Budgeting Basics

A budget is a plan for spending and saving money. The main reason for making a budget and sticking to it is to save for future goals while meeting present needs. Although budgeting can tell us much about our spending habits and ourselves, one survey found that **60 percent of Americans have no budget.** Another survey found that **90 percent of Americans, regardless of income, report not having enough money to meet expenses.** This is not typically an income problem – it is a cash flow problem that can be rectified by budgeting and planning.

People begin to budget for a variety of reasons. Some are forced to control their finances by **life circumstances** such as unemployment. Others budget to rectify **financial problems** caused by over-spending or abuse of credit. Still others budget to prepare for **major expenditures** such as a child's education or to purchase a home.

Functions of a Budget

Planning – Ensures that your total income meets total expenditures, and helps you manage cash flow so income and expenditures coincide.

Communication – A budget is a concrete communication of your personal goals and monetary plans to yourself and others.

Motivation – A budget can help motivate you to reach goals by setting achievable inter-mediate objectives.

Control – A budget allows you to control your finances because it lets you see how you actually performed versus what you planned. You can then modify either the plan or the behavior.

Cash Flow Analysis

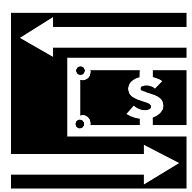
The first step in budgeting for the future is to look at how you currently spend your money. **This is cash flow analysis. This is *NOT* a budget,** since it does not contain goals and is not a plan. It is only a view of your present spending behavior.

Begin by setting up a ledger sheet or legal pad and **gather information on income and expenditures for the last 6-12 months.** Household Budget Guides with preprinted categories are available at office supply stores or a simple web search for a template.

✓ **Income** – Record income from salary, self-employment, unemployment, SSI or SSDI, interest and dividends, alimony and child support. Cash, trust and annuity income, etc. List income after taxes for a more realistic view.

✓ **Expenses** – Expenses can be grouped into subcategories:

- **Fixed Expenses,** which vary little from month to month, include rent, loan payments and insurance premiums.
  Some experts advise making saving a fixed expense to help you develop a "saving habit."



- **Flexible (or variable) expenses** change each month. These include food, utility bills, entertainment, etc.

Create working categories for tracking expenses. A simple system would include housing, food, savings, debt repayment, clothing, household operation, transportation, medical, entertainment, and miscellaneous.

✓ **Begin by filling in** how much you spend in fixed categories from memory.

✓ **Begin to collect information** from credit records, bank statements, receipts and checkbooks. Look over records for the previous month or two to establish basic spending totals under broad categories.

✓ **Establish your own categories** as you go along. This personalizes your budget.

Building Your Budget

Your budget will take into account what you spent on a monthly basis last year in existing categories, what you plan to spend this year, and new categories generated by your goals. The steps in the process are easy to follow.

✓ **Project expenditures** for each category for each month, based on the previous year.

✓ **List anticipated income** for each month.

✓ **Integrate your goals.** Knowing what you want will help you to achieve it. Begin by defining both financial and nonfinancial goals. *NOTE: "Having more money" is not a goal; it is a means to achieving a goal.*

✓ **Focus on savings.** A savings plan is another way to change money habits. Plan to save every month even if it is only $5.00. After one year you will have $60.00; after three years that will add up to $180.00, plus interest if you choose to invest it. Specify which categories you will cut to make up your projected savings. For example, you can save $25.00 a month by cutting entertainment by $15.00 and clothing by $10.00.

✓ **Begin debt reduction.** Save a bundle by paying off installment debt such as credit cards. Cut back on charging, but make the same payments each month. Credit card interest can be expensive, up to 20 percent a year. That would add up to $100.00 a year on a $500.00 balance. Save even more by paying back the higher interest debts first.

✓ **Save for emergencies.** Job loss, a temporary loss of benefits, or a medical emergency can destroy security if you have no reserves.

How Much to Spend

How much you spend in each category will vary with each individual, by geographic region, and income level. The less you make, the greater the percentage taken by basic expenditures;

for example, housing could be 50 percent. The Consumer Credit Counseling Service suggests these percentages:

Housing	**20-35%**
Food	**15-30%**
Clothing	**3-10%**
Transportation	**6-20%**
Entertainment	**2-6%**
Savings	**5-9%**
Miscellaneous	**Varies**

Having More Money

You can **increase your disposable income** in a variety of ways:

- ✓ Cut spending.
- ✓ Be a more effective consumer and reallocate resources.
- ✓ Generate new sources of income through part-time work, starting a business, etc.
- ✓ Explore new possibilities for getting what you want without cash – for example, bartering.

The Operating Budget

Once you set up a budget, keeping track of your progress requires a system. Several types of operating budgets are widely used. They are the **Expenditure Budget,** the **Accounts System,** and the **Bank Account Budget.** Your system should fit your personality and the time you have to give to it.

- ✓ **The Expenditure Budget** is the most detailed. It groups information by categories developed for your Cash Flow Analysis and records the following for each category in each month:
  - What was spent **last year?**
  - What is planned for **this year?**
  - **Actual expenditures** as they occur.
  - **The variance** – how much more or less you spent than you had planned.

  You log in points one and two at the beginning of the month, points three and four at the end, then review and modify your plan.

- ✓ **The Accounts System** is like old fashioned household budgeting using envelopes. The modern version uses columns in a ledger and resembles record keeping in your checkbook. This simple method is low maintenance and lets you see a running total of where your money is going and how much you have left. "Borrowing" from one category ("envelope") to another can be done, but it will eventually destroy your system.

- ✓ **The Bank Account Method** is one of the lowest maintenance systems and utilizes two separate bank accounts: a **checking account** for mortgage, bills, etc., and an **interest-bearing money market account** for long term goals. If a couple is doing the budgeting, each should also have a separate account for personal expenses. This method requires a moderate amount of maintenance and does not yield a running total of money remaining.

No matter which method you choose, review your budget every month. Studies of "successful people" have found that those who set goals and review them on a regular basis achieve more than those who don't.

Make Your Budget Work

- ✓ **Invest** extra paychecks and windfalls.
- ✓ Make **impulse buying** difficult by leaving checkbooks and credit cards at home.
- ✓ **Pay bills on time** to avoid late fees and finance charges.
- ✓ Build **enjoyment** into your budget. You won't succeed if your budget is so strict you can't stick to it.
- ✓ Make **savings** a fixed expense.
- ✓ Start keeping **records.**
- ✓ **Review your budget regularly** to monitor progress.

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It is meant to give you general information and not specific legal advice.

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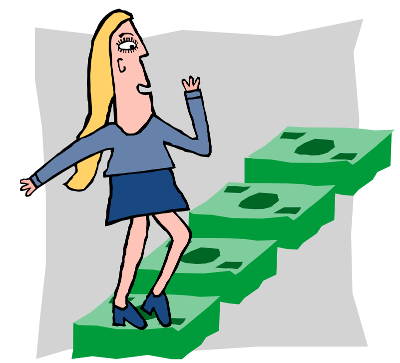
FINANCE

BUDGETING And Building A Better Future



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