Budgeting Basics

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1) Budgeting Basics - Introduction

What is budgeting? Basically, it's making sure that you're spending less than you're bringing in and planning for both the short- and long-term.

Unfortunately, many people think of budgeting as depriving themselves and they avoid it like they do a diet. However, just like a diet is really just a program for eating, budgeting is just a program for spending. If you are hitting a mental roadblock when you hear the word "budget", just call it by a different name, such as "personal financial planning." That's what budgeting is, after all. It's a proactive approach, rather than a reactive approach, to managing your money.

Budgeting is an important component of financial success. It's not difficult to implement, and it's not just for people with limited funds. Budgeting makes it easier for people with incomes and expenses of all sizes to make conscious decisions about how they'd prefer to allocate their money. It can also help people save for retirement, emergencies, a new car or just about anything. For many people, having a solid budget in place, knowing how much money they have and knowing exactly where that money is going makes it
This budgeting tutorial will teach you everything from setting up a budget to updating it as your circumstances change, as well as getting back on track if you go off your budget. Whether you're a college undergrad, retiree or somewhere in between, if you're looking for a way to manage your money better and improve your financial situation, then this tutorial is for you.

2) Budgeting Basics - What Is Budgeting?

Many people think of budgeting as something to do when they're short on cash. College students might turn to a budget to figure out how to make due with their high expenses and limited incomes. Wise new grads create budgets to make sure they're properly allocating their first paychecks among emergency savings, retirement savings, student loan repayments, rent and utilities, and rewards for their hard work like new gadgets and nights on the town. Young couples trying to figure out how to afford a wedding, or newlyweds wondering how to fit the expense of buying a house or having a child into their monthly cash flow, are also likely to make budgets. Of course, budgets are commonly associated with people of all ages who are barely able to make ends meet.

The truth is that budgeting isn't just for times when your money is tight or your life is undergoing a major transition. Budgeting is for everyone, rich and poor alike. In fact, budgeting will be that much easier in times of change if you do it all the time. Where do you think a Fortune 500 company like Amazon would be today without proper budgeting? What about wealthy people like Warren Buffett? There's no way that he or his holding company, Berkshire Hathaway, could have achieved such success without paying attention to their monthly, quarterly and annual cash inflow and outflow. Budgeting won't just get you out of a rut - it can also help you get rich.

Let's look at some ways budgeting can help you achieve your goals. A good budget will help you do all of the following:

Make Long- and Short-Term Projections
A budget will help you plan for short-term expenses, like your monthly bills, and mid-term expenses, like vacations, as well as long-term expenses, like buying a house, paying for a child's college education and putting money away for retirement. When you have a spreadsheet or notebook in front of you showing how much money you expect to make over the next few months (or years), how much of that money goes out every month and how much you have left to save each month, you'll always know when you need to cut back on spending, when you can afford to loosen the reins and how long it will take to save for major goals. And if you're not happy with the numbers, knowing

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what they are will help you take steps to improve your situation, whether that means focusing on paying off credit cards to increase your monthly cash flow, or getting a promotion or switching companies so you can make enough money to afford everything you need and want. (For more, read *Increase Your Disposable Income*.)

**Prevent a Crisis**

Let's say a significant expense arises unexpectedly: maybe you develop a serious toothache and your dentist informs you that you'll need a root canal and a crown. While you may have dental insurance through work, you're still going to have to fork over at least $500 out-of-pocket to get the work done. How can a budget help you handle an expense like this?

If you're new to budgeting and don't have any emergency savings yet, or if your savings have already been depleted by another recent emergency, your budget will help you determine what expenses you might be able to postpone or shift around to help you pay the unexpected bill. For example, maybe you normally pay your car insurance once a year and it's due next month, but you can opt to pay half now and half in six months instead to free up the cash to pay your dental bill. Or maybe your situation is tighter than that, but you can see that if you cut next month's grocery bill from $300 to $200 and go out to eat once instead of twice, you'll be able to start making a dent in your dental bill. Also, you may not have to pay the bill immediately. Payment of almost any emergency expense can be postponed by at least a couple of weeks by putting it on a credit card or asking the service provider to let you make two or three payments over several weeks or months. Of course, if you put the expense on your credit card, you should pay it in full when the bill is due if at all possible to avoid paying interest.

Your budget will also give you an idea of how long it will take you to replenish your depleted savings once you pay off your dental care. (For more insight, read *Build Yourself An Emergency Fund*.)

**Get the Most Out of Your Money**

Chances are you spend at least 40 hours working each week, and that doesn't include the time you spend getting ready, the time you're forced to be away from home because of commuting and lunch time, or the hours of free time that get lost because you're too tired from working all day to enjoy them. If you're going to dedicate that much of your life to earning a living, you owe it to yourself to make sure your money is going to the things that are most important to you.

