	1,089	960
10	Clothing	100	98	78	123	156	86	76	111	124	87	95	123	111	1,268	1,200
11	Transportation (auto operation, public transportation)	340	302	312	333	345	297	287	390	373	299	301	267	301	3,807	4,080
12	Credit payments	249	249	249	249	249	249	249	249	249	249	249	249	249	2,988	2,988
13	Insurance (life, health, other)	45	—	—	135	—	—	135	—	—	135	—	—	135	540	540
14	Health care	140	176	145	187	122	111	156	186	166	134	189	193	147	1,912	1,680
15	Recreation	80	67	98	123	98	67	45	87	98	65	87	87	111	1,033	960
16	Reading, education	40	32	54	44	34	39	54	12	38	54	34	76	45	516	480
17	Gifts, donations	100	102	110	94	87	123	89	95	94	113	87	99	134	1,227	1,200
18	Personal miscellaneous expense	60	89	45	67	54	98	59	54	49	71	65	90	56	797	720
19	Total	2,730	2,702	2,705	2,964	2,674	2,626	2,642	2,638	2,743	2,892	2,786	2,771	2,864	33,007	32,760
20	Surplus (deficit)		28	25	(234)	266	104	88	92	(13)	(42)	64	79	(14)	443	-----

Sheet1 / Sheet2 / Sheet3 /

Ready NUM



CLIENT

“Your Mileage Will Vary”:

- Some clients regularly keep up statements of net worth.
- Other clients may not even have an idea of how to prepare one.
- Whichever client you have, the personal financial statement is essential as your method of assessment of performance.



CLIENT

- When monitoring the plan, the Balance Sheet will show if progress has been made.
- The Income Statement will help identify causes of shortfalls and increases over projections.
- Action Plan: “What can you do to do better in the future?”



Pe



Eighth Edition



THE END!