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Learning Objectives

- Identify the steps necessary to create a personal budget

Even though you may be persuaded by the downsides of budgeting and think, “It’s not for me!” don’t give up until you’ve tried it. Tracking one’s income and spending is a good exercise for anyone, and if you follow the basic process, below, it’s easier than you think.

Stage 1: Determine Goals

The first strategy to create a successful budget is to determine **why** you are doing a budget. Setting goals will give you motivation to stay focused and on budget: something “real” to look forward to or achieve.

Try to set both short-term and long-term goals.

- **Short term goals** should be things you want to do within 6 months to 1 year, such as paying off a credit card or saving for your emergency fund
- **Long term goals** should be things you want to do two or more years down the line, such as paying off college loans or buying a car

If you find the thought of making a budget too dreary to contemplate, start with your dreams, instead. Sit down with a pen and paper and list out all your hopes for what you want to do in your life. Consider how the stress of financing these dreams will affect you in the short-term and long-term. Be understanding of yourself, but also be realistic by asking, “Will you be able to do the things you listed at the rate you are going?”

Stage 2: Define Categories

Making categories helps make the budgeting process easier and quicker. Create a category for each of the areas you spend money or save money by grouping like items. Tracking fewer categories makes it easier to budget overall.

Make a list of all the things you *spend money on* and *save money for*. Once you have your list try to group items together.

Potential categories might include:

- Car: gasoline, oil changes, cleaning, upkeep
- Entertainment: dates, parties, activities, Netflix or other streaming service subscriptions. Anything fun generally ends up in this area
- Food: groceries, dining hall, coffee shops, restaurants, and bars
- Household: food, cleaning supplies, personal care, over the counter medicine, and small appliances
- Housing: rent or dorm costs
- Gifts: gifts for birthdays, Christmas, showers, weddings, Father's Day etc.
- Clothing: clothing, shoes and accessories
- Insurance: auto, rental, health, etc.
- Savings: any money going to savings for specific reasons or a general emergency fund
- Utilities: cell phone, Internet, cable, electric, gas, water, trash, etc.

Stage 3: Schedule Adjustments

Getting a budget up and running often works well for a month or two, and then encounters mysterious problems. Spending may balance out well initially, but then grow harder to predict or control.

A key secret: **budgets need attention and adjustment every month.**

You'll have the same expenses every month, but they won't always be for the same amounts. Therefore, your categories of spending will stay the same, but you'll make adjustments to the *amount* you budget every month.

For example, if your significant other's birthday is coming up, you'll need to consider what you're planning to do or buy for that event, and how that affects other spending for the month.

Each month, consider:

- What events or activities do I have coming up?
- Am I going to be driving more or less?
- What holidays are coming up, and what do I need to do to prepare?
- Is anyone going to be helping me pay for some categories this month?

If a category of your budget needs to **increase** its spending, then another area will need to **decrease** its budget for that month.

Stage 4: Consider Expenses that Don't Happen Each Month

Another challenging area for budgeting concerns things you know you'll have to pay for, but infrequently or not on a set schedule. Such items include:

- taxes
- insurance premiums
- clothing
- vacation
- healthcare

You don't want April to roll around and suddenly have to come up with a big amount of money to pay your taxes.

To prepare ahead of time, start setting money aside every month in a savings account. This will become a new category for your spending. You can divide things like insurance premiums into monthly chunks and sock that away ahead of time, in order to have enough for the lump payment when it comes due. Add an additional amount for less-predictable spending. That way, if you encounter a big sale at your favorite store, then you can stock up and not wreak havoc on your budget. It will take several months to get a cushion, so take that into account now.

It doesn't matter what precise system you use. You just need to have a plan for these expenses.

Stage 5: Unexpected Expenses

The hardest part of budgeting for most people is *unexpected expenses*. These may be unexpected, and sometimes unpleasant, but you **can** still plan for them.

Types of unexpected expenses include

- auto repairs
- home repairs
- veterinarian expenses
- medical bills (like co-pays and prescriptions)

If you have a car, plan to have it repaired. The unknowns are when that will be and how much it will cost. To prepare, set money aside ahead of time. You may think, "Easier said than done!" But putting aside as much as possible (and as realistic) will reduce your debt as well as lower

your stress level!

Two ways you can set money aside:

- Set a lump sum of money aside (the easiest way)
- Set up categories for these expenses (like you did for your monthly expenses). This is more time-consuming but you can track exactly where your money is going.

Note – This is **separate** from your emergency fund. Most financial experts recommend that you have 3-6 months' worth of income in savings for emergencies. **Unexpected expenses are not emergencies.** Emergency funds should be untouched and on-hand for dire situations like losing a long-term job or encountering a major medical issue.

How much money should you set aside?

The best way to figure how much to budget for unexpected expenses is to list all the unplanned expenses you had last year, plus ones you can predict are coming soon. For example, you might predict that if you have a dog, he will have to visit the veterinarian at least 2 times a year for unexpected reasons.

- Make a list of all unexpected expenses
- Estimate how much money you should have set aside for the year
- Take your total and divide by 12 and set this much aside each month

It might take you a while to get enough money set aside. Keep working at this, and don't give up if you don't always meet this target each month.

The Envelope Method

Still not convinced that making and following a budget is doable? The following video describes a budgeting technique that's very easy and straightforward to follow: the "Envelope Budget." Simply placing cash in labeled envelopes (one for each category or purpose) each month can be a very effective means of building healthy spending habits.



[Video Link](#)

You can view the [transcript for “Cash Budgeting Using the Envelope System | CASH ENVELOPES | Young Finances”](#) here (opens in new window).

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