Introduction to Cash Flow, Budgeting and Debt Management

The topics of cash flow, budgeting, and debt management form the foundation of the financial planning process. Regardless of how strong other portions of your financial plans are, they are liable to crumble if they are not built upon a solid foundation. Since these topics are the most immediate and generally "hit closest to home", planning for them tends to be postponed or abandoned altogether. But, with a little bit of time and effort, you can take control of your finances and start building your plans for the future on a solid foundation.

Cash Flow and Budgeting

If you are one of those who has put off assessing your cash flow and implementing a budget, you can take some comfort in the fact that you are not alone. In a 2013 Gallup survey, only 32% of Americans said that they prepare a detailed household budget! If you are one of the more than 2/3 of Americans who aren't preparing a budget for their household expenses, the good news is that you can start taking action today!

The first step for you to take is to outline your financial goals. It will be less difficult to chart a course if you at least have an idea of where you want to go. If you share your finances with loved ones like your spouse, partner or children, it's essential that all of you establish goals together. After you have decided what your goals are, you can then categorize each goal as their time frame:

- Short-term (those planned within the next 2 years) – car, vacation, less debt
- Medium-term (those planned anywhere from 2 to 7 years from now) – house, large vacation, marriage
- Long-term (those planned for longer than 7 years from now) – education, vacation home, comfortable retirement

Once you have listed and categorized your financial goals, you should then prioritize them in order of importance so that you can concentrate your savings to those that are most important to you and your family.

Once you have outlined your financial goals, you can determine your cash flow as the information from that will be used to build your own budget. Cash flow simply is how much of your income is left after subtracting your expenses and can be expressed with the following equation:

Cash Flow = Income – Expenses

The goal of understanding your cash flow is to know exactly what is coming in and what is going out, which brings us to your first **Action Step:**

Record all of your income and expenses for 3-6 months

Since you will initially be looking at your income and spending on a monthly basis, it is important to remember to include not just monthly income and expenses, but also items that only occur once or twice per year such as an annual bonus, car insurance, and homeowner's insurance. These items can be converted into monthly amounts to be included in your monthly income and spending amounts.

It is important to point out that there is no right way to track your expenses. Some options include:

- The Notebook Method – write down your income and expenses in a notebook
- Spreadsheet Program – Microsoft Excel, Apple Numbers, Google Sheets
- Personal Finance Software – Mint.com, Quicken
- Mobile App – Mint.com, Level Money

The important point is that you find a method that is comfortable for you!

Once you have recorded all of your income and expenses, you can create a monthly cash flow statement and see if your cash flow is positive (there's money left over) or negative (going into debt or tapping savings). This brings us to your next **Action Step:**

Take a fresh look at your spending

- Who is doing the spending?
- What are they buying?
- How much is necessary (need it) and how much discretionary (want it)?
- How much is fixed from month to month and how much is variable or changes?
- How does my/our spending reflect my/our financial goals?

Once you've reviewed your spending, you can take what you learned from analyzing your cash flow and spending to create a budget to reflect your financial goals.

So, what is a budget?

- A blueprint for your spending
- A tool to align your spending with your financial goals
- A way to keep your spending within your means

Action Step – Build your budget!

- Place previously tracked figures into categories
- Calculate a monthly and annual average for each category
- Plan future spending in each category to reflect your needs, values, and goals
- Remember to account for irregular income and expenses

When crafting your budget, be sure to include a plan to fund an emergency fund that has at least 3-6 months of expenses. This will help cushion your budget against unexpected expenses or loss of income without going into debt, which is a nice segue into our next topic.

Debt Management

According to the Federal Reserve's July 2015 report on consumer credit, Americans are still holding near record amounts of debt with the average indebted household having a credit card debt of about $16,600! Carrying too much debt can have a number of adverse consequences such as living paycheck to paycheck, stress, and reduced access to credit. Using some simple debt management techniques can help you pay down your debt and/or keep it off.

People can get into too much debt for many reasons – medical expenses, divorce, unexpected decrease in income, or not following a budget, among others. Regardless of why you have gotten in to debt, the important part is that you understand it so that you do not repeat it. The first thing anyone must do to manage their debt is to stop adding more.

Once you have stopped adding to your debt, you can start working on eliminating it. You should already know what your monthly debt payments are from tracking your cash flow and you will also know how much money there is left over at the end of the month to add to your debt repayments. The only missing pieces will be your next **Action Step:**

Obtain your debt balances and interest rates

Once you have this information, you can develop a plan to pay down your debt. There are three main approaches you can use:

- **Financial Approach**
    - Pay highest interest rate debt first
    - Lowers overall interest paid
- **Psychological Approach**
    - Pay down lowest balance first
    - Feeling of accomplishment as debts disappear
- **Cash Flow Approach**
    - Pay off the debt with the highest monthly payment
    - Improves your cash flow most quickly

Whichever approach you choose, the important part is that you are taking the first steps toward taking control of your finances and securing your financial future! Remember that you don't have to handle these issues alone! *The EY Financial Planner Line®* **(**1.877.927.1047) is here to help so call today!

For more resources, log into the *Ernst & Young Financial Planning Center®* at: https://pbucc.eyfpc.com.

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