

Spending Plan Beats Budgeting

Have you ever developed a gut-wrenching fear in the pit of your belly or a feeling of despair when you thought about creating a household budget? Consider thinking about it as a "spending plan". A budget is simply the framework for planning how to spend and save your money. Follow these simple steps to create your own spending plan.

Step 1: Track Expenses

For two months, keep track of every dollar you spend. Yes, every dollar. You'd be surprised at how quickly that daily cup of coffee or late afternoon vending machine snack adds up. Although it may sound like a daunting task, this exercise will be the key to managing your money.

You'll probably find you have two kinds of expenses: fixed and variable. Fixed expenses are those that are predictable and are paid at a regular interval—rent or mortgage, utilities, loan payments, insurance, childcare, etc. Variable expenses are a bit more difficult to capture since the amount and frequency changes. These expenses might include groceries, clothing, doctor visits, entertainment, charitable giving, etc.

To identify these expenses, use your bank statement, credit card statements, check register and ATM receipts to remind you where and when you spent your money. Assign each transaction to a category.

Step 2: Analyze Spending

Using money management software, a spreadsheet program, or even a notebook with a pencil and calculator, create categories for all your spending. Categories can be broad to begin with—housing, utilities, insurance, food, entertainment, etc. As you analyze how your money is spent, you may want to create more detailed categories or subcategories. For example, under utilities you may break down expenses by electric, gas/oil, water, etc. Record the date of each transaction, the category under which it falls, a description of where/how the money was spent, and the amount. Then add up the amount spent in each month for each category.

Step 3: Create your Spending Plan (a.k.a. budget)

Now that you see where your money goes every month, create a plan for spending it. If working on paper, create a grid with your categories listed down the side and the months of the year across the top. Using your analysis from step 2, forecast your spending for each category by month, taking into consideration any circumstances that will affect it by month. For example, your electric bill may be higher in the summer to accommodate air conditioning. Your holiday spending may only take place for three months of the year. Don't worry if your amounts aren't 100% accurate—you'll be able to make adjustments later.

Step 4: Review and Adjust

Your spending plan is a live tool. It will take on a life of its own if you don't manage it. Review your spending every month and make adjustments in your plan where appropriate. The more time you invest in managing your budget, the more it will work for you.