A budget helps you track all your expenses - large and small. It lets you find out how much you spend on everything from coffee breaks to MP3 downloads to gasoline to clothes. If you discover that you're spending $500 a month on clothes and that horrifies you because you haven't been able to afford a vacation in three years, you'll know what to do. And because you know where your money's going and you'll continue to track it, you'll finally be able to save up for that vacation.
Plan for Major Changes
As mentioned earlier, a budget lets you model in advance how a major purchase or life change will affect your finances. Instead of wondering if you can afford a house or panicking about whether you and your spouse can afford to live on one income while the other stays home to raise a child, you'll have the data you need to crunch the numbers. You'll find out before you make any change whether you can afford it and what sacrifices you might need to make. (For more on finances, read Get Your Finances In Order.)

Experience the Freedom of Having Money in the Bank
By helping you sock away money each month, budgeting is an important tool for achieving financial freedom. The ultimate freedom, of course, is being able to retire, but along that winding road are opportunities for many rest stops if you have money in the bank.

Those stops might include:

- having a child
- starting your own business
- going back to school
- taking an extended vacation

Budgeting makes it easier to achieve all of these goals!

Now that you know why you need a budget, let's talk about how to set one up. We even give you a downloadable spreadsheet to get started.

3) Budgeting Basics - Setting Up A Budget

Now you know why having a budget is so important. It can help you:

- Make long- and short-term projections about your financial situation.
- Avert a financial crisis.
- Get the most from your money.
- Plan for major financial changes
- Achieve peace of mind

If you've never had a budget, you may be feeling daunted by the prospect of setting one up. In this section, we'll show you how to set up a budget. We'll provide a sample budget and give you a downloadable Excel template to use if you'd rather not design your own.
First, let's discuss the various systems you could use to track your money:

- **Notebook and Pen:** This least-expensive option is within anyone's means. It doesn't require a computer or the additional software expense. You can easily carry it with you and access it at any time, and electronic failure won't cause you to lose your data. However, notebooks can be misplaced, and meticulous record keeping can be ruined by the swift tip of a nearby glass of water. Perhaps most importantly, it's easier to make mistakes by hand, and it's more difficult to track your long-term spending and savings patterns with a notebook.

- **Spreadsheet:** If you have a computer, chances are it came with Microsoft Excel. If it didn't, you can [download Open Office](http://www.openoffice.org) to get a free spreadsheet program that's compatible with Excel. If you use a spreadsheet to track your income and expenses, you're less likely to make mistakes, and you can easily do calculations like how much you spent on groceries for the entire year. In addition, a spreadsheet can keep a running total of how much money you have left to spend in a particular month that adjusts every time you enter a new expense into your spreadsheet.

- **Financial Software, such as Quicken and Microsoft Money:** The obvious drawback of these programs is that they cost money and may have to be upgraded (for a fee) every couple of years, particularly if you get a new computer with a new operating system. However, they can do much more than a spreadsheet. They keep track of your bank and investment accounts for you, for example, sparing you from logging into all those accounts. The down side is that if your computer gets stolen or hacked, you might wish so much of your personal information wasn't so readily available. (For more on investing, see [Investing 101](http://www.investopedia.com/university/budgeting/default.asp) tutorial.)

- **Online Software:** The most recent entrant to the personal financial planning game is online budgeting software. Some of these programs are free and have as many features as paid programs. Also, since they're Internet-based, you can access them from anywhere - you don't have to be on your home computer. Some people might not feel comfortable giving all their information to an online service, and no matter how well-designed it is, any online system could have weaknesses that hackers can exploit. However, if you're just using it to calculate the running balances for your savings and grocery, bills and other expenses, it might be a nice tool to have.

**Simple Steps To Using Your Budget**

Once you've chosen the system that's best for you, how do you start using it?

1. **Keep Track of Every Expense, Including the Small Ones**
It's easy to remember how much you spent on rent or your mortgage payment, but for other expenses, you'll want to save your receipts. If that drives you crazy, put all your purchases on the same debit or credit card to make record keeping easy. Keep in mind, though, that the transaction descriptions on your credit card statement aren't always crystal clear, and you may be left wondering what exactly is that $19.17 purchase. Don't forget too, that you may be charged for each transaction, and if you don't pay off your credit card on time, you'll be accruing interest as well. (For more about mortgages, see our Mortgage Basics tutorial.)

Another option is to use cash for the small expenses, but only withdraw a certain amount each week or month and enter this in your budget as "miscellaneous." While this method may prevent you from overspending, it will not give you the clearest picture of where your money is going.

2. Update Your Budget - Daily
Tracking your money this way will take minimal time, and you'll be less likely to forget something.

3. Use Accurate Descriptions
Write down your expenses by what they are rather than where you purchased them so you'll be able to figure out later how much you spend in particular categories. For example, if you shop at a big box store like Wal-Mart (NYSE:WMT) or Target (NYSE:TGT), you might make a purchase that includes groceries, clothing and household cleaning supplies. If you list the purchase under "Wal-Mart," you won't really know where that $150 went.

