INTRODUCTION

It sounds obvious but unless there is a sound budget in place we will have no control over our finances and it can hinder our ability to save.

In this paper I want to consider:

1. What is a budget
2. How to create budget
3. Identify routes to overspending
4. How to achieve budgeting success

WHAT IS A BUDGET

"…we have no such thing as a budget anymore our manager freaks when we show him the bill"
– Freddie Mercury

We can't all be as wealthy and successful as Freddie Mercury and Queen, and therefore we can't ignore having a budget in place. A budget is nothing more than a breakdown and plan of how much money we have coming in and where it goes. If we don't know how much money we have coming in and where it goes, the road to financial success will be a difficult one as even the rich and famous have found.

One of the greatest fears when creating a budget is that we will need to cut back on all the things we enjoy like eating out, buying a coffee each morning and possibly holidays.

It is true that what we might discover is that we need to cut back, but the longer we ignore it the worse it will get.

There are three steps to the process:

1. **Tracking income** - the first step in creating a budget is to determine how much income we have.

2. **Tracking expenses** - the second step is to identify all our regular, irregular and fixed expenses.

3. **Bottom line** - once we know the incoming money and the outgoing expenses we can then create a budget.

   After arriving at this stage we can start to adjust our spending habits to reflect our income.

In the second part of this guide we will cover these steps in more detail.

HOW TO CREATE A BUDGET

Creating a budget may not sound like the most exciting thing in the world to do, but it is vital in keeping our financial house in order. Before we begin to create our budget it is important to realise that in order to be successful we have to have as much information as possible. Ultimately, the end result will be able to show where our money is coming from, how much there is and where it is all going.

Here's how:

1. **Gather every financial statement -** this includes bank statements, investment accounts and any other information regarding sources of income or expense. The key for this process is to create a monthly average so the more information you dig up the better.

2. **Record all sources of income -** If you are self-employed or have any outside sources of income be sure to record these as well. If your income is in the form of a regular amount where taxes are automatically deducted then use the net income, or take home pay. Also include any spouses' income. Record this total income as a monthly amount.

3. **Create a list of monthly expenses -** write down a list of all the expected expenses you plan on incurring during the course of a month. This includes a mortgage payment, car insurance, food, utilities, entertainment, savings and essentially anything else you may spend your money on (birthdays, Christmas etc).

4. **Break expenses into two categories: fixed and variable -** fixed expenses are those that stay relatively the same each month and are required parts of your way of living. These include expenses such as your mortgage or rent, utility bills etc. These for the most part are essential yet not likely to change in the budget. Variable expenses are the type that will change from month to month and include items such as food, petrol, entertainment and gifts. This category will be important when making adjustments.

5. **Total your monthly income and monthly expenses -** you should then record all this information on a budget spreadsheet*. If your end result shows more income than expenses then you are off to a good start. This means you can prioritise this excess to areas of your budget such as retirement savings or paying more on credit cards / mortgage to eliminate the debt faster. If you are showing a higher expense column than income it means some changes will have to be made.

6. **Make adjustments to expenses -** if you have accurately identified and listed all your expenses the ultimate goal would be to have your income and expense column equal. This means all of your income is accounted and budgeted for a specific expense. If you are in a situation where expenses are higher than income you should look at your variable expenses to find areas to cut. Since these expenses are typically non-essential it should be easy to shave a few pounds in a few areas to bring you closer to your income.

7. **Review your budget monthly -** it is important to review your budget on a regular basis to make sure you are staying on track. We recommend you create a spreadsheet listing all your expenses so at the end of the month you can sit down and compare the actual expenses versus what you had created in the budget. This will identify any adjustments you may need to make.

*Click here for a free budget worksheet - http://www.shininglights.co.uk/financial-planning/financial-planning-tools/

ROOTS TO OVERSPENDING

To build wealth and reach financial independence, we simply need to spend less than we earn. It is an easy concept to understand, but why is it so difficult? To answer the question, we need to examine the roots of overspending. When we know what factors drive our spending habits, we can fight back and save money so that we can spend less than we earn.

