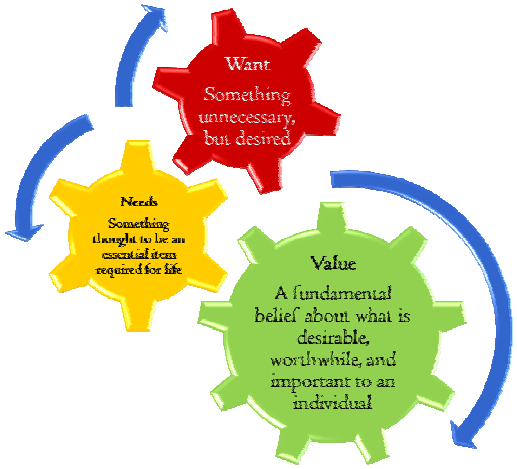
Spending Plans

Family Economics & Financial Education

Financial Planning

Daily, individuals make decisions which influence their financial future. Consider the daily purchase of an item such as a latte. When making the purchase, $3.50 may not seem to be significant. Does the purchase seem more significant when considering it adds up to be $1,260 per year or that it could be $6,838.57 in 25 years if saved in an account earning 7% interest? What if the individual also has aspirations to purchase a new car, attend college, or dreams of traveling to exotic places? The $6,838.57 becomes extremely valuable to helping individuals achieve those aspirations. In the daily act of managing money, individuals are always making tradeoffs. By acquiring one item, the individual will not be able to have the other. **Financial planning** is a process individuals engage in to achieve long-term financial success while having a quality standard of daily living. Within the process, an essential financial management tool is a spending plan. A **spending plan** is a paper or electronic document used to record both planned and actual income through expenditures over a period of time.[1]

Each individual and family has a unique spending plan because the decisions made are based upon their unique values, needs, and wants. A **value** is a fundamental belief or practice about what is desirable, worthwhile, and important to an individual. Values can be influenced by family, friends, teachers, religious affiliations, work/career, media, and law. They guide an individual's choice about their needs and wants. A **need** is something thought to be a necessity or essential item required for life. Examples include food, water, and shelter. A **want** is something unnecessary, but desired, or an item which increases the quality of living. Examples include MP3 players, DVD players, and the newest game system.



A SMART financial goal includes the following components:

- ***Specific:*** State exactly what is to be done with the money involved.
- ***Measurable:*** Write the exact dollar amount.
- ***Attainable:*** Determine how it can be reached.
- ***Realistic:*** Do not set the goal for something unattainable or unrealistic. This involves reviewing a spending plan to ensure the amount allocated can be saved.
- ***Time Bound:*** Specifically state when the goal needs to be reached.

Setting Financial Goals

Financial goals are the foundation of a financial plan. A **goal** is defined as the end result of something a person intends to acquire, achieve, do, reach, or accomplish in the near or distant future. **Financial goals** are specific objectives to be accomplished through financial planning. Both short-term and long-term financial goals are necessary components of an effective financial plan. Goals help individuals to consider their current financial situation compared to where they want to be in the future. They are influenced by a person's values, needs, and wants. **Short-term goals** are less than one year. **Long-term goals** are more than one year.

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Setting Financial Goals

At any time, an individual may have several financial goals and the amount required to achieve each goal may be more than an individual can allocate in their spending plan. Therefore, the process of setting financial goals involves setting priorities and continually examining if the goals are being achieved. In financial management, goals help a person to consider the tradeoffs they are making with each decision. A spending plan then becomes the essential tool to ensuring money is allocated to achieve each goal.

Examples of SMART Goals:

- Short-term goal: I plan to save $10.00 from my monthly paycheck for eight months to purchase a new pair of $80 running shoes for track season.
- Long-term goal is: I plan to save $25.00 from each bi-monthly paycheck for two years to have $1,200 towards a down payment for a used car when I turn 18 years old.

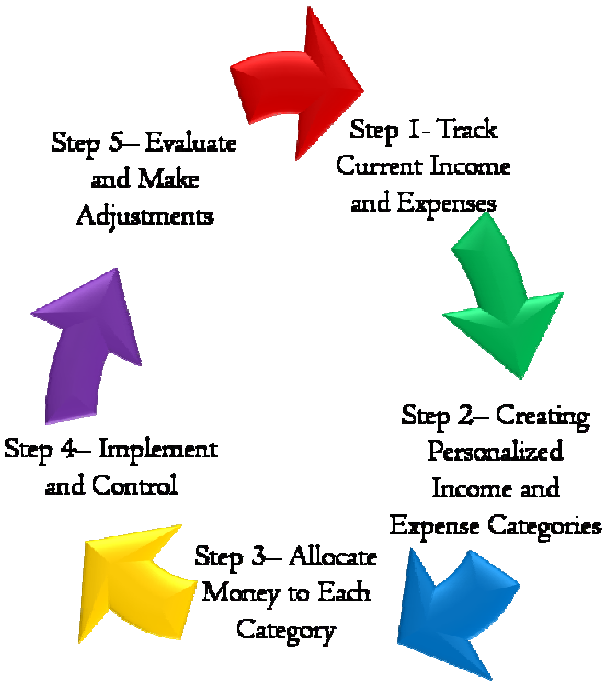
What is a Spending Plan?

A spending plan is comprised of three sections; income, expense, and net gain or loss. **Income** is money earned, and **expense** is money spent. There are two types of expenses; fixed and flexible. **Fixed expenses** often have a fixed amount due each month, are contractual, and not easy to reduce or eliminate. Examples include rent, cell phone bills, and car payments. **Flexible expenses** can vary each month in the amount owed, are not contractual, and do not have to be paid by a certain date making it easy to reduce or eliminate the expense. Examples are food, clothing, and entertainment.

