How to calculate your net worth

Most people are not financially free for one simple reason:

They don’t inspect what they expect. In other words, they don’t keep score of their finances.

People tend to equate financial success with big homes, fast cars and luxurious lifestyles. It’s this type of “material thinking” that holds people back from ever obtaining financial freedom. Need proof? In Thomas Stanley’s two books, The Millionaire Next Door and The Millionaire Mind, the vast majority of the millionaires he profiled didn’t drive expensive cars or lead extravagant lifestyles. No, they valued frugality and the idea of making their money work for them.

So, if you want to be financially free, you have to keep score and there is only one way to keep score…keeping track of your net worth.

Your net worth is simply a total of all your assets minus your liabilities. Assets are things of value such as cash, investments (e.g. stocks and bonds) and the value of your home. Liabilities are the obligations that you owe such as credit card debt, student and bank loans and your mortgage.

Net worth = Total assets – Total liabilities

Calculating your net worth is easy and only takes about 15-20 minutes. It only requires some basic financial information regarding the things you own and the debt that you owe. If you’ve been putting this off, remember this – **your net worth is the single most important number you need to know if you want to become financially free**.

Ready to get started? Great! But first a note a caution. As we go thru the steps below, you’ll need to estimate a few things such as the current value of your home and car. Here’s my advice: Be conservative with your estimates, especially with the values of your home and vehicle. Although inflating the value of large assets may look good on paper, it won’t give you an accurate picture of your net worth. Remember, self-deception is the worst deception.

Let’s get started. Here are ten quick steps to calculating your net worth:

1. On the left side of piece of paper, write the word “ASSETS” in big letters at the top.
2. Underneath that, start listing your largest assets. For most people, this includes their home and possibly vehicles.
3. Next, gather your latest financial statements for your more liquid assets. This includes checking and savings accounts, cash, CDs or other investments such as your retirement accounts.
4. Finally, list any personal items that may be of value. This could include jewelry, coin collections, musical instruments, etc. You don't need to itemize everything, but a good rule of thumb is to list items that are worth $500 or more.

5. Now, take all of the assets you have listed in the first three steps and add them together. This number represents your total assets.
6. On the right side of the same piece of paper, write the word "LIABILITIES" in big letters at the top.
7. Again, start with the major outstanding liabilities such as the balance on your mortgage or car loans and list those.
8. Next, list all of your personal liabilities such as credit cards, student loans, or any other debt you may owe.
9. Add up all of your liabilities to come up with a total.
10. Finally, subtract the total liabilities from the total assets and you will have your net worth.

What does a negative net worth mean? Some people panic when they calculate their net worth and discover that it is negative. If your net worth is negative, it simply means you haven't earned enough money yet to overcome the weight of your debt. That might be acceptable given where you are in life. For instance, if you're a recent college grad and are just starting to pay off hefty student loans, a negative net worth is expected and doesn't necessarily reflect badly on your finances.

If you're older and worried about negative net worth, it's time to take more dramatic steps to get out of debt. This includes making a budget and reducing any unnecessary spending. You'll have to work to pay off those debts and increase your assets. Don't panic, that's why you are here – to learn how to increase your net worth.

Right now, you may be asking "how can I make it bigger?" Every time you make one of those debts smaller or one of those assets larger, your net worth will increase. So, you can increase your net worth by paying off your debts, saving and investing money, and reducing your spending.

On the other hand, your net worth goes down when you spend money on things, such as expensive clothes and interest on loans. Think of it this way, whenever you buy something frivolous, your net worth goes down.

Some people recommend that you calculate your net worth on a yearly basis. I think that's way too long. This is your freedom we are talking about and 12 months is too far in the future to know if something is off track. I recommend that you calculate your net worth every month.

Have you ever heard the story about Donald Trump? At one point in his career, he pointed out a homeless man on the street and claimed the man was wealthier than himself, who had fallen $1 billion into debt. Net worth is an great indicator of your financial position, but what many people fail to understand — and what Trump so clearly did — is that if you have $1 billion in assets and are $1 billion in debt, you essentially have nothing.

The bottom line: Your goal each month is to increase your net worth over the previous month, which means your expenses for the month are less than your income. Life comes at you quickly, so you want to monitor and make changes each month to ensure you are on track. If your net worth is not where you want it to be, start making the necessary changes in your earning and spending actions each month, that will generate a positive monthly net worth. Then work your way to a positive annual net worth, which is a cornerstone of financial freedom.