

Lesson 10

Let's Sharpen the Pencil

We have been talking about it for several lessons, so let's put the pencil to the paper and build your budget to arrive at Milestone 1. For some of you, this will be a landmark moment – you are about to take charge of something you've never been in charge of before. That fact alone should excite you! One of the action steps for Lesson 4 from Week 1 was tracking your expenses, so gather that data as we proceed. **Note:** The forms in the appendix and the following explanation of how to use those forms is based on using a manual budgeting system. It is much easier to visualize the overall budgeting process and to understand making spending decisions using a manual system, like the one I will illustrate in these lessons. In reality, I encourage you to use a computer based or phone app budgeting system to make the entering and calculation of data easier. See Appendix A-6 for budgeting system options. Once you have a clear understanding of the budgeting process, you can apply that knowledge to any type of budgeting system, manual or computerized.



The form on page A-2 in the appendix is the Monthly Expense Tracker (MET). Immediately following the MET are the two worksheets (one for income; one for expenses) on pages A-3 and A-4. Use the worksheets to assist you in determining the totals for both your income and the major spending areas. You are free to make as many copies of the appendix forms as you want. **Complete the Monthly Income Estimate Worksheet** (explanation follows). In the Lesson 7 action step, you were asked to accumulate the necessary information to compute your **Usable Income (UI)**, so this should be a simple math exercise. Identify all income sources. Consider periodic income, recurring gifts, commissions, etc. Refer to page A-8 for how to deal with variable income. Do the best you can to accurately calculate your average monthly income, even if a portion of it doesn't occur each month, e.g. bi-weekly paycheck. As you see in the illustration, the sub-areas are added together to generate the **Total Income (TI)**.

Total Income (TI)	
Salary	<u>3,900</u>
Salary	<u>2,500</u>
Commissions	<u> </u>
Additional Part-time	<u>100</u>
Interest	<u>25</u>
Dividend	<u> </u>
Other (gifts, rebates, etc)	<u>10</u>
	<u>6,535</u>

The **Available Income (AI)** is computed by simply subtracting everything that is withheld from your **TI**. Those self-employed should subtract estimated tax payments. The **AI** should agree with the monthly total of your checks or direct deposit. If any of your income is paid bi-weekly, you will have to do some computation to determine the equivalent monthly amount. Your **UI** is computed by subtracting your giving, saving and investing amounts from the **AI**. **UI is the amount of money you have remaining to spend each month.**

Now let's move to the spending side of the ledger. **Most people don't know where they are spending money.** Most have an idea of their checking account balance and go through the month hoping there will be enough left in the checking account (money to spend) to get them to the next month. The Monthly Expense Estimate Worksheet breaks your spending down into one of eleven different major areas. The major spending areas are not cast in stone, but they do represent the areas where most of us spend money. One huge advantage of developing a budget is to assign that available "money to spend" in the checking account into smaller spending areas. By doing so you gain much more information and much more ability to make wise spending decisions. These decision processes will be explained in detail in the next lesson.

The rationale expressed in the preceding paragraph is why you were given the action step of tracking expenses during week 1 and have been reminded to do so each day. You should have been tracking expenses for about 10 days by now. This is not enough time to determine accurate monthly spending levels for every major spending area, but it should be enough to help you get started estimating your monthly expenses. Using that data plus any historical information you have, **complete the Monthly Expense Estimate Worksheet.** Last week's action step of computing your Minimum Required Expenses (MRE) should also assist you as you complete this worksheet. The process of adding together the sub-areas to determine the total for each major area is also used on the Monthly Expense Estimate Worksheet (see example). Refer to page A-8 for periodic and variable expenses. Do the very best you can to be as accurate as possible.

Transportation	
Payment(s)	<u>275</u>
Gas	<u>115</u>
Maint./Oil Change	<u>30</u>
Insurance	<u>102</u>
License/Tax	<u>10</u>
Commuting	<u> </u>
Parking	<u>15</u>
Other	<u> </u>
	547



When you have computed both income and expense worksheets, it is a simple matter to compare the two, which you will do at the bottom of the Monthly Expense Estimate Worksheet. Obviously, your goal is to have your UI exceed your monthly expenses by as much as practical. The excess is diverted to giving and/or saving/investing, so your final UI will equal your budgeted spending, i.e. a balanced budget. If you find that expenses are greater than UI, it is necessary to **immediately look for ways to reduce expenses.**

Let me emphasize the previous sentence by asking a question. If I put my budget together and my expenses exceed my UI by \$1, would it make any difference to me if I increased my income by \$1 or reduced my expenses by \$1 in order to balance my budget? For those of you who answered there is no difference, let me explain why I think there is. If I increase income by a dollar, it requires extra effort/work, and I have to pay taxes on that dollar, so I only see about 75 cents after taxes. But if I reduce expenses by a dollar I will realize a full after tax dollar reduction, and it didn't require any extra effort or work. I get a bigger bang for the buck – pun intended. **It is always to our advantage to look for spending reductions first.** This may seem counterintuitive. Most people I counsel immediately start thinking about ways to generate more income when they find their UI below their spending level. Consequently, always strive to find ways to first reduce expenses. Then, if additional income is required the additional amount needed will be less once spending has been reduced to the minimum necessary.

If you are upside down, i.e. expenses exceed UI, don't panic! Many find themselves there.

We will discuss a process in a later lesson which will be extremely beneficial in helping you dig out of the hole.



Once you have completed both the worksheets for income and expenses, **transfer your UI and the total (budgeted) amount for each spending area to their appropriate places on the MET** (page A-2). This initial budget will be refined over time as you gather more data. Notice that there are 31 numbered rows on the MET – one for every day of the month. Each day that you have an expense in one of the spending areas it will be recorded in the appropriate row under the appropriate column heading. As the month unfolds, expenses in each spending area are subtracted from the budgeted amount for that spending area. As a result, the remaining balance in each spending area becomes apparent. If you don't use commercial budget software or a phone app, the MET has been adapted to Excel and the math will be done for you. See page A-6 for information on how to access this and other Excel spreadsheets. Also, a link to an MET Sample Budget is provided on page A-6. **In the next lesson we will discuss in detail the decision processes as you move through your budget month. You will then see the power and freedom you will gain by operating on a monthly budget.**

For now, pat yourself on the back – you've just constructed your first one!





REFLECTION: As you recorded and/or estimated your spending in the various spending areas, did anything stand out? Do you sense an area where there is room for reduced spending? Are you encouraged or discouraged with the difference between your UI and your expense total? If discouraged, what can you do about it? Identify and prepare to discuss with your group the statement or concept that was most meaningful to you in this lesson. **Record your thoughts:**



ACTION STEP: Today's lesson is your action step! It may take you more than a day or two to complete your budget, but try your best to have it completed before starting next week's lessons. Continue tracking your daily expenses using the spending areas listed on page A-4.