1. **Easy access to credit -** for most people, this is the biggest reason for overspending. Although access to credit is not as easy as it was prior to 2008 it is still there and it can feel like free money. If you treat it as access to money you don't have then you can find that the monthly repayments grow and it can have a negative impact on your monthly budget. Effectively a credit card should be seen as a debit card where any payments are immediately paid off.

2. **Easy access to cash** - most people have access to their bank account 24 hours a day. Rather than using cash we use debit cards so keeping track of payments is vital because it can feel like you are not spending money and you can lose control of your budget very quickly.

3. **Misusing credit cards -** credit cards can be a great tool when used properly. In the early days you would pay off the debt each month. So effectively you were using an interest free short term loan. Used well this is a powerful financial tool. The problem is when you carry a little over from month to month because the interest grows, the debt grows and it becomes harder to pay down the debt.

4. **Giving in to temptation -**it is very easy to go out and have a good time but do you have the money to pay for it? You can put it on the credit card but if you can't pay it off then it could cost you in the long term. Think of other ways to spend times with your friends which doesn't make a dent in your budget.

5. **Spending to feel good -**spending money feels good. There is nothing wrong with this as long as you don't go overboard. If you can build a feel good fund this will be better than putting it on the credit card.

HOW TO ACHIEVE BUDGETING SUCCESS

Creating a budget isn't incredibly difficult, but where most people fail is trying to maintain the budget. It usually starts with good intentions, but it doesn't take much to derail the whole plan. The reason why this is the foundation stone to good financial planning is that if we can stick to this, then developing goals and the corresponding plan will be easier to do. The three main traits to ensure success are:

1. **Positive attitude -** without a doubt you will need to go into budgeting process with a positive attitude. If you think of budgeting as a chore, or that you are sacrificing something, you'll find it extremely difficult to keep at it. Don't think of the negative aspects of a budget, but think about the rewards.

   If you stick to your budget, what will you achieve? You may get out of debt sooner, you might be able to save money for a family holiday, or even be able to save for retirement or your child's education. Whatever your financial goals are, you need to focus on the budget as a tool to reach these goals.

2. **Stay motivated -** building on the positive attitude, you need to maintain motivation. What can happen over time is that you get into the habit of following your budget, and it all becomes routine. If you lose motivation, you become complacent. To become motivated again, consider rewarding yourself, or even increasing your goals. You need to find something that will push you to go the extra mile.

   If your goal was to have that credit card paid off in eight months and you've been plugging along, challenge yourself to pay it off in seven months. If you do, reward yourself with something you enjoy. The feeling of accomplishing your financial goals is intoxicating, so if you can push yourself to reach these goals, you'll be able to maintain the excitement and motivation needed to keep at it.

3. **Keep realistic expectations** - one of the biggest budget killers is unrealistic expectations. If you set your sights too high, you only become discouraged when you fail to reach them. While it is admirable to try and accomplish great things, you need to set goals that are challenging, yet realistic. One way to do this is to start fairly small with short time-frames. If you create smaller bite-sized goals over the coming months, you can see how likely you are to accomplish them, then, build upon these goals to set your sights a little higher. This is not only a great way to stay motivated, but it also helps keep your goals manageable[/toggle]

CONCLUSION

Creating a budget isn't difficult but it can be challenging. However, it is a discipline that helps individuals when they come to considering their financial plans.

There are two additional tips which many people ignore and can reduce outgoings:

1. Haggle – there are certain outgoings where we can bring the price down – examples include:

    a. Mortgage – extending the mortgage term or looking for a lower rate can bring down costs
    b. Car and home insurance – the renewal price is often higher than the previous year. It is worth shopping around as this can bring considerable savings
    c. Car breakdown cover – at renewal haggle, never pay the full price!
    d. Gas and electricity – avoid the big six, smaller firms can charge less
    e. Life assurance – often replacing existing life assurance with new cover can bring down the costs
    f. Cashback sites – sites like Quidco can provide significant cashback for things like holidays

    This list is far from exhaustive…….

2. Cash – using cash for shopping takes away the temptation to overspend, you can only spend what you have

And finally one area we haven't touched on is debt. This is a complex area and we will always recommend individuals visit a debt specialist like Step Change or CAP Money.