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Taking Stock of Your Finances

There is no time like the present to prepare for a lifestyle where you are financially comfortable. If you are a recent post-secondary graduate or nearing graduation, you might already be feeling some financial anxiety if you have accumulated student loans. You might be concerned about managing living expenses in an urban centre where you would prefer to work. How is it possible to live and put money into an RRSP or TFSA, or save for a down payment on a condo or house? How much will income taxes and other employment deductions suck out of your paycheque?

Those are some big lifestyle and finance questions that you are wise to think about now. Talk to your parents or grandparents about financial security. It is never too early to start thinking about your financial well-being. This chapter helps you start to answer those questions by showing you how to evaluate your net worth and savings rate. The goal is to develop and implement a forward-looking plan tailored to your situation.

How to Calculate Your Financial Worth

Having a sense of what you own (your *assets*) and what you owe (your *liabilities*) is important because it provides some measure of your financial security and your ability to accomplish financial goals such as buying a home, starting a business, or retiring someday.

This section defines "net worth" and then walks you through the relatively simple calculations of determining your own personal net worth.

A definition of net worth

Your *net worth* is determined by a basic calculation. Add up your *financial assets* (for example, bank and investment accounts) and your *financial liabilities* (such as student loans and credit card debt). Deduct the liabilities from the assets. If your assets exceed your liabilities, you will have a positive number. If your liabilities exceed your assets, you are in a debt (negative) situation.

TIP

Your monetary *net worth* doesn't refer to your personal possessions. Your car, clothing, television, computer, and other personal items all have some value, of course. If you need to sell them, you could get something for them on craigslist or eBay. But the reality is that you're unlikely to accumulate personal items with the expectation of later selling them to finance such personal goals as buying a home, starting a business, retiring, and so forth. After all, these items are consumer goods that decline rapidly in value after purchase and use.

What you own: Financial assets

To calculate your financial assets, gather up your bank statements and investment account statements, including your TFSA, RRSP, and RESP accounts, and any other documents related to savings and investments. You may have only one or two bank accounts, and that's fine. Add up all the values of these accounts to find out what you own.

It's typical for most young adults to be in the early stages of accumulating assets. This book will demonstrate how to grow assets.

In addition to excluding personal property and possessions (because people don't generally sell those to accomplish their personal and financial goals), do not include your home under "assets" (if you happen own one). The amount of equity in a home is variable, as it depends on local market conditions, and equity is not *liquid*. (It can't be easily sold and converted to cash.)

TIP

There is one exception to something that isn't generally thought of as a financial asset, which you may or may not want to include in this category. Some people have valuable collections of particular items, be they coins, sports memorabilia, or whatever. You can count such collections as assets, but remember that they're only real assets if you are willing to sell them and use the proceeds toward one of your goals.

What you owe: Financial liabilities

The most common type of financial liability is a loan. A credit card balance is a kind of loan. You have used the bank's money to make a purchase, and the bank charges you interest if you do not pay the amount owing on your card in full within a stipulated time frame. A student loan, line of credit, financing a vehicle, and a mortgage are other common types of loans. Of high concern are "payday loans," which have punishing interest rates that are *usurious*. In short, borrowing money results in a financial liability. Gather together documents pertaining to loans and add up the current debt you are holding.

How to net the difference

TIP

After you total your financial assets and your financial liabilities, you can subtract the latter from the former to arrive at your *net worth*. The formula looks like this:

Financial Assets – Financial Liabilities = Net Worth

If your liabilities exceed your assets, it could be the result of carrying a student loan or some other type of short-term loan. If your liabilities are significant, then acknowledge there are important decisions to make and hard work ahead to fix the situation. You will be in a much better place financially if you deal with these challenges now and understand how money can work for you.

The Importance of Savings

Accomplishing important personal and financial goals such as buying a home, starting a business, traveling, and enjoying a happy lifestyle well into retirement age takes money, and saving money requires a plan (to start with, a budget) and the discipline to hold to that plan.

You can't effectively save for a long-term goal if you don't know how much money you are committing to savings, and the amount of savings the interest rate is generating. Most people can tell you their annual salary, but only a few likely can cite their annual savings. That's because to have an accurate idea of this percentage, you need to do some analysis and calculations. The math isn't that complicated, but it does require some time and effort, especially if you haven't been tracking your spending or net worth over the past year.

The following sections explain a couple of different ways to calculate how much money you have available for savings.

Figuring out your net income

How much money you have available for savings is determined by first tallying up your income and then totalling up your loans and debts. This calculation will provide you with a net income statement. (Step 2 is to then factor in your cost of living, which we cover in Chapter 3, but for now let's get a picture of your basic net worth.)

In Chapter 2, we discuss apps that track spending, help with creating a budget, and make recommendations about investment vehicles. There is a definite element of "buyer beware" when using such apps, but for basic money management you can find some good advice.

Assessing the change in your net worth

If you don't want to be bothered with the time-consuming task of tabulating your spending over the past year, here's an alternative method for arriving at your savings rate that may be quicker for you. Follow these few easy steps and fill in the blanks in Table 1-1.

