

F1 – Project-Stage 6: Evaluate Current Wealth

TCHE322

Lawrence et al(2011). Chapter 2
Tillery & Tillery (2017). Chapter 2
Thomas (2009). Chapter 3

Personal finance planning

Personal finance planning process

1. Define financial goals.



2. Develop financial plans and strategies to achieve goals.



3. Implement financial plans and strategies.



4. Periodically develop and implement budgets to monitor and control process toward goals.



5. Use financial statement to evaluate results of plans and budgets, taking corrective action as required.



6. Redefine goals and revise plans and strategies as personal circumstances change.

Essential Information of personal financial plans *

1. A summary of the goals
2. Significant assumptions and justification
3. **Estimates**
4. Recommendations
5. A description of limitations on the work performed
6. The recommendations in the engagement should contain qualifications to the recommendations if the effects of certain planning areas on the client's overall financial picture were not considered.

** Adapted from Paragraph .35, Statement on Standards in Personal Financial Planning Services No. 1*

Schedule of lectures

Project topic covered

- Financial statements
- Ratio analysis

Groupwork project activities

- Prepare (i) Balance sheet;
(ii) Income and Expense/Cash flow Statement
- Evaluate current financial situation

Financial statements

Serve as planning tools that are essential to develop and monitor personal financial plans.

Balance sheet

- Describes a person's financial position at a given time
- A personal financial statement is: a listing of everything owned or owed presented in a uniform way so that the user of the statement can understand it. (AICPA Personal Financial Statements Guide)

$\text{Total assets} = \text{Total liabilities} + \text{net worth}$


















$\text{Net worth} = \text{Total assets} - \text{total liabilities}$

Income and expenses statement/cash-flow statement

- Prepared on a cash basis
 - **Cash basis:** *Only transactions involving actual cash inflows or actual cash outlays are recorded*

20 RICHEST FILIPINOS IN FORBES' 2022 WORLD'S BILLIONAIRES LIST

BW

Name	2022 Overall Rank (Out of 2,668)	Rank Changes from 2021	2022 Net Worth (in US dollars)	Net Worth % Change from 2021	Industry
 Manuel B. Villar, Jr.	263	▲ 89	\$8.3 billion	▲ 15%	Real estate
 Enrique K. Razon, Jr.	369	▲ 192	\$6.7 billion	▲ 34%	Logistics
 Henry T. Sy, Jr.	1,096	▲ 78	\$2.8 billion	▲ 4%	Diversified
 Andrew L. Tan	1,096	▼ 88	\$2.8 billion	▼ 7%	Diversified
 Hans T. Sy	1,196	▼ 188	\$2.6 billion	▼ 13%	Diversified
 Herbert T. Sy	1,196	▼ 188	\$2.6 billion	▼ 13%	Diversified
 Harley T. Sy	1,292	▼ 118	\$2.4 billion	▼ 11%	Diversified
 Teresita T. Sy-Coson	1,292	▼ 118	\$2.4 billion	▼ 11%	Diversified
 Elizabeth T. Sy	1,445	▼ 146	\$2.1 billion	▼ 13%	Diversified
 Ramon S. Ang	1,513	▼ 69	\$2 billion	▼ 9%	Food & Beverage
 Lance Y. Gokongwei	1,818	▲ 560	\$1.6 billion	▲ 33%	Diversified
 Tony Tan Caktiong	2,190	▼ 891	\$1.3 billion	▼ 46%	Food & Beverage
 Betty T. Ang	2,324	New to List	\$1.2 billion	—	Food & Beverage
 Lucio C. Tan	2,324	▼ 1,399	\$1.2 billion	▼ 64%	Diversified
 Maria Grace Y. Uy	2,324	New to List	\$1.2 billion	—	Telecom
 Nari Genomal	2,578	New to List	\$1 billion	—	Fashion & Retail
 Ramesh Genomal	2,578	New to List	\$1 billion	—	Fashion & Retail
 Sunder Genomal	2,578	New to List	\$1 billion	—	Fashion & Retail
 Roberto V. Ongpin	2,578	▼ 200	\$1 billion	▼ 17%	Diversified
 Dennis Anthony H. Uy	2,578	New to List	\$1 billion	—	Telecom

