



**MEMBER FINANCIAL FITNESS**

# The Budget Book



# Table of Contents

<b>Introduction</b>	<b>2</b>
What is the Purpose of a Budget?	3
<b>Some General Guidelines</b>	<b>4</b>
Deciding on Your Goals	5
Designing Your Budget	5
<b>Making Entries</b>	<b>7</b>
Personal Goals	7
Income	8
Expenses	8
The Bottom Line	11
Budget Summary for the Year	11
<b>Using the Budget in Financial Planning</b>	<b>12</b>



## Introduction

Budgeting: probably the most unpopular word in the financial planning dictionary – and the most misunderstood! Many people think it means setting tough spending limits, penny-pinching, doing without... but a budget isn't a punishment. Quite the contrary; it helps people to manage their money better, to reach their financial goals. This booklet tells you how to budget – sensibly, painlessly and successfully.

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## **What is the Purpose of a Budget?**

A budget helps you to control your spending. It provides a system for estimating how much money you will need to cover various itemized expenses during a particular period (say, each month throughout the year), then matches your actual expenditures against the estimated amounts. You can see at a glance where your monthly income goes, and whether you are spending more than you need to on certain items. You can also keep a regular check on whether you are staying within your budget.

A budget also helps you with financial planning. It shows you how much money you can expect to have left after your expenses have been paid out of your income, so that you can plan what to do with the surplus amount. If you have set specific goals for yourself (as you will if you are planning your financial future), you can decide whether your income after expenses is sufficient to enable you to attain your goals; and if it isn't, you can take steps to either increase your income or reduce your spending.

A budget helps you to save! People who keep track of their expenses often have more money left over at the end of the month than people who simply pay out money without following any kind of spending plan. Also, a good budget allocates a certain amount every month to a savings account or contingency fund, which can be tapped in case of emergency.

A budget is so useful, and more than that, so essential to personal money management, that once you have one, you'll wonder how you ever managed without it.

# Some General Guidelines

Setting up and using a budget involves six basic steps:

1. The first step is to establish your financial goals: immediate, intermediate and long-term.
2. Next, you should examine your current financial position. What is your household income, monthly and annually? How much do you spend? How much is left over for savings and other purposes? What are your debts?
3. The third step is to write out a monthly budget for each of 12 consecutive months, itemizing expenses in various categories and estimating how much you can reasonably expect to spend in each category.
4. Now relate your budget to your overall financial planning. How much money do you expect to have left over after expenses? How will this money be allocated among your financial goals? Following the budget you have set up, how long will it take you to reach each goal?
5. Throughout each month, make regular entries of your actual expenditures in each expense category. At month-end, total the amounts in each category, and match these figures against your original estimates. At year-end, total the monthly amounts for the year.
6. Finally, review and revise the budget to keep it useful and up-to-date. At the end of every month, measure your performance against the budget targets. Mid-way through the year, review the budget categories and estimates and, if they need adjustment, make the necessary changes. At year-end, repeat this review and prepare a new 12-month budget with revised estimates of income and expenses.

This section sets out some suggestions for planning and designing a sound budget. The sections that follow provide more specific information on making entries and using the budget to assist with financial planning.

Keep in mind that this booklet necessarily deals with generalities. You may want to adapt some of the suggestions to suit your particular spending habits and financial circumstances.

## Deciding on Your Goals

Budget planning begins with goal setting. What do you want your money to buy? What are your ambitions, your hopes, your dreams? Are your expectations reasonable?

These are big questions, spanning not only the next 12 months, but the next five to 10 years and beyond – in fact, the rest of your life! Perhaps you have already set your goals: a house, a holiday abroad, your own business or a new career, early retirement.

Most goals require you to do some financial planning if they are to become a reality. Which goals are most important to you? When do you want to reach them? What will each goal cost and what are your financing options (saving, borrowing or a combination of these)?

