FINANCIAL E-BOOK

RUNNING YOUR FAMILY PROFIT AND LOSS STATEMENT

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For three years now, we have been teaching individuals and families to begin thinking about their family finances like they were running a business. We know that in every business the two major dashboards are the balance sheet and the income statement. These two metrics over time develop a real sense of the stability of any company, and those factors will ultimately be a large determinant of the value of the business. Running your family income statement efficiently (or profit and loss statement) will be the main factor in your long terms success or failure in helping create your own financial security. The next few weeks of articles will help shape some context on how to develop a framework of success running your family profit and loss statement.

The balance sheet is simply everything you own versus everything you owe or what some people call your net worth. This includes assets like real estate, collectibles, furnishings, and all of your assets. You subtract all of your liquid cash/investment liabilities including mortgages, student loans, automobile debt, and any other consumer debt to figure out what your net worth is today.

T**he profit and loss is essentially everything** you bring in from both waged income and passive income, and subtracting everything you spend to see if you have free cash flow to save in your family finances. So, how do you build an effective profit and loss?

Since most of us will have a finite amount of revenue, it is important to list all of the sources first where our income will come from over the next year. This will include earned income like salary, bonus, overtime, etc. It can also include other income you may earn on a passive basis such as interest income, dividend income, rental income, royalties, pensions, or any other sources. Each year, you could have one time income such as the trigger of stock options, inheritance, gifts, or other types of income that may come in one year and not the next. This is why it is incredibly important to sit down each year and look at all and any potential streams of income.

After going through this exercise to list all income sources, you should ask yourself the following questions. Is there anything that may change that will boost my income for the year ahead of me? Is there something that might lower my income substantially for the year ahead of me? Will there be any loans or monies owed that will free up cash flow during the course of the year? Is there anybody who owes me money that I may be in receipt of over the next year? Are there any stock options or other stock plans that require action from me this year? All of these types of questions will help you think deeper around what your real sources of income/revenue will look like on your next year's income statement.

The next step which is more difficult and labor intensive is to determine your expenses within the profit and loss statement. From a broad basis, there are two types of expenses. Committed expenses represent categories that are not likely to have substantial change over the next year. This doesn't mean that you won't be able to potentially lower them. It just means that no matter what change you make to the family finances, they will show up as a line item. Discretionary expenses are categories where you have more control as to whether or not they will show up on the profit and loss statement. The final two parts to the profit loss are income taxes and current committed savings. This will include your federal tax, state tax, social security, Medicare, etc. You should also add any current savings such as a 401(k) plan at work, college education savings, or even money you are putting into a share account at the local credit union.

Once all of the revenue and expense sources are listed into your working document, you will quickly gain an idea on whether or not your family has free cash flow. The exercise may prove you should have $700 a month to save, but you just don't know where it goes because you aren't saving it now. Then again, the analysis may demonstrate that you are going backwards each month, and it truly feels like that because you see your savings are going down every month. The first step of running a profit and loss is to define reality. If you can get all of this information in one place, it will help with the next few steps which I will discuss in the upcoming weeks.

Request a consultation if you would like to sit down and build your income statement for 2012. Remember, those that have a plan are more likely to succeed than those that do not have a plan. If you know where you are now, you can chart the right path to reach your goals and achieve financial independence, purpose, and freedom.