MONEY

What You Should Know About...

Managing Your Money

- NET WORTH
- CASH FLOW
- CREATING A BUDGET

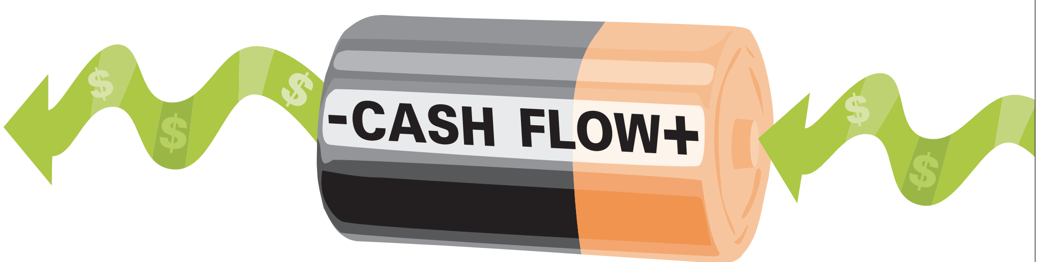
YourMoneyCounts™

You probably realize that managing your money is a good idea, but you might also figure if you manage to pay your bills on time, you're doing fine. While that might be true, ignoring the bigger picture of your income, expenses, net worth and debt can put you in an unexpected bind when you decide you're ready to take on bigger financial responsibility, such as buying a home.

Managing your money doesn't mean creating a strict budget and giving up the extras you enjoy. What it does mean is making decisions about what to spend your money on, which might help you reduce your debt and accumulate more funds in the future.

Cash flow

Even if you spend a lot of time managing your personal finances, you probably don't think of your income and spending in terms of **cash flow**. If they use the term at all, most people think that cash flow is something that businesses have to worry about. But you also have a cash flow, and figuring out whether it's positive or negative is an important part of managing your money.



The ins and outs of your money

The constant movement, or comings and goings of your money, make up your cash flow. When you deposit your paycheck, money is coming in; when you buy something, it's going out. The difference between the two determines whether you have a positive or negative cash flow. For example, if over a year you bring in $50,000 in earnings and pay out $40,000 in expenses, you have a positive cash flow of $10,000. But if you spend $52,000—your cash flow is negative $2,000 and needs attention.

Having a positive cash flow means you can pay your bills on time and cover any other immediate expenses—plus have money left over to spend as you wish. Even more important to your future financial security, having a positive cash flow means you'll be able to save for long-term goals like a comfortable retirement, a down payment on a home or a college education.

Your net worth

Many people find financial terms confusing and sometimes even intimidating. But understanding these concepts is easier than you probably think—and very important. One financial term you'll encounter again and again, whether you're applying for a line of credit, trying to arrange a mortgage or requesting financial aid for college, is your **net worth**. Everyone has a net worth, and calculating yours is simple.

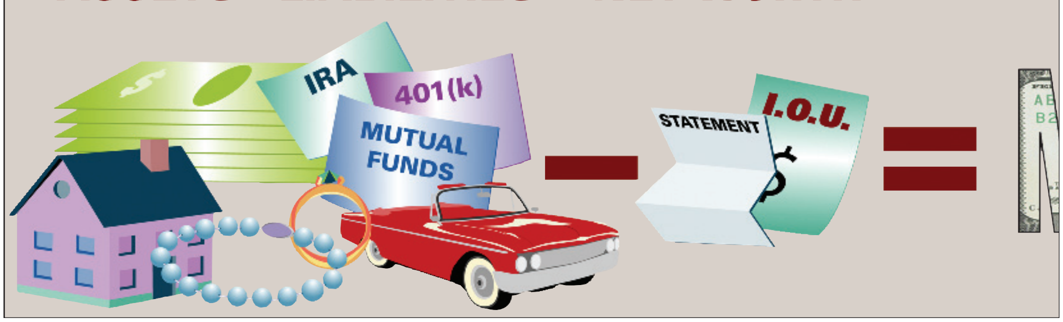
Figuring your net worth

Calculating your net worth involves looking at a detailed picture of your finances. To figure it out, you add the value of the **assets** you own and then subtract your **liabilities**, or what you owe in loans and other obligations. The amount that remains is your net worth.

Assets

- **Cash reserve assets** include the money in your checking, savings and money market accounts, as well as CDs and Treasury bills
- **Investment assets** are securities like stocks, bonds and mutual funds, and any other investments that generate income or may grow in value
- **Personal assets** are your valuable possessions, like art, cars, antiques or jewelry
- **Retirement accounts** include the money you have saved specifically for retirement (which you haven't accounted for in cash reserve assets or investment assets above), such as employer-sponsored 401(k) plans
- **Real estate** is your home and any other property you own

ASSETS - LIABILITIES = NET WORTH



TIP

It's a good idea to have a copy of your net worth statement in your financial files. Then when you need it, you can simply update it rather than having to start at the beginning. You may even want to update it annually as part of a regular review of your finances. It can be a handy snapshot of how you're managing your money.

