Budgeting: Calculating Your Net Worth

What is net worth?

Your net worth is your personal bottom line. It's what your total holdings are worth after subtracting all of your financial obligations. In financial terms, your net worth is equal to your total assets minus your total liabilities. A statement or listing of your net worth is equivalent to the balance sheet for a company and is calculated the same way.

Caution: *Two people may have the same annual income, but very different net worth. Windfall income, savings habits, financial emergencies, and other factors play important roles.*

Your assets are part of the net worth calculation

Unless you have previously estimated your net worth, you might be surprised at how high it is. The reason is that many tend to overlook some of the assets they hold. An excellent example is the cash value of life insurance policies that have been owned for several years. Antiques, collectibles, art, rare books, and many other nonmonetary items can possess significant cash value, too, even if you don't know their true present value. Money owed to you is also an asset because it is rightfully yours. If you legally own a right to something, it, too, is an asset.

An asset might sometimes be intangible. The right to do something, if it can be sold to another, has cash value, even though the exact value is as yet undetermined. The following list is made up of assets that are commonly owned:

- Annuities (surrender value)
- Antiques
- Art
- Asset management account
- Automobile(s)
- Boat(s)
- Bonds
- Business ownership
- Cash on hand
- Certificates of deposit
- Checking account(s)
- Collectibles
- 401(k) plan
- Personal property (including furniture and household items)
- Home--primary
- Home--vacation
- Real estate and investment property
- IRAs
- Jewelry
- Life insurance (cash value)
- Mutual funds
- Pension plan
- Interests in REITs
- Savings account(s)
- Stocks

Liabilities are the other side of the net worth coin

Just as assets are things you own, liabilities are things you owe. Unlike assets, you probably are well aware of your various financial obligations, since lenders are unlikely to let you forget them for long. The amount of a liability is the balance remaining to be paid, not the entire amount of the original obligation. Buying on credit increases your total liabilities, while paying debts decreases them. Some liabilities are difficult to control, such as taxes and basic expenses (e.g., housing, food, medical care, and transportation). However, there are some liabilities that you can control in order to improve your net worth.

The following list illustrates the different types of liabilities you might have:

- Alimony
- Automobile loan(s)
- Business debts
- Charitable pledges
- Credit card(s)
- Credit line
- Education loans
- Home equity loan(s)
- Home mortgage
- Income taxes due
- Insurance premiums due
- Installment loan(s)
- Memberships and dues
- Real estate taxes due

Net worth changes continually

A sizable cash inflow or outflow can suddenly change your net worth. If tomorrow you win the lottery or inherit your aunt's estate, your assets, and therefore your net worth, could increase substantially. Conversely, if volatile investments compose a significant part of your portfolio and the market suddenly declines, so will your net worth.

Steadily increasing net worth is a primary preretirement goal; maintaining it, a postretirement goal

Growing net worth should be your primary, long-term financial goal during your preretirement years. Your accumulated wealth or net worth will probably fund most of your retirement years. Therefore, the faster and bigger it grows, the earlier and more comfortably you will be able to retire. Once you have retired, your goal will likely shift to preserving net worth to carry you through retirement and perhaps leaving a legacy for loved ones .

Calculating your net worth is less difficult than you think

Calculating net worth is a relatively easy process. First, add the current value of all of your assets, then add the current amount of your liabilities. Subtract total liabilities from total assets. A statement of net worth is merely a listing of your current assets and liabilities with their respective current values; it shows the amount by which the totals differ.

Caution: *The word current is important here, because you are measuring net worth at the present time. Consequently, the recorded values of assets and liabilities need to be today's values rather than those of some past or future date.*

Tip: *There are, likely, some assets for which you don't know the current value, yet you feel them to be sufficient enough to include them as part of your net worth. Depending on the item, you can either estimate their value yourself or have them appraised by a professional. When you do estimate, be conservative. Think in terms of what someone else would really pay for it.*

Caution: *Many assets have sentimental value in addition to monetary value. When estimating net worth, consider only the monetary value. When an item has sentimental value, it can be helpful to ask people having no attachment to the item for their* *objective estimate of its value. If several respond with estimates lower than yours, they may be right.*

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