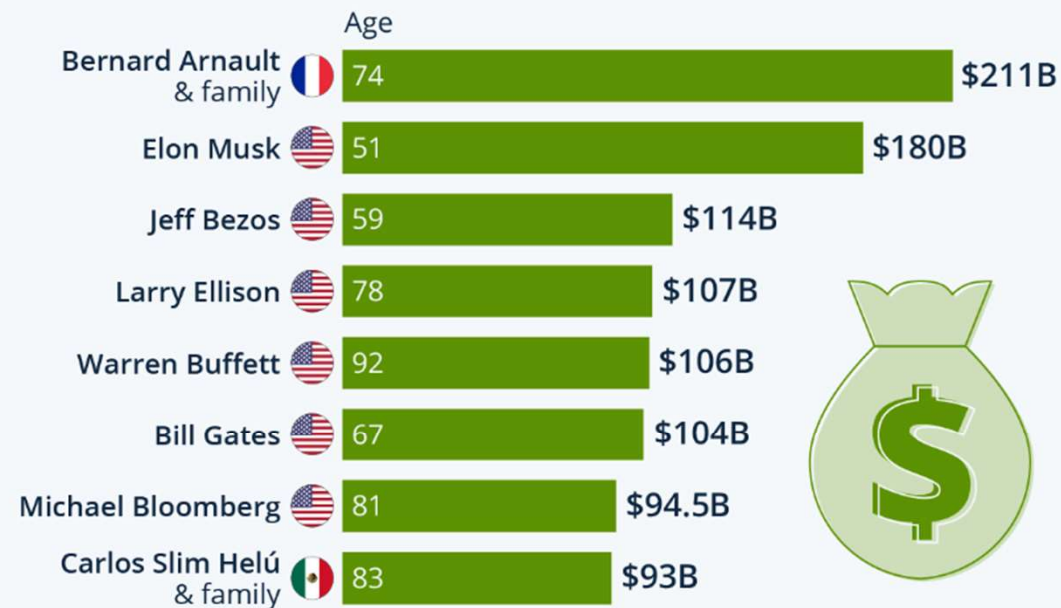
NOTE: The current edition ranked 2,668 individuals with at least \$1 billion, less than the 2,755 in 2021.

SOURCE: FORBES' WORLD'S BILLIONAIRES LIST 2022 (WWW.FORBES.COM/BILLIONAIRES) BUSINESSWORLD RESEARCH: ABIGAIL MARIE P. YRAOLA BUSINESSWORLD GRAPHICS: BONG R. FORTIN

From: Business world online

The World's Richest People in 2023

Net worth of the world's richest people



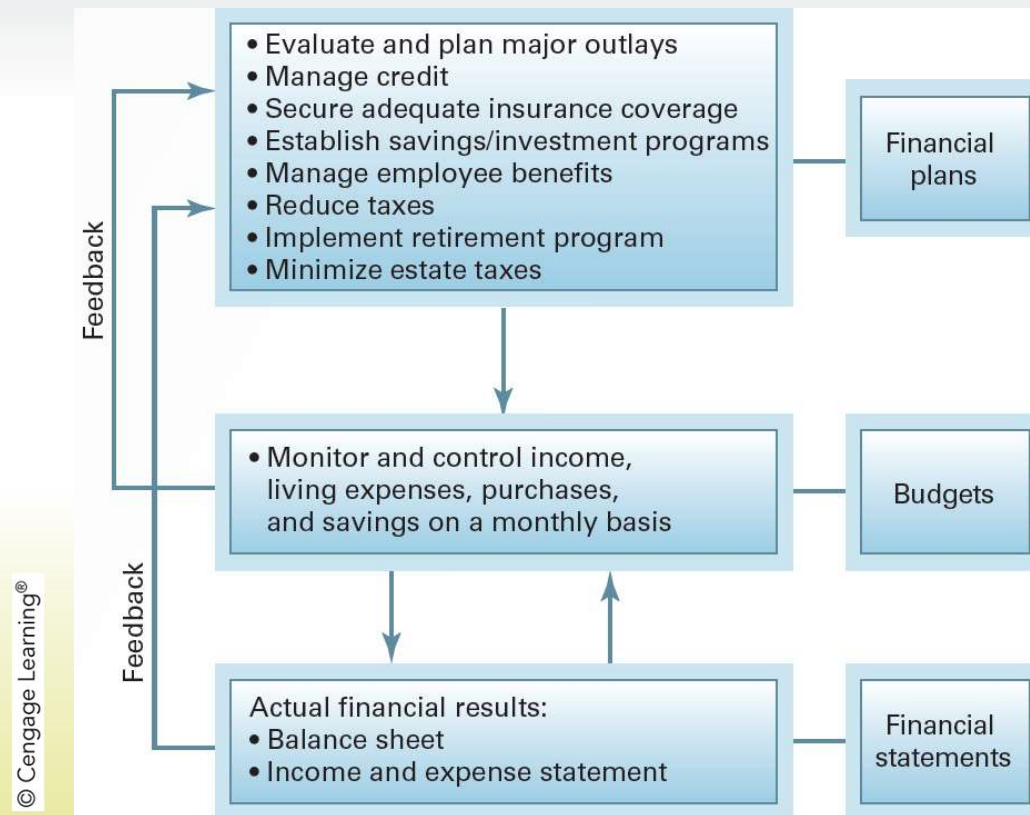
* Net worths based on stock prices and exchange rates from March 10, 2023.

