Budget Basics – Financial Planning Series
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Budget Basics

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$ *Have your ever:*

- run out of money before the end of the month?
- wondered where all the money went?
- borrowed from Peter to pay Paul?

A budget is a plan for spending money, and an essential tool that helps you reach your goals. It may be no more sophisticated than spending only as much as you earn.

$ *Workable Budgets*

A budget should not just meet your basic expenses. A good budget will be a plan for your needs and also your wants. A budget plans spending for a period of time—usually one week or one month. Check your goals and see if there is anything that you need to set money aside for. Planning can help you see how you will get the things you want.

$ *Budgeting Basics*

The basics of budgeting are simple. The difficulty is the amount of discipline it takes to stick to the plan. As income and needs change the budget must also reflect these changes.

A decrease in income is harder to deal with because many changes must be made. Increases in income may also involve some problems, such as what to do with the extra money. It is very easy to just spend more. You should evaluate the increase so that you can use it to its fullest potential. Review the goals you set. (See Extension Bulletin E-1965, *Goals and Financial Planning.*) Could this increase help you reach your goals faster?

$ *Creating a Budget*

Creating a budget to meet your own needs is relatively easy. When two people are involved in one budget, it becomes more complicated. There is more to deal with than just your own needs and values. Both of you may have had your own budget and developed a system for yourself. These systems may need to be revised so that both partners' needs are met. Living with agreements mutually acceptable to both takes both communication and compromise.

The first consideration in budget planning is to determine how you and your partner are spending money and to evaluate your spending habits.

Other considerations that partners need to discuss include:

- are you both working full time?
- will this continue even if you start a family?

Whether you earn one income or two, you will need to discuss how to handle your money. You may both have separate savings and checking accounts. Do you plan to continue with this system? Have you considered joint saving and checking accounts?

Before you plan your budget, it may be a wise idea to contact your financial institution to find how much service charges cost. Are the fees worth paying for separate accounts? Or do you object to them? There is no right answer to these questions. You both need to discuss the options to determine what will work best for your situation. Once you do decide, be sure to include these fees in your budget.

$ *Determining Income*

The first step in creating a budget is listing all available income. How much are you paid each month? Be careful not to overestimate the amount. Remember, net income is the amount of your paycheck after taxes and Social Security have been subtracted. The extra money from overtime or bonuses is not part of your regular income—it is temporary. Don't count on temporary income; use it for a temporary need or to add to your savings for future needs.

$ Expenses

The next step in creating a budget is determining expenses. There are three types of expenses you will need to track: fixed, flexible and periodic.

Fixed expenses occur each month, such as savings, rent or mortgage, installment debt and some credit card payments. These expenses are fairly easy to budget because they remain about the same each month. The bills and statements you receive make recordkeeping easy.

Flexible expenses are expenses that you control. You can determine how much you spend and when. These expenses include food, transportation, clothing and entertainment. These expenses are necessities but they can really upset a budget if a planned amount is not set.

Periodic expenses are expenses that only occur a few times a year, such as taxes, car insurance or car maintenance and they can be both fixed or flexible. They are easy to forget, and because they are usually large they are more difficult to deal with. By planning ahead, you can manage these expenses more easily. One way is to save a set amount each month so that when the bill is due, the money is available. A separate savings account for this purpose may help you avoid using the money for other purposes.

$ Pay Yourself First

Some people feel that savings is what is left over at the end of the month after the bills are paid. This is usually very little. But savings is an important part of a budget for two reasons: to cover emergency expenses and to obtain goals.

For example, what money would you have if you were laid off, went on strike or became disabled? Some of these situations may be covered by insurance. But what do you do until the money comes? How much money would you need to live for one, two, three months? Look at your savings. Is there enough to cover one month? More? Hopefully, you would never need emergency money, but it's good to have the security.

Savings can also help cover smaller emergencies, such as car repairs, a new water heater or other incidental major expenses. These expenses can't be planned. Finally, if you have savings you can take advantage of sale prices on items you really need, such as furniture.

The best way to save money is to plan savings as a fixed expense. Using payroll deduction makes saving easier. A general rule is to save 10 percent of your monthly income. If you can't afford 10 percent, try to save some fixed amount.

Also remember that your savings is there for emergencies or special situations, so you will need to withdraw money sometimes. But don't get carried away. Think about budgeting your savings as well, not just spending it.

