



# Spending Plans

## “Take Charge of Your Finances” Advanced Level

### Financial Planning

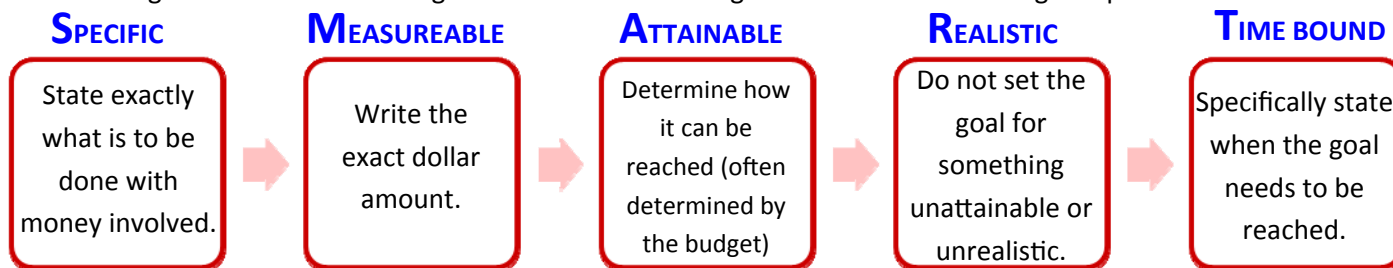
Everyday individuals make decisions which influence their financial future. Consider the daily purchase of an item such as a latte. When making the purchase, \$3.50 may not seem to be significant. Does the purchase seem more significant when considering it adds up to be \$1,260 per year or that it could be \$6,838.57 in 25 years if saved in an account earning 7% interest? What if the individual also has aspirations to purchase a new car, attend college, or dreams of traveling to exotic places? The \$6,838.57 becomes extremely valuable to helping individuals achieve those aspirations. In the daily act of managing money, individuals are always making trade-offs. By acquiring one item, the individual will not be able to have the other. **Financial planning** is a tool used to achieve financial success based upon the development and implementation of financial goals. Within the process, an essential financial management tool is a spending plan. A **spending plan** is a paper or electronic document used to record both planned and actual income through expenditures over a period of time.

Each individual and family has a unique spending plan, because spending decisions are based upon their unique values, needs, and wants. A **value** is a fundamental belief or practice about what is desirable, worthwhile, and important to an individual. Values can be influenced by family, friends, teachers, religious affiliations, work/career, media, and law. They guide an individual’s choice about their needs and wants. A **need** is something thought to be a necessity or essential item required for life. Examples include food, water, and shelter. A **want** is something unnecessary, but desired, or an item which increases the quality of living. Examples include MP3 players, DVD players, and the newest game system. A person’s perception of their needs versus wants affects their spending.

What do you value? How do these values affect your spending?

Financial goals are the foundation of a financial plan. A **goal** is defined as the end result of something a person intends to acquire, achieve, do, reach, or accomplish in the near or distant future. **Financial goals** are specific objectives to be accomplished through financial planning. Goals help individuals to consider their current financial situation compared to where they want to be in the future. They are influenced by a person’s values, needs, and wants. At any time, an individual may have several financial goals and the amount required to achieve each goal may be more than an individual can allocate in their spending plan. Therefore, the process of setting financial goals involves setting priorities and continually examining if the goals are being achieved. In financial management, goals help a person to consider the tradeoffs they are making with each decision. A spending plan then becomes the essential tool to ensuring money is allocated to achieve each goal.

Financial goals should be SMART goals. A SMART financial goal includes the following components:



An example of a SMART financial goal is: I plan to save \$25.00 from each bi-monthly paycheck for two years to have \$1,200 towards a down payment for a used car when I turn 18 years old.

## What is a Spending Plan?

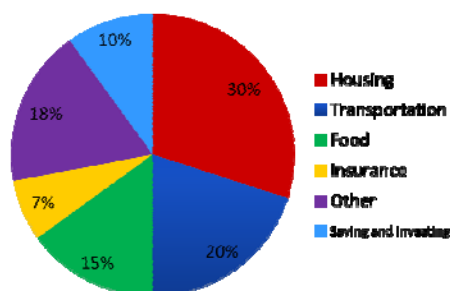
A spending plan is comprised of three sections; income, expense, and net gain or loss. **Income** is money earned, and **expense** is money spent. There are two types of expenses; fixed and flexible. **Fixed expenses** often have a fixed amount due each month, may be contractual, and not easy to reduce or eliminate. Examples include rent, cell phone bills, and car payments. **Flexible expenses** can vary each month in the amount owed, are not contractual, and do not have to be paid by a certain date making it easy to reduce or eliminate the expense. Examples are food, clothing, and entertainment.

## Developing a Spending Plan

### Step One—Track Current Income and Expenses

To create a spending plan, individuals first begin by making estimates of how much money they will earn and expenses they will have during a specific period of time. This time period is often concurrent with payday. For most, this is bi-monthly or monthly income. It is essential that the estimates an individual makes are as accurate as possible for the spending plan to be realistic and effective. If an individual is unsure about how much they are spending, they should track their daily expenses for a few weeks. This can be done by carrying a small notebook and writing down each expense as it occurs or keeping receipts.