Source: Forbes



statista

Exhibit 2.1 The Interlocking Network of Financial Plans and Statements





Income and Expense Statement

- Prepared on a cash basis
 - **Cash basis:** *Only transactions involving actual cash inflows or actual cash outlays are recorded*
- **Income:** earnings received as wages, salaries, bonuses, commissions, interest and dividends, or proceeds from the sale of assets
- **Expenses:** Money spent on living expenses and to pay taxes, purchase assets, or repay debt



Income and Expense Statement

- **Cash surplus:** Excess amount of income over expenses
 - *Results in increased net worth*
- **Cash deficit:** Excess amount of expenses over income
 - *Results in insufficient funds and decreased net worth*



Balance Sheet

- Describes a person's financial position at a given time
- $\text{Total assets} = \text{Total liabilities} + \text{net worth}$
- $\text{Net worth} = \text{Total assets} - \text{total liabilities}$



Assets

- Items that one owns
 - **Liquid assets:** Held in form of cash
 - **Investments:** Acquired to earn a return
 - **Real property:** Immovable assets
 - **Personal property:** Movable and used in everyday life



Liabilities

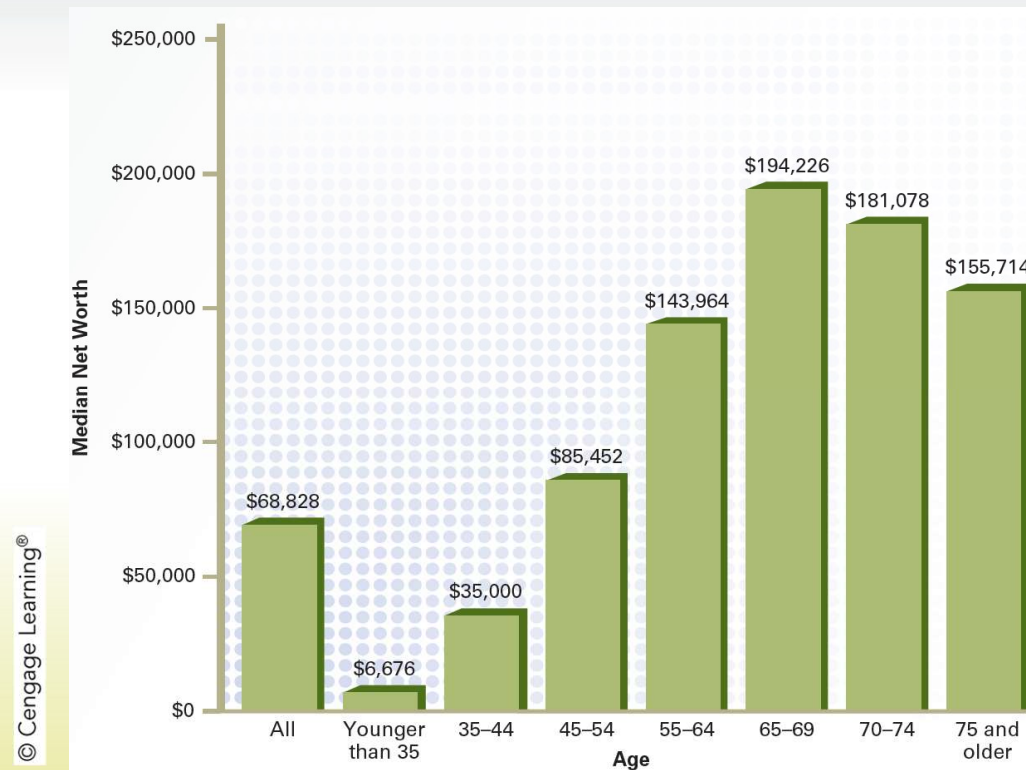
- Debts like credit card charges, loans, and mortgages
 - ***Current or short-term:*** Due within 1 year of the date of the balance sheet
 - ***Open account credit obligations:*** Current liabilities that represent the balances outstanding against established credit lines
 - ***Long-term:*** Debt due 1 year or more from the date of the balance sheet



Net Worth

- Individual's or family's actual wealth
 - ***Equity***: Actual ownership interest in a specific asset or group of assets
- If the net worth is less than zero, then the individual or family is **insolvent**

Exhibit 2.2 Median Net Worth by Age



Source: Adapted from United States Census Bureau, “Net Worth and Asset Ownership of Households: 2011,” Table 1, <http://www.census.gov/people/wealth/>.