$ Personal Spending

Be sure to discuss personal spending. This is another area that often causes some problems between partners. It is important that each of you has some spending money that is yours to spend as you wish. You might want to designate an adult allowance for each of you and pool the rest of your income. If only basic needs are being met, you will quickly become frustrated with your budget. Whatever you decide, talk out all the possibilities and reach a decision agreeable to both.

$ Keeping Records

Working together will help you to develop a budget that meets both your needs. Couples need to communicate their plan for spending money to each other. (Use Extension Bulletin E-1779, *Managing Your Money Worksheets,* to keep track of your budget. Extension Bulletin E-1778, *Managing Your Money* explains how to keep the records listed on the worksheet.)

$ Keys to a Successful Budget

- **Create a simple system.**

Decide who will be responsible for paying bills and keeping records. One partner may take this responsibility, or you may decide to share it. Whatever you decide, be sure you both understand who is responsible for what.

- **Keep accurate records.**

To keep track of expenses, retain all bill stubs and receipts. Write on the back of the receipt the category of the expense, such as food, household supplies or entertainment. This is particularly important for flexible expenses because you will need to look at your checkbook to estimate current spending. Keep receipts in an envelope and record them weekly in each category. Set aside a time to record your weekly expenses.

- **Prioritize expenses.**

Because your income is fixed, you must keep your expenses in line. First subtract your fixed and fixed periodic expenses from your net income. The amount left will be for flexible and flexible periodic expenses.

At the end of the month record the actual amounts you have spent. If you are consistently over- or underspending in a category, reevaluate your budget. It is better to overestimate expenses—this will give you a cushion to work with.

- **Review your budget periodically.**

Once you start recording expenses you may be surprised at how much you spend and where you spend it. This system will allow you to evaluate your spending habits and determine if you need to make changes in these habits.

After several months, spending patterns will emerge. Note each month where expenses were out of the ordinary. You may find that each month there is something that wasn't planned. To deal with this, you will want to make your budget flexible. Remember, your income doesn't usually change but your expenses can.

- **Communicate**

The most important part of budgeting is communicating. Openly discuss your situation. If you have questions, ask them. This will help you stay organized and avoid problems or misunderstandings.

- **Give your budget a chance to work.**

Remember to keep your system simple but organized. You can only benefit from a workable spending plan.

$ *Tips for Unmarried Partners*

As married couples, partners are protected by the law in the event of separation or divorce. But today many partners are not married. In this case your financial agreements are different. Don and Joan German, in their book, *Ninety Days to Financial Fitness*, suggest the following ways that unmarried couples might protect themselves.[1]

- Before you move in together, execute a legal agreement that spells out who gets what and who pays for what if you break up.

- Keep separate checking accounts. With a joint account, either party can draw out all the funds at any time unless the account agreement specifies that two signatures are required. Even this solution is not the best because one party can refuse to sign and hold up funds indefinitely.

- Keep separate savings accounts or investment accounts.

- Maintain separate credit or charge cards. Most lenders won't allow unmarried couples to have joint credit accounts, but even if they do it would be a mistake to have them. Should the relationship end, your partner could ruin your credit history. Also, because you file income taxes separately, it's easier to take interest deductions when the accounts are separate.

- Don't borrow jointly or cosign each other's loans. In either case, the cosigner is responsible if the borrower defaults.

- Prepare a detailed list of the property each person owned before the live-in relationship began. Make two copies and be sure that you both sign each page of both lists. As additional items are purchased, add them to the list with information on the date of purchase, name of owner and amount spent. Have each item initialed by both of you.

- If you plan to purchase a home, have one person buy the home and the other person pay rent to the owner. To be fair, the non-owning partner's rent should reflect the tax advantage of the owner.

- If you rent, do have both parties sign the lease. This protects both parties—if one party moves out the other won't be stuck with the entire rent obligation.

- Agree in writing about who gets any pets if your relationship should end.

- Provide for separate health insurance. Most health insurers do not recognize an unmarried partner as a spouse for insurance purposes.

- Have life insurance on both parties with the other named as beneficiary. This protects the survivor against final illness and burial expenses should one partner die.

- Include your partner in your will. (Obviously this is for long term relationships.)

[1]German, Don and Joan. *Ninety Days to Financial Fitness*. New York: Collier Books, Macmillan Publishing Company, 1986.

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