4. Budget by the Month, Not the Paycheck
This forces you to think slightly longer-term than your bimonthly paycheck, but not so long-term that you're likely to get derailed. Also, you'll get a fresh start every month. If you have a bad month, it's in the past after 30 days. If you have high expenses one month, you can look forward to the following month when, for example, your car insurance isn't due.

5. Plan for Both Fixed and Variable Expenses
Fixed expenses are items like rent and health insurance, and variable expenses are things like utilities and gas. Some costs, like groceries, can fall into either category depending on how much self-control you have.

6. Plan for Occasional Expenses
Budget for expenses that only happen a few times a year like gifts, car insurance and doctor visits. If you have enough room in your budget, you can pay for these as they occur. If you're on a tighter budget, set aside additional savings ahead of time. There is no excuse for going into debt because you didn't realize that Christmas happens every year or that you would need a bridesmaid dress or a tux when your best friend gets
married a year from now.

Your budget can be more or less detailed depending on your level of self-control. Can entertainment be grouped under miscellaneous, or do you tend to spend so much on movies, restaurants and concerts that this needs to be its own category?

In addition, budgeting is a little different if you have a steady income versus an irregular one. If you're paid hourly or on commission, are self-employed, work seasonally or are a student, you probably won't know how much you're going to make until the month is over. Irregular pay makes budgeting a little trickier, but it's still feasible. You will still have to cover certain expenses no matter what, and if you've been in the same line of work for awhile, you probably have a good idea of the minimum amount of money you're likely to make. Budget around that minimum and you might be pleasantly surprised at the end of the month if you make more.

**Budget Example**

Our budget spreadsheet is easily adjustable to accommodate different budgeting needs and styles.

Here's an example:

<table>
<thead>
<tr>
<th>Income</th>
<th>Fixed Expenses</th>
<th>Variable Expenses</th>
</tr>
</thead>
<tbody>
<tr>
<td>Work (after tax)</td>
<td>3000</td>
<td>Housing 1000</td>
</tr>
<tr>
<td>Investment income</td>
<td>100</td>
<td>Groceries 500</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>3100</strong></td>
<td>Gas for car 150</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Health insurance 200</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Gas bill 30</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Electric bill 70</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Internet 50</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Land line 30</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Cell phone 60</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Retirement saving 200</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Emergency saving 100</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Fun savings 50</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Other savings 25</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>2265</strong></td>
<td><strong>Total Income</strong> 3100</td>
</tr>
<tr>
<td><strong>Total Expenses</strong></td>
<td>2754</td>
<td><strong>Remaining</strong> 346</td>
</tr>
</tbody>
</table>

You can make your own, too. All you have to do is change the income and spending categories to reflect your personal situation. Then copy the sheet 11 times so you have
a worksheet for each month of the year. This makes it easy to plan in advance as well as look back on past months and see how you did.

4) Budgeting Basics - Budget Bootcamp

To plan for the short- and long-term, you'll need to have a rudimentary understanding of your finances. In this section, we'll give you the kick-start you need to begin your budget bootcamp.

Know Your After-Tax Monthly Income
Everyone knows his/her hourly wage or monthly salary, but not many people can tell you how much they take home after taxes. It's important to know this number because taxes significantly reduce your paycheck, especially if you have to pay state and/or local taxes.

The easiest way to find out how much you really make is to look at your last pay stub, but if you don't have one handy, you can calculate your take-home pay using an online calculator like the ones found at PaycheckCity.com. Or, if you want to understand the formula that the Internal Revenue Service (IRS) uses, check out the federal tax rate schedules.

A comprehensive understanding of taxes isn't necessary to keep a good budget, but if you're curious, here's how income tax works:

Let's suppose you're filing as a single person and your salary is $40,000 a year. According to the IRS 2007 federal tax rate schedules, your marginal tax rate is 25%. In this scenario, your first $7,825 is taxed at 10%, the next $24,025 is taxed at 15% and the remaining $8,150 is taxed at 25%. On top of these federal taxes, you'll also pay Social Security at a rate of 6.2% on earnings up to a certain threshold ($97,500 in 2008) and Medicare at a rate of 1.45% on all earnings, along with any state or local taxes. (For related reading, see Cut Your Tax Bill With Permanent Life Insurance.)

Ensure That Necessities Fall Within After-Tax Income
Once you know how much you really make each month, start by listing all of your necessary expenses, like rent and utilities, and making sure their total cost is less than your take-home pay. If it isn't, can you cut back somehow? Housing expenses take up the largest chunk of most people's budgets, so that's the best place to think about
reducing your expenses if you're having trouble making ends meet. If you can't reduce the cost of your necessities, it's time to figure out how to get a higher-paying job, which may involve a longer-term strategy like obtaining a vocational or college degree. (To learn more about investing in your education, read Invest In Yourself With a College Education.)