Developing a Spending

Step One–Track Current Income and Expenses

To create a spending plan, individuals first begin by making estimates of how much money they will earn and expenses they will have during a specific period of time. This time period is often concurrent with payday. For most, this is bi-monthly or monthly income. It is essential that the estimates an individual makes are as accurate as possible for the spending plan to be realistic and effective. If an individual is unsure about how much they are spending, they should track their daily expenses for a few weeks. This can be done by carrying a small notebook and writing down each expense as it occurs or keeping receipts.



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Step Two–Creating Personalized Income and Expense Categories

Every individual and families unique values will influence their spending decisions. Therefore, effective spending plans are those which are personalized. This includes selecting spending plan categories based upon sources of income and typical expenses. Income categories may include salary, interest, loans/scholarships, and savings withdrawals. There are several expense categories most households have. Most expenses are taken out of an individual's **net income**. An individual's net income is considered take home pay. Taxes however are taken out of gross income. **Gross income** is the total amount of money earned during a pay period before payroll deductions. Taxes are one of the largest expenditures that an employee has taken out of their paycheck.

Taxes: Required citizen charges by local, state and federal governments used to provide public goods and services.

Housing: The largest of the four major expenditures.

Transportation: Part of everyday life and the second most expensive major expenditure.

Food: The third most expensive major expenditure.

Savings: A portion of income should be saved each month to build an individual's wealth and create financial security.

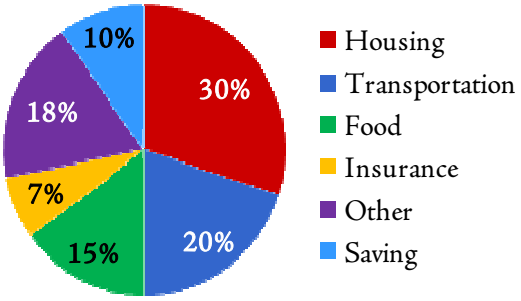
Insurance: Therefore, insurance is the foundation for every individual and families spending plan.

Other: Individuals have many other expenses that fulfill needs and wants as a part of daily living and area a major part of a spending plan.

Step Three–Allocate Money to Each Category

After tracking spending and determining categories reflective of an individuals earning and spending practices, individuals are ready to create their plan for how much to allocate for each category. This becomes the individuals spending plan identifying how they will earn and spend their money during the specified time period based upon their values, needs, and wants. Several programs are available to help individuals create a spending plan including using paper and pencil, Microsoft Word and Excel templates, and online templates. The income and expense sections of the spending plan should be totaled. Then, evaluate if they have a **net gain** or **net loss** which is the amount of money remaining after subtracting expenses from income. If a person has a net gain that indicates that there is remaining money to either save, spend, or invest. If a person has a net loss then they are spending more money than he/she is earning and has to use credit (borrowed money) to meet their financial obligations. The spending plan must be adjusted to ensure that income and expenses are equal (reach zero).

On average, households allocate their expenses into the following categories:



Step Four–Implement and Control

At this step consumers are ready to put their plan into action. Control systems are ways to assure that the tracking of expenses are done in an accurate way. Control systems are used to help track income and expenses. Continually monitoring spending allows and individual to know if they are spending too much in a category and must make adjustments to avoid using credit.

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Step Four–Implement and Control

There are several different ways to monitor spending and an individual must choose which works best for their personality. Examples include:

Envelope system – Individuals place the actual budget amount of cash from a paycheck into the specific envelope labeled for the expense. Each time money is taken out, the amount should be written down on the envelope. Another way to track this is to place receipts inside the envelope. This will help an individual to evaluate their spending plan at the end of each month. A consumer should be aware that if they choose to use the envelope system and a theft occurs there is no reimbursement for lost cash such as what is offered by a credit card for unauthorized charges.

Check register system – This helps consumers to track all expenditures in a checkbook register which has been divided into spending plan categories.

Electronic Spending Plan Systems – multiple types of software are available for consumers to use to help keep track of their financial records. Excel spread sheets with formulas are available to help consumers calculate the costs of expenses and income. Additional programs are available for purchase that can be used online or downloaded onto a computer to aid in setting up financial plans.

Step Five-Evaluate and Make Adjustments

This is the step where the consumers can evaluate the previous steps to determine if their financial plan is working. This is determined by assessing if goals have been met, the allocations in each category are accurate, money is being saved, and credit is not being used. If any of these criteria are not being met, it is time to adjust the spending plan!

Net Worth Statement

A spending plan is a tool for daily cash management. An effectively managed spending plan allows an individual to not have credit and begin creating wealth for long-term security. **Wealth** is defined as having a large amount of money or valuable possessions. Wealth is the most important predictor of an individual's overall financial security identifying the standard of living a person will be able to have during retirement. Wealth is measured with a net worth statement. A **net worth statement** describes an individual or families financial condition on a specified date. There are multiple components including:

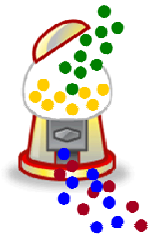
Assets – Everything a person owns with monetary value. **-** **Liabilities** – Debts or what is owed to others. **=** **Net worth** – The amount of money left when liabilities are subtracted from assets.

The financial plan process is on going. Plans will change depending on an individual or family's financial situation. If consumers continue to monitor, change, and evaluate their plan set into place they will be financially successful.

Gumball Analogy

Always have more money coming in than out to achieve your financial goals!

- Income (money in)
- Net worth (wealth)
- Flexible Expenses (money out)
- Fixed Expenses (money out)



1. Garman, T., & Forge, R. (2003). Personal Finance. 7th edition. New York: Houghton Mifflin Company.

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