Liabilities

- **Short-term debts** are the bills you currently have, like credit card charges, personal loans, income and property taxes, and insurance
- **Long-term debts** are loans on which you make installment payments over a long period of time, like a mortgage or college loan

If your assets are greater than your liabilities, then you have a positive net worth—and usually a much better chance of being approved for a loan should you need one.

If your liabilities are greater than your assets, you have a negative net worth, and your first goal should be to reduce your debt.

How a budget works

Since it's impossible to keep mental track of all of your expenses over the course of a week or two—let alone a year—it's important to have a **budget**. Making a budget doesn't have to be painful. A budget is really just a plan for how you're going to spend the money you have coming in for the expenses you have going out.

The nuts and bolts

A budget is a plan that allows you to set spending goals and track your actual cash flow to make sure you're staying within the boundaries you've set for yourself. Usually, it's a month-to-month projection of the amounts you allocate to each of your expenses based on the income you have. When you make a purchase or pay a bill, write it down and subtract it from the total you planned for that expense.

For example, if you budget $500 a month for food, you'd keep track of everything you spent at the grocery store, any restaurant meals and your morning coffee. If, after several months, the $500 is unrealistically low you can either cut back where you can or you revise your budget to allocate more money to food and less to something else.

You're probably wondering: How is it possible to project expenses for the future? Part of the budgeting process is using the receipts, credit card bills and checkbook register you have from last year as a reference. Another approach is to track your spending for a month or two—writing down every penny you spend. That should give you a sense of where your money is going and what you can expect to spend in the future. It may also provide a valuable clue about where you could cut back on your spending.

MY BUDGET

	MONTH PLAN	MONTH SPEND
Mortgage	$1000	
Food	$500	
Car	$300	
Credit Card	$150	
Loan	$200	
Utilities	$100	
Cable	$50	
Entertainment	$100	
TOTAL	$2400	$

Is a budget worth it?

Although it will take some start-up time and effort on your part, charting and sticking to a budget will give you a thorough picture of your spending habits, and can help you make better choices in the future.

A budget enables you to plan how you will spend your money before you reach for your wallet, checkbook or credit card. That way, you're less likely to make impulsive and perhaps unnecessary purchases, and you can fully understand where your money goes.

What goes into a budget

You can use the detailed net worth worksheet on page 12 to calculate your own net worth.

Once you understand the importance of a budget, it's time to figure out how to build one for yourself. Since you have so many different expenses, from rent to car payments to your morning coffee, it's best to sort them into helpful categories. When you have done that, you'll find it much easier to see where you spend the most—and where to spend less. It is helpful to put your expenses through two sets of filters.

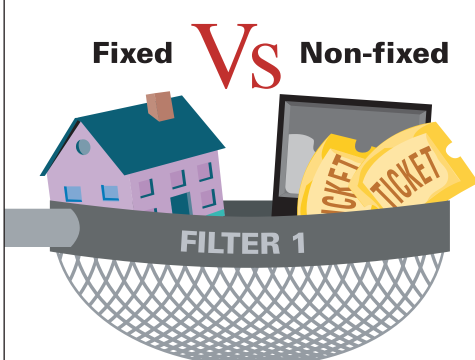
Filter 1: Fixed vs. variable expenses

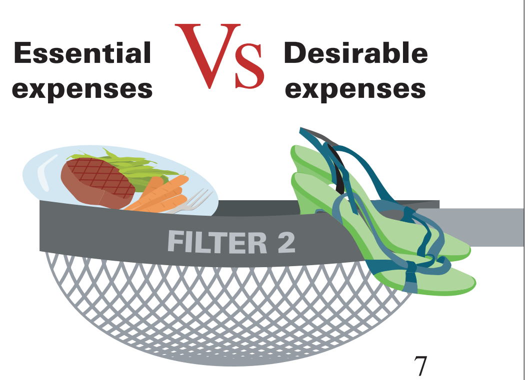
A **fixed expense** is one that does not vary in amount from payment to payment. Your mortgage payments, college loan payments, insurance premiums and gym membership are all examples of fixed expenses. If you use utility company budget (or payment) plans or have a cell phone contract, those expenses may be fixed as well.

Variable expenses are those that may change in amount from one monthly payment to the next, like groceries, utility bills, entertainment, dry cleaning, cable television and transportation expenses, including the cost of gas.