**Major expenditure percentages provide a reference and may be used as a guide when creating a spending plan**



### Spending Plan Development Process



It is important to take into account all expenses when creating a spending plan. Sometimes small expenses may be missed, but those small expenses can add up very quickly to become large expenses. When tracking expenses make sure to take into account the expenses on the following page.

**Taxes and Payroll Deductions:** Most expenses are taken out of an individual's **net income** (take home pay). Payroll deductions however are taken out of gross income. **Gross income** is the total amount of money earned during a pay period before payroll deductions. Payroll deductions include **taxes**, which are required citizen charges by local, state, and federal governments. Taxes are used to provide public goods and services. Other payroll deductions may include employer-sponsored retirement and health insurance.

**Saving and Investing:** Savings is a portion of current income not spent on consumption. It is recommended to save 10-20% of net income until at least 6 months worth of expenses are reached. Once this amount of savings is reached, continue to invest 10-20% of net income.

**Housing:** Expenses associated with housing may include: monthly payment, utilities (electricity, water, garbage), property taxes, home or renters insurance, maintenance, and household furnishings.

**Transportation:** Expenses associated with transportation may include: monthly payment, license and registration, insurance, fuel, repairs and maintenance, and public transportation fees.

**Food:** Expenses associated with transportation may include: food at the grocery store, meals at restaurants, snacks (coffees, treats), party and entertainment foods, and non-food kitchen supplies (dish soap).

**Insurance:** Insurance is an arrangement between an individual and an insurance company to protect the individual against risk. Home, renters, automobile, health, disability, and life are types of insurance.

**Other:** Individuals have many other expenses that fulfill needs and wants as a part of daily living and are a major part of a spending plan. Examples of other expenses include: family member care, communication and computers (cell phone, Internet), medical costs not covered by insurance, clothing, personal care, educational expenses, pet care, entertainment, gifts and charitable contributions, and credit costs (loan payments).

### Step Two—Creating Personalized Income and Expense Categories

Every person's values will influence their spending decisions. Therefore, effective spending plans are those which are personalized. This includes selecting spending plan categories based upon sources of income and typical expenses. Income and expense categories should be based off of the tracking completed in step one.

### Step Three—Allocate Money to Each Category

After tracking spending and determining categories reflective of an individual's earning and spending practices, individuals are ready to create their plan for how much to allocate for each category. This becomes the individual's spending plan identifying how they will earn and spend their money during the specified time period. Several programs are available to help individuals create a spending plan including using paper and pencil, Microsoft Word and Excel templates, and online templates. The income and expense sections of the spending plan should be totaled. Then, evaluate if they have a **net gain** or **net loss** which is the amount of money remaining after subtracting expenses from income. If a person has a net gain that indicates that there is remaining money to either save, spend, or invest. If a person has a net loss then they are spending more money than he/she is earning and has to use credit (borrowed money) to meet their financial obligations. The spending plan must be adjusted to ensure that income and expenses are equal (reach zero).

## Step Four–Implement and Control

At this step consumers are ready to put their plan into action. Control systems are used to help track income and expenses and assure that the tracking of expenses are done in an accurate way. Continually monitoring spending allows an individual to know if they are spending too much in a category and must make adjustments to avoid using credit. There are several different ways to monitor spending and an individual must choose which works best for their personality. Examples include:

**Envelope System** – Individuals place the actual budgeted amount of cash from into the specific envelope labeled for the expense. Another way to track this is to place receipts inside the envelope.

**Check Register System** – Track all expenditures in a checkbook register which has been divided into spending plan categories.

**Electronic Spending Plan Systems** – Multiple types of software are available for consumers to use to help keep track of their financial records.

## Step Five-Evaluate and Make Adjustments

This is the step where the consumers can evaluate the previous steps to determine if their financial plan is working. This is determined by assessing if goals have been met, the allocations in each category are accurate, money is being saved, and credit is not being used. If any of these criteria are not being met, it is time to adjust the spending plan!

## Net Worth Statement

A spending plan is a tool for daily cash management. An effectively managed spending plan allows an individual to not have credit and begin creating wealth for long-term security. **Wealth** is measurement of how much a person or household owns once all debts have been paid. Wealth is the most important predictor of an individual's overall financial security identifying the standard of living a person will be able to have during retirement. Wealth is measured with a net worth statement. A **net worth statement** describes an individual or family's financial condition on a specified date. There are multiple components including:

**Assets** – Everything a person owns with monetary value.  
Examples may include cash, value of an automobile and home, and investments.

**Liabilities** – Debts or what is owed to others.  
Examples may include credit, unpaid bills, and loans such as education, home, or automobile.

**Net Worth** – The amount of money left when liabilities are subtracted from assets.

The financial planning process is ongoing. Plans will change depending on an individual or family's financial situation. If consumers continue to monitor, change, and evaluate their plan set into place they will be financially successful. In relation to the gumball analogy, always have more money coming in than out to achieve your financial goals!

o **Income** (money in)

o **Net Worth** (wealth)

o **Flexible Expenses**  
(money out)

o **Fixed Expenses**  
(money out)