If you can, consider savings as one of your necessities. This will make you more likely to save because you'll think of it as a necessary "expense" rather than an optional one. As the saying goes, "pay yourself first." This will help keep you from running up your credit when the unexpected occurs, and it can help you achieve your life goals faster.

Some Required Expenses Don't Occur Monthly
Costs like car insurance and visits to the doctor may not be monthly charges for you, but rather expenses you pay only once or twice a year. Nonetheless, you have to pay them, so don't forget to factor them into your necessities. One way to do this is to make a list of all your expenses that only occur a few times a year, add up their total cost, divide it by 12, and add the result to your required monthly savings. This will ensure that you have enough cash on hand to pay these bills when they are due.

Check Your Breathing Room
Hopefully, you still have some money left over after meeting your basic necessities. Make sure you know what this amount is so you won't exceed it. If you're not satisfied with how much fun money you have, use the ideas in the last section to increase your cash flow. Since not having as much fun money as you'd like isn't as dire of a situation as not being able to pay for food or shelter, you can consider short-term strategies to increase your income, like acquiring a temporary second job or selling some possessions you no longer use.

Some Discretionary Expenses Also Aren't Monthly Costs
Expenses like gym memberships, vacations and gifts are not actually required expenses and they may not be the same price each month. So, if you want to be able to afford them, you should again make a list of all these optional expenses that only occur a few times a year, add up their total cost, divide that sum by 12 and add the result to your optional monthly savings. This way, you won't be tempted to go into debt or have to skip out on these items.

Calculate Long-Term Costs for Necessities and Discretionary Spending
To determine whether your spending in a certain category is really worth it to you, think of it in terms of yearly rather than monthly cost. Maybe $1,700 a month for a luxury apartment seems like an acceptable price, but how about $20,400 a year? And that's after tax. If that luxury apartment is in Chicago, for example, the first $25,000 you earn will just cover your housing costs because the combined federal and state taxes in Illinois require you to earn $25,000 to take home $20,000. If that expense is worth it to you and you can afford it, there's nothing wrong with it, but sometimes looking at the big
picture makes spending seem less pleasant.

Now let's move on to part 5, where we'll share some tips for managing and staying within your budget.

**5) Budgeting Basics - Budgeting Tips**

When you're getting used to budgeting for the first time, it's helpful to know how to manage and stay within your budget.

- First and most importantly, allow yourself to be flexible. If you want to spend more on groceries one month because you're having a party or craving something gourmet, there's nothing wrong with that. Just spend less in another area to compensate. Don't expect to always stick within the amounts that you set for yourself as guidelines when you first created your budget.

- Next, make sure to leave room in your budget for some fun things. Maybe your budget is so tight that the most fun you can afford are the ingredients to make some chocolate chip cookies, but at least allow yourself that. Or maybe you're in a better situation financially and the choice is between saving 12% for retirement one month or buying a concert ticket and still saving 10%. You should reward yourself. For most people, lifestyle tends to inflate when income goes up. This isn't inherently a bad thing as long as you are still meeting your financial goals and obligations. After all, if you reward yourself the same way on a $7.50 an hour wage or a $75,000 a year salary, where's the incentive to work harder? If you don't reward yourself, it will be emotionally difficult to stick to your budget in the long run.

- Always make sure, however, to keep spending below your income. Special events like Christmas should also fit into your income. Rather than pile the gift purchases onto your credit card in December, buy gifts throughout the year or save a little each month to make the holiday affordable. (To learn how to budget for the holidays, read *Keep Holiday Debt From Snowballing*.)

- Don't go into debt for things that are not long-term investments (long-term investments being a house or an education that you can reasonably afford). Consumer debt will strike a major blow to your finances. When you finance a car, for example, not only does the asset depreciate every year, cost money to maintain and eventually become obsolete, you're also losing money on interest every month. (For more insight on consumer debt, see *Digging Out of Personal Debt*.)

- If you don't have enough cash on hand every month no matter what, or if you tend to spend money you know you should be saving, consider adjusting your
withholding. To do this, you'll need to fill out a new W-4 form and give it to your employer. If you want, you can even download and print the form yourself from the IRS website.

One reason you have taxes withheld from each paycheck is that if you haven't paid at least 90% of your tax liability by the end of the year, you'll have to pay a penalty. The W-4 instructions are designed to get you in above this threshold. However, if you normally have little or no tax liability in April, you may be able to claim fewer allowances and get more of your pay monthly instead of waiting for a refund in April.

- Conversely, if you have more than enough money to meet your monthly obligations, but any extra money tends to burn a hole in your pocket, you can increase your allowances, essentially allowing the government to save your money for you. Then, you'll get a bigger refund in April. You can even have the IRS deposit your refund directly into the account of your choice, like a savings account, eliminating all temptation for you to spend it.

