YOUR WEALTH

Personal Financial Statements

>>>Get the basics on how to disclose your financial affairs.

By Evan Gutman, CPA/CFF, and Michael H. Karu, CPA/CFF, of Levine, Jacobs and Company, LLC

Personal financial statements are prepared for many purposes including obtaining credit, tax and retirement planning, or public disclosure of financial affairs.

The primary focus of these statements is to list a person's assets and liabilities at their estimated current value. Typically, the methods used to determine current values should be disclosed. The requirement of using current value is a significant distinction between personal financial statements and business financial statements. Business financial statements reflect assets at their historical cost (the amount originally paid), rather than their current value. The individual's net worth is the difference between assets and liabilities, after deducting estimated income taxes.

Personal financial statements consist of a Statement of Financial Condition and notes explaining various items. The Statement of Financial Condition is essentially a balance sheet.

Assets and liabilities should be presented in order of liquidity and maturity. Marketable securities should be shown at quoted market prices. Receivables should be shown at discounted amounts using appropriate interest rates. Life insurance should be shown at the cash value of the policy less loans against it. Regarding real estate, the methodology to establish current value may take into account factors including appraisals, sales of similar property the discounted amount of projected revenues from the property and tax assessments. The personal financial statement should also include a provision for estimated income taxes on the differences between current values of assets and liabilities.

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One of the most significant items on a personal financial statement will often be the value of an ownership interest in a business entity. Only the net investment in the entity at its current estimated value should be presented, rather than the assets and liabilities held by the entity. For instance, if an individual owns 100 percent of a corporation that manufactures products, and the corporation owns the building where the products are manufactured, only the current value of the stock owned should be reflected. It would be an error to present the value of the building separately. The reason is that the corporation, rather than the individual, owns the building. In addition, with respect to closely-held business entities, certain footnote disclosures should be included. These disclosures include the name of the entity, the person's percentage of ownership, the nature of the business and summarized financial information about the business.

To determine the value of an ownership interest in a closely held business, several procedures may be used. These include a multiple of earnings, liquidation value, appraisals and discounted amounts of projected revenues. Often, it will be necessary to have a professional determine the value of the interest held.

Since personal financial statements may often play a critical role in determining whether credit is to be extended, it is typically advisable to utilize the services of a professional who understands the intricacies involved with their preparation. NJB