Filter 2: Essential vs. desirable expenses

An **essential expense** is one that it is impossible, quite literally, to do without. Even though a diet might be the way to drop a few pounds and save a dollar or two, you can't do without food altogether, so food is an essential expense. The only way to reduce these





expenses is to exercise self-restraint when you can—maybe you don't need to order the surf'n'turf every time you go out to dinner, or you can go out less frequently.

A **desirable expense** is one that you can do without but would rather not, like a new pair of shoes or a plasma screen TV. This is the category where, with disciplined decision-making, you can cut your spending or postpone a big purchase until you've saved enough to pay for it.

How to use your budget

When all of your expenses are sorted and labeled, what next? The categories themselves won't tell you everything you need to know to cut spending. You'll probably know right away which categories could stand a little trimming. But if you need a little guidance, a helpful tool is a **spending ratio**.

You can use the detailed budget worksheet on page 14 for help creating your own budget.

Spending ratios

A spending ratio compares your total income to how much you use for a certain expense. For example, say the gross income that you earned last year was $50,000. In your budget you find the **fixed expense** of housing, and see that you paid $18,000 in rent or mortgage bills last year, or $1,500 a month.

You realize you can't just stop paying since housing is an **essential expense**. But, your spending ratio for last year was $18,000 to your $50,000 income, or 36%, and you may want to reduce it.

So what do you do? You might be able move to a less expensive apartment or a smaller house. If you are able to reduce your rent by a third, your spending ratio would decrease to $12,000 of your $50,000 income, or 24%, which you decide is a much more manageable number for your

$$\frac{\text{What you paid}}{\text{Your total income}} = \text{Your spending ratio}$$

Flexing your money

A very important thing to remember when it comes to budgets is to remain flexible. Don't beat yourself up if you spent $40 more than you'd planned while out on a special occasion, or if your housing spending ratio is 31% instead of 29%. You can make up for the added expenses in any number of ways. Just be sure not to ignore them or pretend they didn't happen.

particular situation. That frees up $6,000 a year in your budget that can be used for other things, like saving toward retirement.

But if your home is in a neighborhood with a great local school system, is close to your work and health care providers, or you simply love it, you might want to budget for the higher housing costs and cut back in other areas instead.

Pay yourself first

If you're like most people, by the time you get around to paying all of your bills and covering expenses, there's not much left of your paycheck for savings. "Pay yourself first" is a helpful expression to remind you that your savings should be thought of as an expense, just like food or housing, and should be included in your budget.

Make saving part of each paycheck a priority: See if you can have a set dollar amount directly deposited to your savings account by your employer (which many do, and is an easy way to begin saving). If you don't see the money, you won't be tempted to spend it. Think of it as paying yourself before paying anyone else.

Personal reserves

No matter how well you prepare your budget, you will run into unexpected expenses. Whether it is a relatively minor cost like a parking ticket, or a more serious one such as car repairs, you'll eventually be forced to pay for something you hadn't planned on.

It's a good idea to set aside three to six months' worth of living expenses in an **emergency fund** for these unexpected expenses. Using the example of $50,000 in annual expenses, this means between $12,500 and $25,000 in such a fund. Although it may seem like you can't afford to save that much, you can't afford not to save. Remember, you don't have to create the full emergency fund all at once. You can budget for it too.

Write yourself a check

Once you've established an emergency fund and prepared for all the expected expenses in your budget, you can really start saving money. If it feels like you're just scraping by and can't afford to save, here are a few tips for finding that extra dollar or two:

- Reinvest any money you make on existing investments like mutual funds or stocks, as opposed to having any dividends or gains sent to you via separate check
- Deposit a big chunk of cash gifts or bonuses from work before they disappear—consider this "found money" and save it
- Bringing lunch to work one day each week could save you $20 or more each month
- If possible, write yourself a check at the end of each month when you pay your other bills, forcing you to save
- Washing your car by hand may save you $10 or more each month
- Take advantage of any matched-savings programs that may be available to you, such as employer matches on some 401(k) savings plans
- Eliminating one fast-food meal and eating at home each week could save you $15 each month

Budgeting tips

There's no question that sticking to a budget can be difficult and at times frustrating. There's also no guarantee that you'll see huge savings in the short term. Here are a few budgeting tips, though, to make your path to success a little easier.

Tip #1: Stick with it

Your spending habits vary from day to day and month to month, so it's going to take a sustained effort on your part to monitor your finances.

Tip #2: Going digital

If doing your budget with pen and paper seems too old-fashioned, there are many budgeting software titles and online resources that can help.