- Likewise, if your employer offers direct deposit, you may be able to deposit a portion of your paycheck directly into a savings account. If you already have sufficient cash reserves, you could also improve your savings rate by increasing the amount of your paycheck that goes directly into your retirement account. Again, these options will put a portion of your money automatically out of sight and out of mind.

**Additional Tips**

- **Rent:** You don't have to wait until the first of the month to pay your rent. If you comfortably have the money in your account earlier and think you might spend it, just send in your check early.

- **Mortgage:** If you're a homeowner, making an extra payment toward your principal when you can afford it will shorten the life of your loan and the amount of interest you'll ultimately pay. This tactic may not be terribly rewarding in the short-term, but you'll thank yourself for it down the road.

- **Utilities:** Switching to compact fluorescent bulbs, especially in the lights you use most, will dramatically reduce the lighting component of your electric bill. Keeping your thermostat slightly lower in the winter and slightly higher in the summer than what you'd optimally like will reduce your heating and cooling costs, and you'll probably get used to it after a few days. Using ceiling fans and wearing more or less clothing are a lot less expensive than using more energy.
- **Clothing:** The deepest discounts are generally available at end-of-season sales. The rest of the time, you can save money by getting a store credit card that offers cash back rewards or coupons (make sure to pay off the card in full and on time every month or you won't come out ahead), signing up for store email lists to get special coupons, and buying gift cards at a discount on eBay (Nasdaq: EBAY).

- **Groceries:** Many of us have stockpiles of food in the freezer and pantry that we've seen so many times, we've forgotten they're there. Determine how to incorporate these items into your meals and you'll get a break on the cost of groceries while you clean out your closet.

- **Transportation:** Plan errands so that you don't make multiple trips. Go to the grocery store on the way home from work, or do all your errands for the week on Saturday morning. As an added bonus, you'll save time in addition to money and gas.

Now you have lots of ideas for how to stick to your budget. In part 6, we'll discuss how to use your budget as a tool to achieve your goals.

### 6) Budgeting Basics - Goal Setting

An important part of effective budgeting is setting goals and using your budget to help you achieve them. Your goal might be as simple as saving up enough money for tickets to a basketball game or as lofty as retiring by 50. Or it might be both! Budgeting makes it easy to establish both short- and long-term goals and track your progress toward them.

The following are some ideas for how to use your budget to help you meet your goals:

**Get Beyond the Next-Paycheck Mindset**

When you're always thinking about the arrival of your next paycheck, that probably means you're burning up your current paycheck and spending the next one (whether by mentally accounting for where it will all go or by putting purchases on credit cards) before you even get it. If this situation describes you, it's likely that you're living beyond your means. Since no job is truly guaranteed, and thus neither is your next paycheck, making it a goal to fit your expenses into your current income is an important one. This way, even if you lose your job tomorrow, at worst you'll be starting at zero - you won't already be in a hole.

**Substitute for the Short-Term**

For a short-term goal, such as being able to afford tickets to a basketball game next month, you may simply be able to substitute one expenditure for another. If you normally go out to eat, maybe you can trade a meal for a game. If your budget is tighter than that, you may have to take a more drastic measure like cutting your grocery bill by...
eating lots of pasta- and rice-based dishes and cutting back on more expensive items like meat and cheese.

Calculate Your Long-Term Needs
For a long-term goal, such as retiring by a certain age, find an online retirement calculator that allows you to enter variables, such as your age, amount currently saved, expected rate of return on your investment and age you want to retire by to find out how much you need to save per month to reach your goal. Note that online calculators can produce varied results, so it's best to try several and get a general sense for the amount you need to save. Then, start considering this savings amount as a non-negotiable monthly "expense" and adjust your other spending as needed to make room for the new amount. (For more, see Unexpected Bumps That Can Derail Retirement.)

Start a Rainy Day Fund
To make sure that unforeseen expenses don't cause your goals to careen off track, build up some cash reserves. Three to six months' worth of expenses is a good cushion. This will help protect you from a sudden loss of income, an unexpected car repair bill or the like. (Have a better budget now, read Six Months To A Better Budget and Build Yourself An Emergency Fund.)

Save for Fun Things, Too
If all your savings are going toward dreary activities like paying off debt and saving for unexpected car repairs and medical bills, your only incentive to save might be the fear of what will happen if you don't. Fear is a great motivator, but it's not very fun. So even if you're in debt up to your eyeballs and are committed to getting out as quickly as possible, it's a good idea to plan some rewards into your savings program. You may think that a $750 vacation is setting you back, but consider what would happen if you didn’t take that vacation. You might go on a spending binge one day to compensate for how deprived you've been feeling under an avalanche of bills, and not only might it cost more than the vacation would have, but you won't get the several days of relaxation that a vacation could have brought. (For related reading, see Enjoy Life Now and Still Save For Later.)