You may find it helpful to group your goals into time categories: short-term, mid-term and long-term. Then rank them in order of importance, and note the cost involved. This simple plan will serve as the foundation of your budget. And, most important, it will give you an incentive to keep to the budget because the faster you can save money, the sooner you will attain your goals.

Goals – and budget – are flexible. You may well find that they will change over the years as your lifestyle, earning power and attitudes change. For this reason, it is a good idea to review your goals periodically and revise your plan accordingly.

## Designing Your Budget

A budget is personal. There is no single format that suits all circumstances. Nevertheless, every good budget has certain basic features that make it work:

- The budget must be realistic. There is no point in setting stringent spending limits that you don't have a hope of meeting. While there may be periods in your life when it will be necessary to watch every penny you spend, your normal budget – especially your first one – should be sufficiently generous that you are comfortable working with it. At the same time, it shouldn't be too generous. If it is, you will find yourself spending more than you should, and your savings will not grow as quickly as you had hoped.
- The budget must be both comprehensive and concise. It must include all expenditures that you can predict over the course of a year but the list should not be so detailed that you will have to spend hours keeping your records up to date. You will find that many expenses can be grouped

into categories so that the budget itself will list perhaps a dozen or 15 items in the average month. In the next section of the booklet, suggestions are made for the headings you might want to use.

- The budget should be flexible. As you work with it, you may find that your original format can be improved. Perhaps some of your spending estimates range too high or too low. Review the budget regularly and revise it if necessary until it fits your particular needs. Also, if your financial situation changes significantly part way through the budget year, consider whether you ought to draw up a new budget immediately instead of waiting until year-end.
- The budget should cover an extended period – typically one year – and expenditures should be segregated into shorter periods – usually calendar months. Although the one-year period need not be a calendar year, this format often corresponds to significant financial events such as the end of the personal income tax year and the awarding of salary increases by employers. Similarly, calendar months often correspond to regular billings by utility companies, lenders and landlords.
- The budget should be legible. This seems obvious but it is worth emphasizing the advantage of a neat and well-organized budget record. If you can't easily read your entries, you will make mistakes in calculating totals and eventually you will find it too troublesome to work with the budget. As a practical suggestion, make your entries in pencil so that they can be erased and corrected or revised.
- A budget requires commitment from everyone who contributes to household income and expenditures. If you have a spouse, companion, or family, involve that person or family in all budget discussions, from initial planning, to design of the budget, to review and preparation of a new budget at year end.

How you actually set up your budget is a matter of personal choice and preference. To help you with the format, we suggest using the model "Working Budget" workbook available from your credit union. You may want to use this exactly as presented, or you may adapt it to your own requirements. We suggest, however, that you will find it useful to incorporate into your personal budget the four main sections contained in the working budget. These are "Personal Goals", "Income", "Expenses" and "Balance Sheet".

The next section sets out guidelines for keeping an up-to-date budget record.

# Making Entries

When you sit down to draw up a budget and over the months as you record new entries, keep in mind three rules or requirements necessary to the success of your budget:

1. **Regularity.** Be systematic in keeping track of daily expenditures and bringing your budget record up to date. If you aren't methodical, you will overlook some expenditures and distort the picture of your spending pattern. And if you let several months go by without making entries, the paperwork involved in catching up will be quite intimidating. In the end, it will be too much trouble and you'll give up the budget.
2. **Accuracy.** While it isn't necessary to account for every cent of income and expenditures, you should be reasonably accurate in recording amounts. If your estimates turn out to be wrong, correct them as soon as you become aware of the error.
3. **Honesty.** Don't fudge the books! You will only defeat your purpose if you record lower amounts than you have actually spent and the record won't balance at the end of the month.

The following are some suggestions for making entries in the four sections of the working budget.

## Personal Goals

Goals are divided into three categories – short-term, mid-term and long-term – and space is provided for a cost estimate for each goal. When you list your goals, write them down in order of importance (most important to least) and briefly note a target date for achieving the goal.

