Financial budgeting: A1 – A7

What is a budget and why is it important to use it?

A budget is a financial plan of income and expenditure over a period.

By using the budget, we monitor our income and expenditure, achieve our financial goals more easily, avoid over-indebtedness and generally control our money.
The goal of budget management is to spend less than we earn.

What is income and what is expenditure?

Income

is all the money we have earned or received?

Sources of income can be: salaries, pensions, pocket money, scholarships, benefits (maternity allowance, unemployment benefit), rental fee (from real estate), child allowance, return on savings and investments...).

Income can be regular or extraordinary.

Regular income is permanent and stable (or rarely changes), e.g. monthly salary, pension, income from renting real estate.

Extraordinary income often changes, and we cannot count on it, e.g. additional or bonus salary, income from a second job.

Expenditures

are all expenses and financial obligations that we are obliged to pay.

Sources of expenditure can be: living expenses (food, rent, utilities, clothing, footwear), transportation costs, personal expenses (sports activities, make-up), entertainment expenses (travel, cinema).

Expenses can be permanent (fixed) and changeable (variable).

Fixed expenses are most often contracted and do not change over time, e.g. rent, monthly public transport ticket.

Variable expenses are not contracted and may change, e.g. food or travel expenses.

How to create a budget in 5 steps?

1. Determine the time period for which the budget is created and record your income and expenses in that period.

2. In a spreadsheet, create an income category and an expenditure category. Sort expenditures by purpose (e.g. utilities, food, hygiene ...). As a separate item in the table, list savings as the difference between total income and total expenditure.

3. Allocate an amount of money to each item of expenditures.

4. Monitor your spending. Keep the receipts, keep track of every expense, and check to see if the expenditures are in line with the plan.

5. Evaluate the efficacy of the planned budget and adjust it if necessary.
   Is income lower, higher or equal to expenditures in a given period?
   Has the planned saving been achieved in one month?
   How to improve the budget?
   Which expenditures can be reduced?

   The budget can be created using a mobile application, a personal organizer, or an electronic programme. If it is created for a shorter period, it will be more realistic (accurate).

Budget results

By analysing the difference between income and expenditure, we determine the success of budget management.
Three results are possible:

1. Surplus: Income is higher than expenditure, so there is a surplus of money for savings and investments.

2. Income and expenditure are equal: There is no surplus or deficit, and the budget is balanced.

3. Deficit: Income is lower than expenditure, so borrowing is needed to cover the expenses.

Responsible spending (What do I need and what do I want?)

<u>A need</u> represents all that is necessary for existence and our own well-being.

Basic life's necessities are water, food, accommodation, education, health care…

<u>A want</u> is a desire for a product and service that has some value for us, e.g. travel, fashionable clothes …

By distinguishing between needs and wants, we avoid possible indebtedness.

- ## Setting financial goals

  Successful personal finance management is based on a financial plan.
  The financial planning process consists of 3 steps:

  1. Assess the current financial situation by creating a cash flow that shows the difference between income and expenses.

  2. Setting financial goals and creating a financial plan

     Every goal must be:
     - Specific - clearly defined (it is visible what needs to be done)
     - Measurable - determine the monetary value of the goal
     - Achievable - plan actions that will help achieve the goal
     - Realistic - assess the possibility of achieving the goal in relation to income
     - Time-specific - set a time limit for achieving the goal

  3. Reviewing the financial plan and assessing whether we did everything as planned.