Pay Off High-Interest Debt
Any debt that costs more than you can earn from your investments after taxes should be paid off as quickly as possible. As a general rule, the only low-interest debt is student loans and mortgage debt. This is considered "good debt" since your money can earn more for you if you invest it than what you’d save by paying off the loan. If your mortgage interest rate is 6%, your credit card rate is 20% and your investment return rate is 10%, pay off your credit card first, then invest anything remaining.

Save Automatically
Use automatic withdrawals to stick to your savings goals. By having money automatically deducted from your paycheck and invested in your company’s 401(k) or
403(b) plan, or by setting up your own automatic monthly transfer from checking to savings, your money will be out of sight and out of mind. For long-term savings, put the money somewhere illiquid, like a 401(k), so you won't be tempted to steal from your future self.

For short-term savings, you'll need to keep the money accessible, but don't make it too accessible. For example, if your checking and savings accounts are at the same bank, it's all too easy to rapidly transfer money from your savings into your checking account. If you have these accounts at two different institutions, the transfer will take time, and that time delay may be enough to cause you to rethink your decision if you're trying to spend your savings on something you shouldn't.

**Reduce Spending in a Particular Category**
Remember how we said that budgeting isn't about deprivation, it's about putting your money to its highest and best purpose? One of your new budgeting goals might be to reduce your spending in a particular category, now that you know where your money is going, so you can put that money toward something that is a higher priority for you.

**7) Budgeting Basics - Mistakes To Avoid**

Everyone makes financial mistakes from time to time - that's just part of life. However, knowing about common mistakes beforehand can reduce your odds of making them. Let's take a look at some of these common budgeting mistakes:

**Mistake #1 - Forgetting to Write Down Expenses**
It's impossible to stick to your budget if you don't know where your money is going. Ideally, you need to keep track of every single purchase, whether it's something small like a parking garage fee or something bigger like a new television. The best way to remember everything you buy is to update your budget each night before you go to bed while your purchases are still fresh in your head. You could also carry around a small notebook so you can jot down your purchases throughout the day as you make them, or make all your purchases with the same debit or credit card (effectively having someone else create the spending list for you).

The most simple budget-tracking tool is the cash envelope method. This involves taking several envelopes, writing the name of the budget category on the outside (like "groceries" or "fun money"), putting the amount of cash you are allowed to spend each month in them, and then making sure you don't run out of that cash before the month is over. This method will prevent you from overspending, but you won't reap the benefits of knowing exactly where your money goes unless you can remember to replace the money you take out with the receipts of each item you bought.

**Mistake #2 - Intentionally Not Writing Down Purchases**
One of the ugly truths about budgeting is that when you keep track of your expenses, it's painfully clear when you've gone off track. That's the whole point, though, and every day is a fresh chance to make better decisions. Go ahead and write it down when you've gone over your budget, because that negativity you feel will help prevent you from overspending more or doing it again. Just think of this step as damage control - don't skip writing down expenses just because they don't match up. Own up to your purchases and then move on.

Mistake #3 - Buying On Impulse
If you buy a pack of gum in the checkout lane every time you go to the grocery store and you go to the grocery store twice a week, that seemingly inconsequential purchase is costing you $8 a month, or almost $100 a year. Add a few impulse buys at a few other stores over the course of a month and no matter how inexpensive they are individually, they will add up. There's nothing wrong with buying gum, but if you notice by reviewing your budget that you're buying it at a rate of 52 packs a year, you can plan to buy your gum in bulk at a big box store for a third of the price and save money. Writing down even those minor $1 purchases every time can help you spend more wisely in the long run.

Mistake #4 - Becoming the Victim of Budget Busters
Sometimes you go out to do something or buy something expecting it to cost a certain amount of money - an amount you've budgeted for - but when you get home you've spent much more. How does this happen?

Perhaps you decide to go out with some friends on a Saturday night and you think you're just going to a bar, but once you get there the group decides to go out to eat. You're already along for the ride, so it's easier to give in to the pressure to join in on the food rather than be the odd one out. In that same scenario, after you've had a couple drinks, money may not seem like such a big deal and you may buy everyone a round against your normally better judgment. (Learn more by reading Budget Without Ditching Your Friends.)

These things happen, and you won't always be emotionally strong enough to prevent them. However, if you know that you have a tendency to buy more than just one thing when you go to the store, or if you know that your friends have a tendency to change their plans at the last minute, either avoid these activities or create a bigger budget for them ahead of time.

Mistake #5 - Being so Frugal it Makes You Miserable
Budgeting is like dieting: If you try to deprive yourself too much, you'll just binge later and throw all your hard work out the window. A spending binge can set you back far more than treating yourself occasionally, so go for the occasional minor splurge. Buy that bottle of wine or those new flowers for your yard. Let yourself take a vacation. Just keep your treats within your spending limits and you'll be fine. This may mean you're
saving $200 a month instead of $300, but it's better than saving $300 a month for six months, making yourself miserable in the process, then going out and blowing $2,500 in the seventh month.