You will not be able to complete this section until you have worked out your monthly spending estimates. Below the total estimated cost for each category is a line reading "Total Monthly". Here you should write your estimated contribution to each category, calculated as a monthly average amount. This money will come from the balance left over (your "discretionary income") after all expenses and minimum monthly savings have been deducted from income. You may find it difficult to arrive at a realistic estimate before you have actually put the budget into effect. Don't worry about it; you can always come back and revise the figures.



## Income

When you list estimated income amounts for each month, remember to include sources of income other than salary or wages. For example, if you have money invested in stocks or bonds on which you receive an annual dividend or interest payment, record the amount you expect to receive. If this is an estimate, remember to verify it against the actual payment when it is made and correct it if necessary. Also keep the income record up to date during the year, adding any unexpected receipts and making adjustments to other estimated amounts.

If, at some time over the next 12 months, you expect to receive a salary increase, don't include it in the income record until it comes into effect. The increase may turn out to be less than you hoped or it may not materialize after all and, in any event, you may find it quite difficult to arrive at an estimate of the net increase since various deductions will be made by your employer (for tax, pension and so on).

If you are self-employed, remember that you have to pay income tax and Canada Pension Plan (CPP) installments out of your gross receipts. Either write the net income amount in the income record or include an extra category under "Expenses" to provide for these deductions. (Consult Canada Revenue Agency [CRA] current tax guide for individuals in your self-employment category, to determine the appropriate amounts to be deducted.)

Total all income amounts for each month and enter this figure on the "Expense" page for that month. Remember to double-check actual receipts against estimates and correct the "Expense" page as well as the income projection.

## Expenses

The working budget workbook organizes expenses into 10 categories and also includes an entry in the same section for "Minimum monthly savings". Although savings is not an expense item, the budget should provide for a contribution every month to an emergency reserve or contingency account. These savings are quite separate from savings toward your personal goals, contribution to registered retirement plans and other designated investments. The reserve or contingency fund is your cushion – your security against an unexpected major expense or a temporary loss of income. It should not be considered accessible for other purposes.

The 10 expense categories, briefly discussed on the next two pages, cover most people's range of household and personal costs. But in your own particular case, you may want to change the headings or add new ones. The working budget is only a guide.

When you enter expenditures under the various headings, provide as much detail as you need to identify the reason for the expense, but not so much that record-keeping becomes a chore. Basically, what you will want to do is to be able to review your monthly spending and pinpoint any items that could be considered unnecessary or some form of overspending.

### **Rent or Mortgage Payment**

If you are a homeowner, and property taxes are not included in your mortgage payment (or you own the home and don't have a mortgage on it), be sure to list property taxes under this heading. If you live in a condominium or a unit in a housing co-operative, include your share of taxes and maintenance costs.

If you make a separate payment for rental of a parking space or garage, you can include it under this heading or under "Transportation".

### **Utilities**

Include payments for heating, electricity, water (if applicable), telephone, cellphone, cable television and Internet.

### **Food and Household Goods**

Enter all grocery expenses and costs for household goods such as soap, cleaning products and toilet paper. Also include expenditures on meals that are regularly bought in restaurants, at school or at work.

### **Clothing**

You should budget for replacing worn clothing, new seasonal purchases, as well as dry cleaning and laundry. Also include expenditures on sportswear (or, alternatively, list these under "Hobbies, Recreation, Entertainment").

## **Health & Dental, Insurance, Tuition, Charity**

These items are self-explanatory. With regard to health costs, such as medical care or drugs, you may choose not to budget for them if they are fully covered under insurance plans.

## **Transportation**

If you have a car, include all associated costs: licence fees, insurance, loan payments (if applicable), fuel, seasonal servicing, oil, antifreeze and so on. In your budget estimate, provide an amount to cover vehicle maintenance and repairs. Also include expenditures on public transportation and taxis.