1. **Calculate your net worth.**

   Refer to the earlier section "How to net the difference" for an explanation of how to do so.

2. **Calculate your net worth from one year ago.**

   You can determine your year-ago net worth by tallying your financial assets (savings and investments) from one year ago and subtracting your financial liabilities (loans and debts) from one year ago. Don't count your home as an asset or your mortgage as a liability. Your concern here is financial assets.

3. **Correct for any changes in value of investments you owned the past year.**

   Suppose that your net worth today is $15,000, whereas one year ago it was $10,000. You might conclude that your net worth has grown by $5,000 ($15,000 – $10,000 = $5,000), but that figure may not be correct, and here's why: A year ago, when you had a net worth of $10,000, you presumably had savings and investments, and those would've changed in value over the past year. Suppose you made some good investments and they produced $1,000 in returns (from interest, dividends, appreciation, and so on) over the past 12 months. You're happy to have made $1,000 on your investments, but that money isn't new savings and shouldn't be counted in your savings rate calculations. So, you really saved $5,000 – $1,000 = $4,000.

Conversely, if your net worth was reduced over the past year by declines in the value of your investments, you should add back that figure when determining your savings rate. If your investments declined by $1,500 in value over the past year, you really saved $5,000 + $1,500 = $6,500. Table 1-1 walks you through this part of the analysis.

Today	One Year Ago
Savings and investments ($_____)	Savings and investments ($_____)
– Loans and debts ($_____)	– Loans and debts ($_____)
= Net worth today ($_____)	= Net worth a year ago ($_____)
Correct for Changes in the Value of Investments You Owned the Past Year	
Net worth today	$_____
– Net worth a year ago	$_____
– Appreciation of investments over the past year	$_____
+ Depreciation of investments over the past year	$_____
= Cash savings amount	$_____
Annual gross income	$_____
Savings rate (savings amount divided by your annual gross income)	_____%

Table 1-1: *Your Savings Rate over the Past Year*

To better understand your financial picture over the course of a year, create a budget that helps you track monthly expenses and income, so that you'll have a clear financial picture from month to month. This can help you avoid making mistakes.

Common Financial Mistakes Young Adults Make

One motivation for reading the rest of the book is to reduce your chances of making common mistakes. Your 20s and 30s are decades where lack of financial knowledge is exposed and reflected in the beginning of costly money mistakes, such as those covered in the following sections.

Excessive spending and the accumulation of consumer debt

Too many young adults leave home as "experts in spending," and have little knowledge about living within their means and saving and investing. Many things may tempt you — the never-ending stream of gadgets and electronics, cars, restaurants, bars, nightclubs, new clothing, concerts, sporting events, and so on.

Check out Chapter 3 for information about reducing your spending on items you don't need.

Defaults on student loans or other debts

This problem is often the consequence of excessive spending and accumulating too much debt. Being overwhelmed with debt, which may be exacerbated by a job loss or unexpected expenses, can cause people to fall behind on their student loan or other debt payments. Student loans represent a large portion of unsecured debt among Canadians who file for insolvency. The increase in tuition, study materials, and cost of living away from home are contributing factors to student loan debt. See Chapter 4 for information on paying down debts.

Failed relationships that damage your credit rating and financial health

You know what they say about love being blind, right? Well, one of the things many 20- and 30-somethings don't think about when in a relationship is how the things they're doing are going to work out (or not work out) if the relationship fails.

Sharing bank accounts and bill paying may not present glaring problems when everything is going well, but you can quickly end up with a tarnished credit report if your love boat runs aground.

Falling behind on tax payments and the violation of tax laws

Filing your annual tax return with the Canada Revenue Agency (CRA) and making quarterly tax instalments to the CRA if you're self-employed are responsibilities you must take seriously. While paying taxes seems an onerous task, think of it this way: You are making money. This is a good place to be in. An accountant can help you save on taxes. Not paying taxes in full and on time is asking for trouble. You could get socked with hefty interest and serious penalty charges.

Poor investments

TIP

You work hard to earn money and then to save it. So, you should do your homework to ensure that you invest it well. There is a bewildering array of financial products from banks and insurance companies, and day-trading has become popular. But you must be knowledgeable about how markets work and how much you are paying in commissions and fees. Think twice about investing on your own if you are not prepared to devote the time you need to understand the products and how to manage them. You also don't want your money sitting around for years on end in a low-interest bank account, which is what often happens to people who don't know how to invest.

Neglecting to secure proper insurance coverage

Most young Canadians don't spend a lot of time thinking about risk. After all, most of them are healthy and energetic, and Canada enjoys a universal healthcare system funded by taxpayers. So, things like private health insurance or disability insurance seem unnecessary or for older people, like their parents.

The good news is that supplemental private insurance costs less when you're younger because you're less likely to suffer a major illness or disability than someone decades older than you.

Being taken and duped by biased and/or shoddy advice

Many companies and people have something to sell. Some of what they're selling is good stuff, much of it is mediocre, and some of it is downright awful. You don't need to pay high commissions or end up in the wrong type of investments or insurance.