Taking Your Financial Pulse

Consumer Alert!

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"If money talks, all mine ever says is good-bye."
-Anonymous

When was the last time you checked your financial condition? Do you really know your bottom line, right now? If you think a reluctant glance at the balance in your checking account will suffice, then read on. This publication will help you understand some of the basic financial measurements and provide direction for creating a program of financial health.

Why You Want To Know

Your financial pulse is just a way of referring to your financial condition. Some people want to avoid taking stock of their financial condition because they know the outlook isn't good. Others may think that ignorance is bliss. In reality, not knowing is not good. It's hard to figure out where you want to be if you don't know where you are. Besides, other people are going to take your financial pulse; when you apply for a credit card, or a car loan, or a mortgage, or for insurance, or for a job, and so on. When they do, you won't want to be unpleasantly surprised.

Warning Signs Of Debt Trouble

- Having to use a credit card to pay for a necessity.
- Only being able to make the minimum monthly payment.
- Arguments over money issues.
- Difficulty keeping track of financial records.
- Non-existent or grossly inadequate savings.

How To Take It

There are a number of different measurements of financial health. Two common types of tools for checking your financial health are financial statements and financial ratios. Essential financial statements include the Net Worth statement (or balance sheet) and the Cash Flow statement (a list of income and expenses, otherwise known as a budget). Essential financial ratios include: Basic Liquidity ratio, Asset-to-Debt ratio, Debt-Service-to-Income ratio, Debt Payments-to-Disposable Income ratio, and Savings ratio. Finally, your credit scores are another indication of your financial condition.

Net Worth Statement (balance sheet)

A Net Worth Statement shows what the financial result would be if, in one moment, you sold everything you owned and used the money to pay everything you owe. When you use the worksheet, remember to fill in today's date and calculate all balances based on this date. The Net Worth Worksheet shows you the big picture of your financial condition at a specific moment in time. It can help you see what resources you have available to reach your financial goals. To calculate your net worth, add up the present value of everything you own (assets), then subtract the current balance of everything you owe (liabilities).

Net Worth Worksheet Date:

Things You Own (Assets)

Cash/Cash Equivalent	**Amount**
• Cash on hand (wallet, purse)	
• Checking accounts	
• Savings accounts	
• Money market accounts	
• Cash value of life insurance	
• Money owed to you	
Investments	**Market Value**
• Retirement savings (IRA, 401k, etc.)	
• Mutual Funds	
• Stocks	
• Bonds	
• Other investments/securities	
Property	
• House	
• Other real estate	
• Vehicles (car, boat, etc.)	
• Rare items (jewelry, antiques, etc.)	
• Household items	
• Other property	
Total Assets:	

Contents On Back

Things You Owe (Liabilities)

Bills	Balance
• Rent	
• Utilities	
• Insurance premiums	
• Credit cards	
• Charge accounts	
• Other	
Loans	
• Mortgage(s)	
• Vehicle loan(s)	
• Personal loan(s)	
• Education loan(s)	
• Life insurance loan(s)	
• Other	
Legal Obligations	
• Taxes	
• Child support, alimony	
• Other	
Total Liabilities:	

Total Assets:	
- Total Liabilities:	
= Net Worth:	

Cash Flow Statement (budget)

A Cash Flow Statement is a list of income and expenses for a specific period of time. When it shows monthly figures it is commonly referred to as a budget. It lets you see what money came in and where money went out. It is a tool to help you track and manage spending. A summary Cash Flow worksheet is below. For a complete worksheet, read our publication *The Spending Plan*.

Cash Flow Period:	
Income total from all sources	
- Expenses Fixed, Variable, Optional	
= Surplus/Deficit:	

Bad Debt vs Acceptable Debt

Remember that not all debt is bad. It's easy to identify some examples of bad debt: high interest debt, debt with payments that are too high for your budget, debt for which you have little or nothing to show. Acceptable debt has the following characteristics: it's likely to increase your net worth (ex. assets that increase in value), it's likely to increase your earning potential (ex. education expenses), and its' usually tax-deductible.

Financial Ratios

Financial ratios are another set of tools for assessing your financial condition. Here are some that are commonly used by lenders and financial institutions.

Basic Liquidity Ratio $= \frac{\text{Monetary Assets}}{\text{Monthly Expenses}}$

Liquidity refers to how quickly an asset can be converted into cash. This ratio is used to calculate the number of months you could maintain your current expenses if your income stopped. Many financial advisors recommend that you keep an emergency fund of enough monetary (liquid) assets – "Cash/ Cash Equivalent" from the Net Worth worksheet – to cover at least three months of expenses.

Asset-to-Debt Ratio (Solvency) $= \frac{\text{Total Assets}}{\text{Total Debt}}$

This ratio is another expression of your Net Worth because it compares your total assets with your total liabilities. If the result is a number greater than 1, then you are said to be "solvent" (which is a good thing). A higher number indicates greater financial health. If the number is less than 1, then you are said to be "insolvent." Severe insolvency can lead to filing bankruptcy. Remember that solvency and net worth are not indicative of your worth as a person, but merely your financial condition at one moment in time.

Debt Service-to-Income Ratio $= \frac{\text{AnnualDebt Payments}}{\text{Gross Income}}$

This ratio compares the total annual amount you spend repaying all your debts with your gross annual income. It gives a picture of your total debt burden. This ratio should be less than .36 (36%).

Debt Payments-to-Disposable Income Ratio $= \frac{\text{Nonmortgage Debt Payments}}{\text{Disposable Income}}$

This ratio estimates funds available for monthly nonmortgage debt. Debt payments (excluding mortgage debt) are compared with disposable income (income after taxes and withholdings). This ratio should be less than .16 (16%).

Savings Ratio $= \frac{\text{Annual Savings}}{\text{Annual After-tax Income}}$

This ratio compares your savings to your net income (after taxes) on an annual basis. This ratio should be at least .10 (10%).

Credit Scores

Another gage of your financial condition are your credit scores. A credit score is a number that predicts how likely you are to repay your debts. A score of 720 or higher is great. The number is based on information in your credit reports. Each of the nationwide credit bureaus will provide you a score that can be purchased separately or together with a credit report (a statement of your credit history):

- **Equifax**: 800-685-1111 www.equifax.com
- **Experian**: 888-397-3742 www.experian.com
- **TransUnion**: 800-916-8800 www.transunion.com.

You can also purchase your **FICO** score at: www.myfico.com. To learn more about credit scoring, read our publication *Raising Your Credit Scores.*

Shaping Up

After you've measured your financial condition, you'll probably want to take action to improve it. The next step will be to set realistic financial goals. For help with this, read our publication *Reaching Your Financial Goals*.

After you've defined your goals, you'll want to take steps towards them. However, you won't be able to take any steps unless you are spending less than you earn. For assistance tracking your spending and living within a budget, read our publication *The Spending Plan*.

In addition to living within your means, you'll need motivation and methods for creating savings. For assistance with this, read our publication *Be A Saver*.

These are the first steps in financial planning. To learn more about financial planning, check out the resources listed below or consider seeking the advice of a competent and qualified professional financial planner.

To Find Out More

- *Personal Finance* (Garman & Forgue, Houghton Mifflin Company)
- *Personal Finance For Dummies* (E. Tyson, Wiley Publishing Inc.)
- Financial Planning Association: www.fpanet.org; National Association of Personal Financial Advisors: www.napfa.org.
- *Reaching Your Financial Goals* (Alliance); *The Spending Plan* (Alliance); *Be A Saver* (Alliance); *Raising Your Credit Scores* (Alliance): www.knowdebt.org/education.php.

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