Mistake #6 - Ignoring the Time Value of Money
Sometimes the cheapest way isn't the best way. If milk, bread and eggs are cheaper at one grocery store and chicken, butter and cereal are cheaper at another, you shouldn't go to both stores every week to get the best possible deal on each and every item. Besides, unless you have incredible self control, you'll probably be tempted to buy something at the second store that wasn't on your list, thus defeating your whole purpose.

Correcting Your Mistakes
Correcting your budget mess-ups isn't hard, it just takes a few moments to realign your thinking patterns:

- Think about your spending not only in terms of money but also in terms of time, aggravation and sanity. When you have limited time, determine where your money-saving efforts are best spent. For example, should you focus on cutting out coupons to save 30 cents at the grocery store, or would you come out further ahead by using that time to switch over to a checking account that doesn't charge a monthly maintenance fee and a low balance fee? (For more, read Understanding The Time Value Of Money.)

- Everyone will go off his or her budget occasionally no matter how much money is available. It's human nature to be imperfect. Accept it as a certainty that will happen. While it shouldn't be an excuse for poor choices, the best way to correct your mistakes is not to beat yourself up for them. Take what actions you can to correct the mistake - maybe you can return something you purchased, or make up for the extra spending by selling something you own on eBay. Maybe there's nothing you can do except vow to do better next time. Then, forgive yourself and start fresh.

- If you need help staying on track, ask someone to hold you accountable. This could be a friend, relative, significant other, spouse or even a financial advisor. Pick someone with whom you feel comfortable discussing money. This doesn't mean you have to share with them the details of how much you spend and make, but you should at least be willing to speak honestly with this person about what your goals are, what steps you are taking to achieve them and whether you are staying on track. It's important to pick someone who won't be judgmental if you slip up or set a goal they don't necessarily agree with.

Staying On Track
For some people, an independent professional, such as a financial advisor may be the
best bet for keeping you in line without picking a side. You may think you can't afford the hourly fee, but if you're routinely spending $300 a month on items you don't need, and being held accountable by a professional only costs you $100 a month, you'll still be coming out ahead. On the other hand, you don't want to go too far in the other direction and pick someone who will give you no flack whatsoever if you aren't achieving your goals. Pick someone who has been supportive in the past and wants to see you succeed.

If you can't afford a financial advisor but seek the neutrality and confidentiality of a third party, you may be able to find a local government agency or nonprofit organization that offers credit counseling, debt management or money management assistance. Though you may have to provide documentation proving that you qualify for their assistance, services designed to help the low-income or deeply indebted will most likely be free - beware of those wanting to charge you a fee.

8) Budgeting Basics - Maintaining Your Budget

A budget should evolve as your circumstances change. Don't expect the budget you made at 25 to still work for you at 35, or even 27. Your income and expenses will change over time, often annually. You might also face a financial emergency or receive a windfall, such as an inheritance. Whether you experience a major financial event or a smaller one like getting a raise, you'll want to update your budget accordingly. In this section, we'll discuss some common changes to your life and how you might want to adjust your budget as a result. (For related reading, see Bursting Boomers' Inheritance Dreams.)

1. Getting a Raise
When you get a raise, you should consciously choose how you will spend the extra money. First, keep in mind that if you get a raise of $200 a month, it won't be nearly that much after taxes. If your marginal tax rate is 25%, an extra $200 a month will leave you with $150 after taxes - less if you also pay state taxes. Just like you've done with the rest of your money, decide what the best use of your new income will be. Do you want to save it? Improve your cable lineup? Go out to eat more? If you don't decide what you want to do with the money, it might evaporate without you knowing where it went.

2. Losing Your Job
If you lose your job, you'll almost certainly need to scale back your spending.

Examine your budget to see where you can cut back. You may be able to cut out a particular category entirely, like going out to eat. Or you may be better off making smaller cuts in several categories, like decreasing your grocery bill by $20 a month. You may not be able to reduce your expenses enough to fit the reduced amount of money you have to spend, but because you've been budgeting, you should have at least some
money stashed away for emergencies. This is the time to use it if you need it.

If you haven't started to budget yet, and you've lost your job, then picking up a part-time job can go a long way towards helping cover bills as you hack and slash your spending.

One exception would be if you've been at a company so long that you receive a generous severance package with which you can maintain your same quality of living for an extended time. Barring that, a smaller severance package or state unemployment insurance can help tide you over, but neither will provide you with the kind of income or financial stability you're probably used to. (For more on severance, read Negotiating Severance Agreements.)

3. Having a Financial Emergency
Losing your job could certainly count as a financial emergency, but it's not the only one you might encounter. Your beloved 1988 Honda might suddenly sputter its last breath - or at least the last breath it's willing to take unless you want to pay for some costly replacement parts. If you don't have good public transportation where you live or a friend, relative or coworker who can take you to work, you'll need to find a new vehicle fast, and probably rent one in the meantime. Again, your emergency fund is a good place to look for the money for a new car. If you don't have an emergency fund, you'll have to find the money elsewhere in your budget. Even if you do have an emergency fund, you'll need to adjust your budget so you can replenish it over the upcoming months.

