

## Cash Flow and Budgeting

Understanding cash flow from an income and outflow perspective is critical to achieving financial balance and reaching future goals. Income is the primary resource available to reach these goals. Examining where that income goes is necessary to ensure efficient and effective use of resources. To start, add up salaries, interest, self-employment income, and any other sources that will provide total income. These additional steps will provide guidance:

### Track expenses

Understand where money is going over a set period; while a tedious task, tracking can be quite simple

- Layout all expenditures incurred on regular and infrequent basis
- Break expenses up into categories (e.g., housing, food, clothing)
- Consider spending patterns in the categories on a regular basis (e.g., monthly, quarterly)

Consider a systematic approach to account for bills received at different times as opposed to recording estimates from memory. Track figures historically (e.g., past 6 months) and prospectively (e.g., next 3 months) in order to create an accurate and detailed record of expenses. Credit card and bank statements can help breakdown spending into amounts and categories.

### Reduce expenses

Knowing expenses allows for the reduction and elimination of unnecessary spending that may help free up cash flow for other financial goals. It may be helpful to compare expenses to certain objective norms. These norms are generally expressed as ratios or percentages of gross income, for example:

- Housing – 27%
- Transportation – 17%
- Food – 13%
- Savings – 11%
- Utilities – 7%
- Healthcare – 6%
- Entertainment – 6%
- Clothing – 4%
- All other categories – 9%

If housing accounted for 55% of overall expenditures, something is probably amiss. Similarly, entertainment costs that take up 25% of a budget could signal a problem.

Following are some tips for expense reduction:

- Bring lunch to work instead of buying it
- Check for insurance discounts by bundling homeowner's and auto insurance; consider increasing deductibles
- Travel locally this year to reduce vacation costs
- Explore strategies to reduce interest costs associated with debt
- Use coupons

## **Budget**

A budget is a plan that will guide future spending decisions. Unlike cash flow, a budget is not a historical record of what has been spent, but rather a target for how much to spend moving forward. A budget is a changing, fluid item. Finding realistic guidelines may require several months before getting it right. When building a budget, there are several basic factors to consider:

- Job security
- Secure income from work and other sources
- Relatively fixed or variable expenses – frequency of change or variance
- Large expenses that are only paid a few times a year (e.g., car insurance, property taxes)

Concerns about job security should trigger more savings and less spending in preparation for potential unemployment. This will create cash (or emergency) reserves between transitions until another job is found. A cash reserve recommendation is commonly six months of living expenses, although it may feel safer to keep 12 months or more.

Building a budget requires time, effort, and conservative assumptions. It's important not to overstate income or under-estimate expenses. For example, Denise decides not to include her yearly bonus because she feels that it is not always a guarantee that she will receive one. Keep budgets realistic.

Once a budget exists, it will need to be implemented and monitored. Using records of income and expenses that have fit into the budget will allow for specific analyzing. Consider utilizing a spreadsheet or personal finance software (e.g., Excel, Quicken, Mint) to assist in implementing the budget. Using the computer method requires detailed spending input for accurate tracking of expenditures creating awareness of how much money actually remains within a budget category for a specific month. Of course, pen and paper work too!



Post a budget copy somewhere convenient to assist in monitoring—next to a kitchen calendar or on a desk. Then note day-to-day expenditures on blank spaces provided next to each expense category. Recorded figures serve as a reminder of how much remains for each month's expenditures.

Regardless of what method is used, the keys to success for adhering to a budget are:

- Accurate recordkeeping
- Consistency of effort
- Discipline in curtailing expenditures

Even a well-designed budget is worthless if it is ignored.

For more resources, log into the *Ernst & Young Financial Planning Services Center*® at: <https://pbucc.eyfpc.com>.

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