## **Household Maintenance**

In this category, you would include babysitting and child care fees, home cleaning services, house repairs, property maintenance, furniture and fixtures.

## **Hobbies, Recreation, Entertainment**

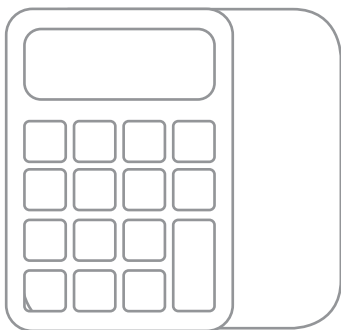
This category can include a wide range of expenses: movies, concert tickets, sports fees, club memberships, CDs/DVDs, books and magazines, dining out and entertaining friends and family at home.

## **Vacation/Holiday Savings**

If you would like to plan an annual vacation, budget for the cost of travel, meals, accommodation and incidental expenses.

## **Other**

This open category can include miscellaneous items that do not fit under other headings; for example, cosmetics, hair care, veterinary fees (if you have a pet), gifts, home furnishings, plants, art and so on.



## **The Bottom Line**

At the end of the monthly expense summary are three lines for recording your budgeted and actual total expenses, your budgeted and actual total income, and the difference between these figures – the amount of discretionary income you have left.

Discretionary income represents the bottom line in more than a physical sense. It is, in effect, a measure of the success of your budget. The whole point of budgeting is to control your spending so that you keep back an increasing proportion of your income for other purposes. These “other purposes” are, of course, centered on your personal financial goals.

You will remember that the first page of the working budget was left incomplete, with no entry for “Total Monthly” contributions to the three sets of personal goals. When you have estimated your income, simply total these last amounts for all 12 months, then divide by 12. This will give you an estimate of average monthly discretionary income spread over the budget year. Use this figure to determine how much you will allocate as a “Total Monthly” contribution to your short-term, mid-term and long-term goals. This determination is a matter of open choice. Some of the considerations you will want to keep in mind are discussed in the last section of this booklet, “Using the Budget in Financial Planning”.

## **Budget Summary for the Year**

The budget summary shows you how realistic your budget is and how successful you have been in keeping to it over the course of the year. On this last page of the working budget, you summarize all the totals for the year, month by month, for income, budgeted expenses and actual expenditures. A column is provided for recording the difference between your budget estimates and your actual spending. A consistently wide gap between the two figures could indicate one of three things: if the difference is positive (that is, you spent less each month than the budgeted amount), your original estimates were probably too high; conversely, if the difference is negative (you spent more than the budgeted figure), your estimates may be too low or, more likely, you are overspending.

The budget summary will be helpful to you in planning a new budget for the next 12 months. You should also review the monthly expense record and, if you have overspent, identify the items that threw you off budget. Be patient. It will take a little time to get used to controlling your spending. But working with a budget can become an easy, automatic habit if you only persevere.

# Using the Budget in Financial Planning

It should be clear by now that a budget assists with financial planning in a number of important ways.

1. A budget requires you to decide exactly what your goals are and to establish priorities among those goals. Even though your goals may change over time, or the order of priority may shift, it is surely obvious that making these basic decisions is the first necessary step toward achieving what you want.
2. A budget enables you to make better use of the money that comes into your hands. When you match income amounts against necessary living expenses, you can see exactly how much is available to you, month to month and over the year, for other desired but non-essential purchases. By itemizing expenses and assigning dollar amounts to them, you become aware of where your income is going and where your spending is higher than it needs to be. You may also discover that merely controlling your spending will increase your discretionary income.
3. A budget also helps you to see whether all of your goals are attainable, given your current earning level and your income expectations in the long term. If they aren't, you may have to give up some of those goals; or, if they are important enough, you can start planning how to increase your earning power (for example, by retraining or further education in your area of employment).
4. A budget can broaden your understanding of both the function of money and its potential. If you have been accustomed to spending most of your earnings on household costs and daily living expenses, you probably regard money as no more than a commodity that passes rather quickly through your hands and disappears. When you plan and follow a budget, you begin to see that money can work for you; that you can keep more than you thought you could, that what you keep can be directed to certain uses which will in fact give you access to more money, and at the same time, allow you to reach your financial goals. This awareness of the larger role of money is the basis for effective financial planning.
5. A budget tests your commitment to your goals. This also is a prerequisite of successful financial planning.