4. Making A Big Purchase
Adjusting your budget so you can afford a major purchase, like a new car or a wedding, is similar to adjusting it for when you lose your job or have a financial emergency. You'll need to find significant ways to cut back in one or more spending categories and perhaps a way to increase your income as well. The difference is that since you're cutting back for something you chose, it won't be as painful.

5. Incurring a Major New Expense
If you buy a house, have a child, send a child to college or the like, you'll need to adjust your budget permanently (for quite a few years at least). This may require you to rethink every aspect of your earning and spending. For example, is there a way you can make more money? Do you really need cable TV? Can you ditch your land line and use VoIP instead?

To prepare yourself for the change and make sure you can afford it, adjust your budget several months in advance and pretend as if you already have the new expense. This way, if you find out you can't meet all your obligations, you won't incur any real damage and you'll have time to fix things before the real expense kicks in.

6. Overhauling Your Social Life
If you go from being a homebody to party animal, your financial situation will change too. Also, if you start dating someone new, this can shift your finances for better or for worse, depending on which side of the spending equation you're on and the tastes of the person you're dating.

7. Changing Your Habits
Any time you change your habits, you will see a corresponding change in your finances - sometimes giving you more money, and sometimes less. Sometimes being a healthier person doesn't equate to healthier finances though. For example, if you decide to trade in your steady diet of pizza and cheeseburgers for one that includes foods like fish and fresh produce, you may see your grocery bill increase. If starting a new exercise routine is also part of this lifestyle change, you may need to factor a gym membership into your monthly budget, or at least a new pair of tennis shoes. But if you rid yourself of a habit like smoking, not only will you immediately reduce the unhealthy pull on your budget, you'll also reduce the unhealthy pull on your cardiovascular system.

8. Getting Rid of a Major Expense
If you've finally finished putting all your children through college and they've all moved out and acquired jobs, not only will you no longer have tuition expenses, you'll be free of paying for someone else's food, clothing and other costs. Paying off your mortgage is another time in your life when your expenses will significantly decrease. What will you do with all this extra money? Your budget's goals can guide you. Maybe you'd like to work less and enjoy life more, take a major vacation or ramp up your retirement savings.

As you can see, multiple factors can change your financial situation from month to month and year to year. It's important to be flexible and adjust your budget to reflect these changes so that you'll be able to continue making the best possible use of your money.

9) Budgeting Basics - Conclusion

Budgeting is an important component of financial success and one that's not difficult to implement. Let's recap what we've learned in this tutorial:

- Budgeting isn't just for poor people or for times when money is tight or your life is undergoing a major transition. Budgeting is for everyone because it makes it easier to achieve financial goals of all shapes and sizes, whether that goal is to stay out of debt next month or to pay cash for a sports car.

- Budgeting allows you to make long- and short-term projections about your financial situation, prevent crises, get the most out of your money, plan for major life changes and enjoy peace of mind.
• Budgeting systems - ranging from a simple notepad and pen to online financial management software - are available for all needs and preferences.

• Budgeting monthly, rather than by the paycheck, can help you learn to take a longer-term view of your finances. (For related reading, see The Beauty of Budgeting.)

• Keep track of all your expenses, not just the big ones. Those daily lattes can add up!

• Getting a basic sense of your financial picture is an important component of budgeting. Make sure you know how much you make after taxes and how your required and optional expenses fit into that picture.

• Being flexible with your budget categories and allowing yourself affordable rewards will prevent budgeting from being a drag and help you stick with it.

• A well-maintained budget can help you meet short-term goals, like saving for a vacation, as well as long-term goals, like saving for retirement.

• Avoid budgeting mistakes like being so frugal it makes you miserable or ignoring the time value of money. Since you've already learned about these and other common budgeting mistakes and how to correct them, you probably won't make them. If you do mess up, remember that you're only human. Forgive yourself, correct the mistake if possible and vow to do better going forward. (For more, read Get Your Budget In Fighting Shape.)

• A budget should evolve as your circumstances change. Don't expect the budget you made at 25 to still work for you at 35 or even 27. Your income and expenses will change over time, often annually. For example, if you get a raise, you'll want to adjust your budget to reflect how you want to spend or save the extra money.

As long as you're spending within your means each month, a budget is a great tool for helping you sleep soundly at night. You know where your money's going, you know that you're on track to meet your financial goals and you know that you've planned to weather the storms that will arise from time to time. If your spending is too high for your income, a budget serves as a pesky but necessary reminder that you need to change things - and the sooner you listen to those irksome numbers, the better off you'll be. Living paycheck to paycheck only works temporarily - sooner or later you will have an expense you can't meet or a goal you can't achieve if you don't learn how to budget.