Financial Snapshot Exercise: Week 3

Establishing Your Current Financial Wealth

"Annual income twenty pounds, annual expenditure nineteen six, result happiness.
Annual income twenty pounds, annual expenditure twenty pound ought and six, result misery."
Charles Dickens, 1849

Where are you now?

Where are you now on the path to fulfilling your goals? Your start point is now so this exercise will help you measure where you are today financially. This is vital because by completing your Financial Snapshot you'll have a way of measuring your progress towards your goals.

Right now, you're going to create your first set of real financials so that you can establish how secure your position is right now, and see just how much work has to be done to achieve your goals. Let's start with your assets …

Assets and investments

Feed your investments and they will one day be able to feed you. There is a difference, though, between assets and investments, and between investing and speculating. The difference is principally this: investments produce income into the future, assets don't.

For instance, compare …

- A shareholding in a profitable company … versus a Rolls Royce.
- A property that someone can rent to live in or run their business from … versus a kilogram of gold.
- A bank guarantee to pay you interest on your money for as long as you lend it to them … versus a collection of rare stamps.

The property and the gold, the share and the car, the loan and the rare stamps – they're all assets because they all have a value. But only the assets that produce regular and reliable income are valuable into the future are investments. And if the income is likely to grow then the investment value will grow too.

The value of an asset, by comparison, isn't necessarily likely to grow because it doesn't offer the same potential for income. Whereas an investment produces something, an asset doesn't. The value of an asset will rise or fall based on external circumstances.

Why is it important to distinguish between assets and investments?

Consider the price history of an ounce of gold over the last 30 years. In 1980 the value was at an all time high, a period which lasted for a year or two. The price subsequently plummeted and stayed depressed for well over two decades, only to return to the 1980 high in about 2009. The booms and busts have been spectacular but as the value hasn't even kept pace with inflation over that long period. The only way to make money out of gold is to consider current events and speculate on their impact on its future value.

You profit from holding an asset by taking a bet on its future value. This gamble is not a high probability method for creating sustainable wealth.

Accumulating assets doesn't improve your chances of achieving the goals you set last chapter. So the name of the game is to accumulate investments, not assets, which is why we need to separate your assets and your investments, and concentrate on the ones that give you a higher chance of success. Complete the worksheet below.

Lifestyle assets	Value
Personal Residence	
Home Contents	
Motor Vehicle (s)	
Holiday House	
Boat	
Collectibles	
Working Cash	
Other	
Total (A)	

Investment assets (specify)	Value
Cash reserves	
Shares	
Managed Funds	
Investment property	
Other	
Total (B)	

Not sure how to value certain items? For instance …

- Do you have a super fund that includes a 'defined benefit', which means the fund doesn't work like a growing bank account but rather the retirement benefit is calculated based on how long you've been a member and your pay rate when you retire?
- Perhaps you have a deferred bonus plan at work which you're only entitled to it if you stick around for long enough, but it has no value if you were to leave today?
- Are you wondering about including an inheritance that will happen one day but you're not sure when?

Easy solved: these are classified as 'future income' which are lump sums or deferred income items, there's a table for them later.

Are you wondering what 'working cash' from table A is, and how this differs from 'cash reserves' in table B? This is important to your financial fitness for reasons that will become clear later, but for now, here's the definition:

- Working cash: the combined balance of any accounts that are 'working accounts', containing money for living expenses. It also includes money that is earmarked for a particular thing you're saving up for (e.g. xmas presents). In short, it's money you are likely to spend. It's not an investment asset because it's (a) at call, and (b) not likely to be around for long.
- Cash reserves: the combined balance of any accounts that are set aside for a 'rainy day'. This is money which is for emergencies and not allocated to any particular expense.

If you have all your cash sitting in an offset account, for instance, then this consists of both working cash and cash reserves – draw a line in the sand and decide how much belongs to each category and complete tables A and B accordingly.

Liabilities

Debt, while not necessarily the enemy of your goals, does need to be repaid sooner or later. Complete the worksheet below. If the loan is an investment loan and therefore tax deductible, indicate in the column provided.

Debt	Amount outstanding	Deductible?
Home Loan		
Line of Credit		
Credit Card		
Investment Loan		
Other		
Total (C)		

Current Income

The purpose of this exercise is to measure your predictable, consistent income 'in-the-hand', from all sources. Use whatever frequency you like (yearly, weekly, monthly, etc) so long as you end up with one number down the bottom.

Annual income source	Partner 1	Partner 2	Total	Freq.
Net Salary/Wages				
Business profits (after expenses)				
Interest from bank accounts				
Share dividends (cash component only)				
Rent from property (after expenses)				
Centrelink benefits				
Family Tax Benefit Part A & B				
Other				
		Total Income (D)		

Deferred Income

Are you expecting lump sums or additional income streams down the track which you haven't included above? They go here. Complete the table below as it applies to you.

One-off future income source	Value	Date expected
Inheritance		
Bonus		
Asset sale		
Other		
Total		

Expenses

Working out what your expenses are, often called a budget, is an exercise that many find confronting. Not only can it be daunting, it is easy to get overwhelmed by detail the exercise is never completed. It doesn't need to be that way. All you really need is the final number for all your expenses so that you can determine whether your incoming-minus-outgoings is 'in the black' (surplus) or 'in the red' (deficit). If you are confident you know what that figure is fill in the table below.

For most people to arrive at that number, though, some investigation is required. There's a handy tool at https://www.moneysmart.gov.au/managing-my-money/budgeting/how-to-do-a-budget that you can use to prepare yourself a budget. Use it to monitor your expenses day to day. Once you have a final figure then fill in the table below.

Annual Expenses	Total
Total (E)	

Your financial statements

Now that you have completed these exercises you can organize the information into a useful format, your Financial Statements. Populate the table below by carrying across the numbers you have from A, B, C and D, then do the maths to calculate F and G.

Income Statement		Investment Balance Sheet	
Total income (D)		**Total investment assets (B)**	

Total expenses (E)		**Total Liabilities (C)**	
Surplus/Deficit (F = D-E)		**Net Worth (G = B-C)**	

The two critical numbers on your financial statement

The bottom line. Do you have a surplus or a deficit on your income statement? Do you have a positive or negative net worth in your balance sheet?

Whatever the number is … is what it is. Don't panic, we've just started.

Congratulations, you've just taken your first financial snapshot which is something you're going to do once a year as part of your financial fitness regime. Now you know where you are and where you want to be at some point in your future, it's time to put together your **Plan to Become Financially Fit** …