



BUDGETING TO MEET GOALS

In personal finance, you set financial goals so you can plan your budget around those goals. After all, they are your priorities, aren't they? Here is how financial planners work with budgets:

A budget has two main components: cash coming in (inflows) and cash going out (outflows). If you subtract the outflows from the inflows, the answer should always be zero. That is called balancing the budget.

The outflows represent cash paid to meet your goals. For example, you may have short-term goals of providing food, shelter, and clothing for your family. Your expenses for food, shelter, and clothing are outflows that satisfy that immediate need. You probably get cash to meet those goals from income earned from work, so you really do not have to plan too far into the future. However, let's say you have a goal to purchase a replacement vehicle in a year or two. Where is the cash going to come from? It is not likely to come from income earned from work the month prior to satisfying that need, is it? More likely, it will come from savings or borrowing. Inflows provide cash needed to meet your goals. However, with planning for your goal, you will know how much can come from savings and how much should be borrowed.



Income is an inflow, but so is money taken from savings and borrowing. Income is money earned from work and investments, or received as a gift. Using a budget in this way identifies cash coming in and how we spend it. It can be a valuable tool for planning future spending and for making investment and borrowing decisions. When used to make decisions about future spending, saving, and investments, a budget is a cash-flow management plan.

When working on your spending plan, you will discover that certain expenses such as rent or mortgage payments, loan payments, utilities, etc. are recurring expenses and are about the same from month to month. These expenses are fixed and easy to budget. Other expenses, such as entertainment and vacation costs, purchases of clothing, and major household items do not recur each period, or their amounts are very different from month to month. These are variable expenses and require more planning. Some expenses may also be discretionary or non-discretionary, depending on whether one has a choice of incurring the expense or an option as to when to incur the expense. For example, paying the utility bill is non-discretionary, since if you don't pay it, the utility company can turn off service. Entertainment is discretionary, since you get to choose when, where, and how much it will cost. Your intermediate and long-range goals will probably fall into the variable and discretionary groups of expenses or outflows.

When budgeting to meet your goals, you will need to know how much of your income will go for non-discretionary and fixed expenses. The rest is available for variable and discretionary expenses.

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Most financial advisors agree that the best way to avoid financial problems and to save for future expenses is to "pay yourself first." This means that a certain amount of money from your gross income should be withheld and set aside into a savings plan to be utilized later in meeting a financial goal.

By keeping a written record of your income and expenses, you are better able to project when you will need additional inflows from savings or borrowing, and which expenses can be reduced or postponed to a future period when you have better inflows.

If you need more cash to meet your goals, you have one of two choices: earn more from work and investments, or spend less on lower-priority items. Many mistakenly think that borrowing helps. Just the opposite is true, because money borrowed must be repaid with interest. This raises the cost of goods or services paid for with borrowed money. Some goals may cost more than one is able to save in time to meet the need. Borrowing will allow you to meet the need, but ultimately it will take longer to repay the loan with interest than it would have taken to save the money from the beginning. For example, a home mortgage of \$100,000 at 6% interest for 30 years will cost over \$215,000. You didn't plan on that, did you? And a \$100 purchase on a credit card at 18% interest costs \$130 if paid over three years.

Economizing means planning your expenses to match your goals and inflows from income over time. The key to successful economizing is setting and prioritizing your goals. You can usually accurately predict future income. Set your goals so that your long-term expenses do not exceed your long-term income.

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