Two of the most popular computer programs are Quicken® and Microsoft® Money. Most programs have the capabilities to perform basic budgeting tasks as well as much more sophisticated transactions. They can be powerful tools to help manage your finances.

Tip #3: Keep it simple

Most experts agree that the key to creating and following a successful budget is to keep it simple and practical. Most of all, be realistic about your spending habits. If you love going to the movies, don't drop them completely. Instead, try to cut back on the number of times you go, or look for budget theaters.

Tip #4: Ask for help

If you feel that it's impossible to stick to your budget and you're on the verge of ripping it to shreds—or deleting it from your computer—turn to someone else for advice. Whether it's a professional financial counselor, an employee at your bank or a friend who's a little better with money than you are, it's always a good idea to ask for help.

Net worth worksheet

To calculate your net worth, you first add up the values of all of your assets.

My assets:	**Value:**
All the cash in your **savings account**	$__________
All the cash in your **checking account**	$__________
The current value of any **certificates of deposit** (CDs)	$__________
Any **cash** you have at home, in your wallet or in a safe deposit box	$__________
The value of your **money market account**	$__________
The **cash surrender value** of your life insurance policy	$__________
The value of any **savings bonds**	$__________
Any **money you're owed**	$__________
Any **stocks** you hold outside of a retirement account	$__________
Any **bonds** you hold outside of a retirement account	$__________
Any **mutual funds** you hold outside of a retirement account	$__________
The vested value of any **stock options** you hold	$__________
Any **other investments** you hold outside of a retirement account	$__________
The value of your **individual retirement account** (IRA)	$__________
The value of your **Keogh** account	$__________
The value of your **401(k)** account	$__________
The value of your **403(b)** account	$__________
The value of any **other retirement plan** you have	$__________
The market value of **your home**	$__________
The market value of any **other real estate** you own	$__________
The value of any **car** you own	$__________
The market value of a **boat, plane** or **other vehicle** you own	$__________
The value of any **jewelry** you own	$__________
The value of any **collectibles** you own	$__________
The value of any **furniture** or **other personal property**	$__________
Any **other asset** you own	$__________
Total amount of assets =	**$**__________

Next, you add up the amounts of all of your debts.

My liabilities:	**Value:**
Total remaining amount of your **mortgage**	$__________
Total remaining amount of your **car loans**	$__________
Total remaining amount of your **bank loans**	$__________
Total remaining amount of your **student loans**	$__________
Total remaining amount of your **home equity loan** or **second mortgage**	$__________
Total remaining amount of your **other loans**	$__________
Your **credit card balances**	$__________
The **real estate taxes** you owe	$__________
Any **income tax** you owe	$__________
Any **other taxes** you owe	$__________
Any **other debts**	$__________
Total amount of liabilities =	**$**__________

Finally, subtract your total liabilities from your total assets, and the result is your net worth.

Total assets $__________

–

Total liabilities $__________

=

Net worth $__________

Budget worksheet

The first step in creating a budget means either analyzing your past spending, or tracking your future spending, relative to your income.

If you're using your past spending history, collect your receipts, credit card bills and use your checkbook register for the past few months to figure out how much you spend in each category. Write those amounts in the columns to the right. Then add the amounts in Months 1, 2 and 3 for each line item, and divide by 3. Record this number in the "3-Month Average" column to get an idea of what you spend in a typical month. Averag-ing your spending over three months rather than basing it on one month can give you a more accurate picture of your true spending patterns. If you haven't kept detailed records in the past, you can use this chart to track your spending over the next few months.

Income	**Month 1**
Salary	________
Bonuses	________
Interest income	________
Other income	________
Total Income:	________
Expenses	
Housing	________
Food (groceries, dining out)	________
Clothing	________
Auto (car payment, gas)	________
Phone	________
TV/Cable	________
Insurance (home, auto, etc.)	________
Entertainment	________
Gifts/charities	________
Utilities (gas, water, electric)	________
Miscellaneous	________
Total Expenses:	________

Total Income		________
Total Expensses	–	________
Net Income	=	________

Now that you've seen how much you tend to spend in a particular area, determine how much you'd like to spend on that expense each month. Record this amount in the "Planned"

Month 2	Month 3	3-Month Average	Planned	Difference

column. Once you've come up with a final allocation for each category, subtract your "3-Month Average" expenses from your "Planned" expenses, and record these numbers in the "Difference" column. They're the difference between your current spending habits and your newly allocated amount.

You've now created your budget! Look for areas that have large differences and begin to think about ways to cut back spending in those categories. You probably won't be able to change some expenses, such as your insurance or childcare costs. Others, such as entertainment or clothing, may provide you with more flexibility to scale back your spending.

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