

A Comprehensive Balance Sheet

for Personal Finance

An Internet search for “personal finance software” shows there’s no shortage of technology available to help you establish financial order. Just about every program will aggregate your data, balance your checkbook, communicate with your financial institutions, and produce reports, charts, and graphs.

But data may be meaningless without an interpretative framework. There must be a model that gives meaning to the numbers, evaluates success or failure, and provides clarity for future decisions.

PROTECTION				
If You Are Sued \$5,000,000	If You Get Sick D-\$9K / H-UNL	Wills & Trusts P-Y, N / M-Y	At Death P-\$4.8M / M-\$2.5M	
ASSETS		LIABILITIES		
Personal Property	\$193,000	Short Term	\$0	
Savings	\$162,180	Taxes	\$27,150	
Investments	\$92,568	Mortgages	\$455,000	
Retirement	\$165,620	Business Debt	\$0	
Real Estate	\$625,000	Total	\$482,150	
Business	\$0			
Total	\$1,238,368	NET WORTH	\$756,218	
CASH FLOW				
Earnings	Protection Costs ¹	Asset Building ²	Debts & Tax Costs ³	Left for Lifestyle
\$245,000	\$23,702	\$50,650	\$90,600	\$80,048

The Domains

Effective models for personal finance should include the following domains:

Assets • **Liabilities** • **Cash Flow** • **Protection**

Assets and **Liabilities** are personal finance standards; they are frequently combined to define your current wealth status (“*am I a millionaire?*”) or determine whether financial objectives have been achieved (“*do I have enough money to retire?*”). **Cash Flow** insight as to the trend of your finances, if your wealth is growing or diminishing, and how fast. **Protection** is a risk management assessment, indicating your ability to sustain growth and maintain or transfer your accumulated wealth. Together, these domains give you an “active snapshot” of your financial condition, telling you where you are, what’s happening, and where you are headed.

One way to illustrate the relationship between these domains is with a stylized diagram of a house.

In this analogy, the Cash Flow domain is characterized as the foundation on which personal wealth is constructed. Cash Flow tabulates your income (from earnings, interest, capital gains, etc.), then accounts for how it is disbursed for taxes, insurance, debt service, lifestyle, and saving.

Because most of us begin our financial lives with minimal financial assets, the ability to effectively manage our cash flow to **maximize saving** will have a big impact on our wealth-building success.

An essential discipline for saving is the willingness to delay gratification. But where cluttered financial households often default to reducing lifestyle in order to increase saving (“we’ll just have to do without”), organized households may improve cash flow through tax savings, restructured debt, or more efficient insurance coverage.

If Cash Flow is the foundation, the Protection domain represents the roof that helps *shelter one's financial assets*. Investment risk, legal action, sickness or accidents, or a premature death can disrupt or erase years of diligent accumulation. The potential for irrevocable financial loss means risk management has to be a primary emphasis. For as long as they are part of one's financial program, assets (and the liabilities that often are connected to them) should be given full protection. In the case of estate planning, this protection extends beyond one's life. Protection should be considered be **first, full and forever**.

The Living Balance Sheet®

Completing the analogy, **Assets** and **Liabilities** combine to make a Net Worth statement, which *determines the size of the "building"* situated between the foundation of Cash Flow and the roof of Protection. Assets are material items that can be valued — personal property, savings, investments, retirement, real estate. (Your ability to earn an income is an asset, but can't usually be included on a Net Worth statement.) Assets must be valued correctly, which often means considering the liabilities that may be connected to them. The market value of a residence is reduced by the mortgage taken against it. A retirement plan may have a \$1 million balance, but taxes on distributions will reduce the spendable value.

A "living" balance sheet is one that gives relevant real-time feedback, keeps you focused financially, and frees you to enjoy the passions and pleasures in your life

At different stages in one's financial life, the relative importance of these domains can change. For those just beginning their financial lives, the Cash Flow and Protection domains have precedence. As assets (and perhaps liabilities) accrue, more time and energy may be devoted to asset management. As we age, **a common objective is determining if there are enough assets to replace income, and when it may be possible to make this transition.**

Putting Technology to Work, Building Your Wealth

When you understand how these domains interact, you can use the computing power of The Living Balance Sheet® to generate calculations, evaluate progress, and guide future strategies. But the art in the process is translating facts to effective actions; the number-crunching capabilities may be wasted if insights can't be extracted from the data. To receive the maximum value, most of us need some professional assistance. Someone who can show how...

- ▶ **Assets integrated with corresponding liabilities can illustrate real rates of return, including "carry costs" such as interest, taxes and maintenance.**
- ▶ **Percentages of cash flow allocated to insurance or savings in relation to gross income may reveal imbalances in spending or risk.**
- ▶ **Determining your marginal tax rate can guide retirement account allocations.**
- ▶ **An overview of debt could prompt a restructuring, either to improve cash flow or reduce interest costs.**

These "snapshots" of your current financial status and possible changes can be archived for comparison. The combination of historical reference points and on-going communication with your financial institutions means clearly defined objectives can be tracked in real-time.

Making it Work for You

Using The Living Balance Sheet® in conjunction with your financial representative can be a "lifestyle change." It's not a 30-day strategy to regain your financial shape that only comes into play when things have gotten out of hand. You should expect an adjustment period, but over time, this new approach should be more organized yet less time-intensive. When you are fully engaged in the process, the result is a "living" balance sheet, one that gives relevant real-time feedback, keeps you focused financially, and frees you to enjoy the passions and pleasures in your life.

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