Budgeting and Planning

Building a Better Future

An illustrated fact sheet explaining how to control financial problems by budgeting and planning. Explains the functions of a budget, how to do a cash flow analysis, and how to create a workable budget. Also describes how to stick to a budget and make it work.

BUDGETING
AND PLANNING:
BUILDING A
BETTER FUTURE

Publication Series

- This publication is not currently associated with any training series.

Languages Available

- English
- Spanish
- Vietnamese
- Korean
- Chinese

Table of Contents

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% of Americans have no budget. Another survey found that 90% of Americans, regardless of income, report not having enough money to meet expenses. This is a cash flow, not an income, problem that can be rectified by budgeting and planning.

People begin to budget for a variety of reasons. Some are forced to by life circumstances, like unemployment, to control their finances to survive. Others budget to rectify financial problems caused by overspending or abuse of credit. Still others budget to prepare for major expenditures like a child's education or to purchase a home.

Functions of a budget

- Planning: It 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 intermediate 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 spend your money now. This is a "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 drug and office supply stores.

- 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" and "flexible." 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 the "saving habit." Flexible (or variable) expenses change each month. These include food, phone bills and entertainment, etc.

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

1. Begin by filling in how much you spend in fixed categories from memory.
2. Start to collect information from credit records, receipts and checkbooks. Look over records for the previous month or two to establish basic spending totals under broad categories.
3. 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 on this year, and new categories generated by your goals. The steps in the process are easy to follow:

1. Project expenditures for each category for each month, based on last year.
2. List anticipated income for each month.
3. Integrate your goals. Knowing what you want will help you achieve it. Begin by defining both financial and non-financial goals. (Note: "having more money" is not a goal; it is a means to achieving goals.)
4. Focus on savings. A savings plan is another way to change money habits. Plan to save every month even if it is only $5. At year's end you will have $60; after three years that's $180, magnified by interest, if you invest it. Specify which categories cuts will come from to make up your projected savings. For example, you can save $25 a month by cutting entertainment by $15 and clothing by $10.
5. Begin debt reduction. Save a bundle by paying off installment debt like credit cards. Cut back on charging but make the same payments each month. Credit cards can be expensive, with interest rates up to 20% a year. That's $100 a year on a $500 balance.
6. Pay back the higher interest debts first; you save more.
7. 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 you will spend on basic expenditures (e.g., housing may be 50%). Consumer Credit Counseling Service suggests these percentages:

1. Housing: 20-35%
2. Food: 15-30%
3. Clothing: 3-10%

4. Transportation: 6-20%
5. Entertainment: 2-6%
6. Savings: 5-9%
7. Miscellaneous: Varies

Having more money

You can increase your disposable income in a variety of ways: 1) cut spending; 2) be a more effective consumer and reallocate resources; 3) generate new sources of income through part-time work, starting a business, etc.; 4) explore new possibilities for getting what you want without cash--for example, try 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
- the Bank

The Expenditure Budget: this is the most detailed. It groups information by categories developed for your Cash Flow Analysis and records the following for each category for each month:

1. What was spent last year.
2. What is planned for this year.
3. Actual expenditures as they occur.
4. The variance--how much more or less you spent than you had planned. You log #1 and #2 at the beginning of each month and record #3 and #4 at the end. Then review and modify the plan.

The Accounts System: this 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 eventually it will destroy your system.

The Bank Account Budget: this is one of the lowest maintenance systems and utilizes two separate bank accounts. One is a checking account for paying bills, and the other is 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

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