# Cash Flow & Net Worth

Progress is getting nearer to where you want to be.

* C.S. Lewis

AN ACCURATE cash flow statement and a comprehensive Net Worth Statement are crucial when analyzing a financial plan's overall health and long-term sustainability. This is particularly vital for individuals in or nearing retirement.

My Chapter Objectives:

* Utilizing financial statements
* The proper use of debt
* Key tax terms
* Facilitating tax flexibility
* Real Estate for income

## 3.1: Key Planning Documents

TO GET a basic idea of a retirement plan’s sustainability, at least two documents are required:

* A Net Worth Statement (or Balance Sheet)
* A Cash Flow Statement

Net Worth Statement: A document that shows a global overview of an individual’s financial situation. An up-to-date net worth statement helps clarify the specific components of the financial plan to any interested parties.

A Net Worth statement will:

* Provide a basic sense of financial health
* Help identify the overall savings available for sustainable distribution upon retirement

Cash Flow Statement: A document that shows annual (or monthly) inflows and outflows. A detailed cash flow statement allows for a deeper analysis beyond expenses alone. It identifies where money is coming and going and helps pinpoint possible improvements when finding new resources to improve planning outcomes.

A cash flow statement summarizes income and expenses over a period. It combines budgeting with assumptions. Benefits include identifying areas for improvement or verifying the validity of planning assumptions.

Key components include:

* Cash inflows (income): Salary, investment income, rental income, business income, required minimum distributions (RMDs), and other income.
* Cash outflows (expenses): Fixed expenses (housing, transportation, debt payments, utilities, insurance). Variable expenses (food, entertainment, personal care, medical care, and taxes).
* Net cash flow: Calculated by subtracting total cash outflows from total cash inflows

A Cashflow Statement will:

* Measure the amount of annual positive (or negative) cash flow
* Help develop a realistic “vector” and identify the overall long-term sustainability of the financial plan
* Help to chart financial potential
* Help to identify potential tax efficiency, coordination tactics, and other financial planning opportunities.

Having professional help when analyzing financial planning documents is a good idea.

### How can I estimate my net worth?

A Net Worth statement, or Balance Sheet, is designed to be simple. It provides a comprehensive overview of your financial situation on a single page, clearly showing your net worth (assets - liabilities).

Start by evaluating your financial life by jotting down your possessions: your home, car, retirement account, and even artwork. Assign a value to each item you think it could realistically fetch if sold. Next, think about your financial obligations: a mortgage, credit card debt, or loans against a 401(k). These are your liabilities.

When filling out the balance sheet, start by entering the approximate gross values of your assets in the assets column. These are the values before any liabilities are deducted. Next, record any liabilities, which are the debts associated with your assets or separate financial obligations.

Take greater control of your financial situation and track your net worth over time. Generally, the goal is to increase net worth as market investment performs, property values appreciate, and liabilities get paid off. However, it's also common (especially in retirement) for specific assets like investment accounts and cash reserves to decrease as money is spent.

Over time, remember that the balance sheet is a flexible tool. It's important to keep it relevant, as it quickly and easily conveys your financial position to interested parties such as family or trusted professionals. A balance sheet also acts as a helpful resource when money needs to be raised for an unexpected event.

## Learning Objective 3.2 Positive Cash Flow

POSITIVE CASH FLOW is new money identified as being available to save or deploy in addition to what is already being spent or contributed towards savings. It is the ‘firepower” available after everything to increase or better coordinate additional money needed for tomorrow's retirement goals.

Tips to improve cash flow may include:

* Eliminating or reducing non-essential expenses
* Increasing income or working longer
* Selling or rethinking an existing asset’s strategy
* Being more tax-efficient
* Taking (or delaying) social security or a pension
* Refinancing or tapping into a home’s equity

Once positive cash flow is identified, one can start determining and consistently setting aside savings. Assess how much can be saved, then decide where to save it. This savings location decision should be based on the appropriateness of the savings vehicle, eligibility to contribute, the correct type of contribution (e.g., pre or post-tax money), and tax savings today versus tomorrow.

Typically, advisors suggest saving around 15% of gross income. However, this is a broad recommendation. Various factors collectively determine what’s needed to meet retirement needs.

### How can I calculate my savings?

Use this exercise to coordinate savings locations. Determine the current level of savings versus total gross income (or income before any deductions or taxes). Generally, retirement savings are money set aside for longer periods. These dollars are targeted for retirement income or to supplement future retirement expenses and likely have a much different strategy than more near-term dollars.

Start by researching your various savings accounts. These could be employer retirement plans, such as a 401(k), or supplemental accounts, like a Roth or post-tax account. Typically, bank checking accounts are money set aside for emergencies or planned expenses, so contributions may not be part of retirement-oriented savings.

Next, finalize the spreadsheet by adding the account name, type of account, taxable nature (e.g., Traditional or Roth), and contribution amount (bi-monthly, monthly, quarterly, or annual). If a participant has access to multiple plans, ensure the accuracy of contributions and that there is no overfunding. The spreadsheet should automatically validate total savings and then convert this total to a percentage relative to gross income. The beauty of this exercise is its flexibility. Our general guideline is to save approximately 15% of gross income; however, this can vary significantly depending on savings requirements and life stage.

Consider other areas for savings, such as reducing discretionary spending, cutting down on unnecessary subscriptions, or finding ways to save on utilities. If needed, use our budget worksheet, a tool designed to help you track your income and expenses, to help identify these areas of improvement. You can then redirect these dollars toward savings.

Commit to revisiting this worksheet periodically to ensure the current level of retirement savings is on pace. Remember to update gross income and individual savings amounts to reflect your overall savings accurately.

## 3.3: Compounding Interest

COMPOUNDING INTEREST uses the reinvestment of interest to grow an investment over time. It is the key to offsetting long-term inflation and building foundational wealth, essential for any financial plan’s long-term stability.

The essence of wealth creation is setting money aside for a very long time.

Investment results will vary from those shown here. Investing involves risk, inconsistent returns, and the possibility of a loss of principal. The investment results shown are hypothetical and are for illustrative purposes only. The calculations do not consider any taxes, inflation, or fees. The figures do not represent past or future investment results and do not represent any specific product.

*Disclosure:* The Securities and Exchange Commission has not approved or reviewed the content of this application. By clicking, you are linking to an external S.E.C. website.