

The Personal Budget

The basic purpose of a personal budget is to plan how an individual's money will be spent. Given limited financial resources, a budget is a method of managing personal cash flow, to both meet current obligations as well as provide for future spending.

Reasons to Prepare a Personal Budget

The creation and use of a personal budget serves two key functions.

- **A planning tool:** Correctly used, a personal budget can insure that income and expenditures match, both in amount and timing. It can serve to spotlight potential cash-flow problems, as well as identify opportunities to make better use of current income.
- **A yardstick to measure progress:** By comparing the planned budget against actual results, an individual can see if progress is being made toward meeting specific goals. This measuring process will often highlight areas where changes should be made.

Preparing a Personal Budget

There are a number of steps involved in preparing and using a personal budget.

- **Past income and expenditures:** This initial step is to record information on past cash flow, both income and spending. Ideally, a year's worth of data should be gathered, to even out the effect of seasonal variations¹. Paycheck stubs, check registers, cancelled checks, copies of paid bills and recent income tax returns are excellent sources of this information. If desired, an individual may want to keep a daily spending diary for a short period of time.
- **Establish goals and designate resources:** Explicit goals should be set, with dollar amounts and a realistic time frame within which each goal is to be accomplished. From the available cash flow, specific dollar amounts are dedicated towards meeting each goal. Goals can be simple and immediate (making ends meet each month) or they can be more complex and long term (funding retirement).
- **Maintain records:** Perhaps the most difficult part of the budgeting process is consistently keeping adequate monthly records of income and expenditures.
- **Periodic review:** A periodic review, comparing the planned budget with actual results, provides a means of measuring progress toward an individual's goals. The review will usually indicate if changes should be made, either in income, expenditures or both.

¹ For example, heating bills are usually less in summer than in winter.