If your budget is well thought out and you stick to it, you will have a certain amount of money – discretionary income – to use for “other purposes” than covering predictable expenses. Assuming that you are following the working budget model (or some variant), you will have earmarked some or all of these funds for monthly contributions to your goals. Now you are in a position to develop your financial planning at a higher level. You need not think only in terms of cash, but you can direct the surplus to investments and payments against borrowed funds.

Cash surplus should never be left idle in a non-interest-bearing account. There are many options, and the more surplus you have, the wider your range of choices. You can, for example, deposit some or all of your discretionary income in a basic savings account or a Tax-Free Savings Account. Once your savings reach a certain level, you can transfer them into term deposits or an RRSP, which usually earn a higher rate of interest. Or you can invest in stocks and bonds.

You can also use your accumulated savings to secure a loan. Suppose, for example, that one of your short-term goals is to buy major appliances, such as a washer and dryer. If you have some money set aside, or if you have enough discretionary income to meet the monthly payments (without, in any month, running short of surplus after ordinary expenses), you might apply to your credit union for credit financing. Or suppose that you want to buy a house. You will need enough cash for the down payment; then you can apply for a mortgage loan.

An application for credit is usually strengthened if the applicant has been following an established household budget. Other considerations come into play as well, such as the applicant’s previous credit record, stability of employment and other current debt obligations. But an accurate and up-to-date budget generally indicates a concern for controlled spending and some attention to financial planning – both factors that are important to lenders.

Any debts that you incur will have to be incorporated into your budget. Repayments will be recorded in the appropriate expense categories at the time they are due (usually monthly). You will also have to reassess your “Personal Goals” list to see whether your priorities, target dates, contributions – or the goals themselves – need to be changed.

Financial planning is a very broad topic – too broad to be dealt with adequately in this booklet. It encompasses many specialized areas, such as home buying, retirement planning, estate planning, investments, education planning, insurance and income tax planning. Budgeting opens the door to many possibilities.

Ask your credit union manager or financial advisor about the options that are of particular interest to you as well as about other financial planning information available.



**Other booklets available for consumer information include:** *The Credit Book*, *Planning for Your Retirement*, and *Facts About Mortgages*.

Ask for copies at your Credit Union.

## branch locations

### Ashcroft

250-453-2219

### Barriere

250-672-9736

### Chase

250-679-8831

### Clearwater

250-674-3111

### Lillooet

250-256-4238

### Merritt

250-378-5181

### Kamloops

Lansdowne

Branch

250-374-3361

Summit Branch

250-314-1210

Tranquille Branch

250-376-5544

Valleyview

Branch

250-374-6676

### Kelowna

Glenmore Branch

250-762-2262

Kelowna Branch

250-869-8300

Mission Branch

250-763-8144

Orchard Centre

Branch

250-860-7400

Rutland Branch

250-469-6575

### Lake Country

250-766-3663

### Okanagan Falls

250-497-8204

### Oliver

250-498-3457

### Osoyoos

250-495-8027

### Vernon

250-545-1234

### West Kelowna

250-469-6550

## other services

### Member Service Centre

1-855-220-2580

### Online and Mobile Banking

[www.interiorsavings.com](http://www.interiorsavings.com)

### Commercial Services Centres

Kamloops 250-851-2814

Kelowna 250-469-6500

### Telephone Banking

Kelowna 250-862-ISCU (4728)

Toll free outside Kelowna area

1-877-861-ISCU (4728)

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