Balance Sheet Format and Preparation

- List your assets ***at their fair market value*** as of the date you are preparing the balance sheet
- List all current and long-term liabilities
- Calculate net worth

TABLE 4-1

PERSONAL STATEMENT OF FINANCIAL POSITION ASSETS AND LIABILITIES

Examples of Assets	CASH/CASH EQUIVALENTS	INVESTMENTS	USE ASSETS
	Cash	Life insurance cash values	Residence
	Checking accounts	Qualified plans	Personal property
	Money market deposit account	Real estate (investment purpose)	Collectibles (personal use)
	Money market mutual fund	Collectibles (investment purpose)	Second home
	Savings accounts	Variable and fixed annuities	Automobiles
	CDs close to maturity	IRAs	Closely held business interest
	Laddered CDs	Mutual funds	
		Individual securities	

Examples of Liabilities	CURRENT LIABILITIES	NONCURRENT LIABILITIES
	Income tax payable	Automobile loan
	Credit card balance	Mortgage

Tracking financial progress: Ratio analysis

Balance sheet ratios

- Solvency ratio
- Liquidity ratio

Income and Expense statement ratios

- Debt service ratio/Debt-to-income ratio
- Debt Payments-to-Disposable Income Ratio

disposable personal income Amount of income remaining after taxes and withholding.

PITI ratio or front-end ratio: is the ratio of specific monthly housing costs divided by gross monthly income. Specific housing costs for the PITI ratio are: **P**rincipal, **I**nterest, **T**axes (property) and **I**nsurance. If applicable, homeowners' association (HOA) fees and private mortgage insurance (PMI) also are considered.

- Savings ratio: should save a certain percent of gross income, 10% could be a bare minimum.

Ratio	Formula
Solvency ratio	$\frac{\text{Total net worth}}{\text{Total assets}}$
Liquidity ratio	$\frac{\text{Total liquid assets}}{\text{Total current debts}}$
Savings ratio	$\frac{\text{Cash surplus}}{\text{Income after taxes}}$
Debt service ratio	$\frac{\text{Total monthly loan payments}}{\text{Monthly gross (before-tax) income}}$

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Tracking financial progress: Ratio analysis

- Basic liquidity ratio: Can I Pay for Emergencies?

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

You can use the **basic liquidity ratio** to determine the number of months that you could continue to meet your expenses using only your monetary assets if all income ceases.

Patricia

After establishing the client–planner relationship, Patricia Planner starts into the data-gathering phase of planning. She has asked a client couple to bring in a list of assets, debts, and cash flow items. The clients provided the following list:

Robert and Mary Client (dated end of last calendar quarter)

Robert:	Age 41
Mary:	Age 40
Home:	\$445,000 (cost basis \$220,000)
Gross income:	\$120,000 (annual)
2010 model car (60,000 miles), good condition	
Checking account balance:	\$3,641
Personal property (worth approximately 25 percent of home)	
Variable housing expenses:	\$3,600/month
Other variable expenses:	\$8,600/month
Income tax (state/federal):	\$18,000 annual
Life insurance cash value:	\$8,450
XYZ municipal bond fund:	\$5,650 (cost basis \$6,000)
Auto company stock:	\$22,400 (cost basis \$14,500)
Raw land held for second home to be built:	\$43,000 (cost basis \$20,000)
Tech stock:	\$32,400 (cost basis \$8,250)
Social Security/Medicare tax:	\$6,000 annual
Salary income:	\$125,000

Jewelry (appraised value):	\$14,500
Credit card loan (12.8 percent interest):	\$12,600
Mortgage:	\$333,330
Mortgage payment (monthly):	\$1,666
Certificate of deposit (matures in 24 months, 1 percent interest):	\$10,000
401(k) retirement plan:	\$145,000
2009 model SUV (40,000 miles, excellent condition)	
2007 model car (75,000 miles, good condition)	
25 percent interest in bakery business—appraised value of firm:	\$220,000
2010 model car loan balance:	\$1,850 (4 percent APR)
Car payments:	\$300/month
Other debt payments:	\$100/month
All asset and liability data are for the end of the last calendar quarter.	
Other facts computed by Patricia:	
Net worth decreased 15 percent from last year.	
Inflation is 2.4 percent.	
Investment assets decreased 14 percent from last year, and home decreased \$80,000 from 2008.	
Capital gains bracket 15 percent, average combined tax bracket 25 percent.	
For car valuations use www.kbb.com trade-in value.	

Groupwork project activities – Evaluate Current Wealth

- Prepare
 - (i) Balance sheet;
 - (ii) Income and Expense Statement on a cash basis
- Evaluate current financial situation
- Creating the statements, evaluating the financial condition of the clients by computing ratios and **comparing them with norms**

Groupwork project activities – **Evaluate Current Wealth**

- Think about your own financial situation and construct a cash flow statement/income and expense statement and a balance sheet.
- You will not be expected to share this with the class, but be prepared to discuss the following:
 - Did you have any difficulties classifying items (in particular: assets versus expenses)?
 - Were there any items that you missed initially? Sometimes it can be difficult to determine all sources of income and expense, or all assets and liabilities, at first glance.