Chapter 4-Finanical Decisions and Planning

Section 4-2-Basics of Budgeting

Budgeting

- What is a Budget? a spending and saving plan based on expected income and expenses.
  - a critical part of managing your money.
    - Estimate income and expenses to create a financial plan
    - Create financial goals to meet your daily and future spending and saving needs based on expected income
  - Reasons to make a budget:
    - Helps save money
    - Helps manage your money
    - Helps make better spending decisions
    - Helps meet financial goals
    - Helps plan how to spend your money

Where to prepare a budget?

- Pencil/paper
  - Make a budget on a sheet of paper
  - Have to make manual calculations
  - Could be messy (erasing expenses/income)
  - Keep secure if it contains account numbers
- Software Package (spreadsheet software)
  - Computer program-allows you to insert numbers and formulas quickly to compute amounts
  - Easy to maintain
  - Clean looking/easy to update
  - Keep secure with password if it contains account numbers
- Budget Apps
  - Some free
  - Keep data secure
  - Some request access to bank accounts/savings accounts

Preparing a budget

- Use software package or create manually.
- Step 1: Estimate Income
  - List your sources of income (money earned or unearned)
- Step 2: Plan Savings
  - Plan Savings
  - Pay Yourself First (put money into savings before you consider other expenses)

Preparing a budget

- Step 3: Estimate Expenses
  - Items for which you spend money (clothes, lunches, gas, utilities,etc.)
  - **Variable Expenses**: an expense that can go up and down each month
    - Example: electric, gas, grocery, clothing
  - **Fixed Expenses**: an expense that stays the same from month to month
    - Example: Rent, house payment, insurance premium
  - **Charitable Giving**: Donating money or time to a cause that you believe in

Preparing a Budget

- Step 4: Balance the Budget
  - This amount should be the same as the total income amount.
  - You should have a zero balance, because you have planned how all of your income will be managed
    - Expenses (what you need to pay for)
    - Savings (pay yourself first)

Budget Analysis

- You should not expect income, savings and expenses to be exactly as you plan
- There will be budget variances
  - **Variance**: the difference between planned amounts and actual amounts
    - **Positive Variance**: earn or save more money than estimated
    - **Negative Variance**: make less or have more expenses than planned

Recordkeeping methods

- Keeping good records will help you prepare a better budget
- Good information will help you to better analyze your budget
- Records allow you to have history of your savings and expenses
- Records help you plan for your future by looking at your past financial information

Manual Records

- Consist of information recorded using pen and paper
- Manually compute variances and make notations about what to change
- Keep records so you can review them over time
- Store these records in a safe and secure place
- Protect them against fire and other types of damage
- Advantages:
  - Paper copies always available
  - Can make notations on paper copies beside information
- Disadvantages:
  - Need a secure place to store
  - Can be messy from erasing information
  - Not easy to update
  - Not easy to calculate variances

Electronic Records

- Consists of information that is stored in a soft copy, such as in a software package on your computer
- Advantages:
  - Can quickly update records
  - Print copies
  - Calculate budget variances
- Disadvantages:
  - Must have electronic device to access
  - Could lose information (make backup copies)
  - Easier to have personal information stolen
- Records should be protected with passwords
- Consider **encryption**-the process of converting data to a coded form to protect your information
- Use a **firewall** if you store your personal records in a Cloud environment
  - Firewall-software or hardware device that filters information coming into your computer