Budget building blocks

Firming up your financial foundation

A budget is like a diet: It's not a question of whether you have one, but how you manage it. And like dieting, effective budgeting helps you feel better and live better — though, yes, there may be some belt-tightening in the early stages.

It can be stressful if you don't have a clear picture of the income and expenses flowing through your wallet and household. In a sense, you may be managed by your money, rather than the other way around.

Budgeting turns the tables, giving you clarity on the type, tally and timing of your income and expenses. By being conscious and in control of your cash flow, you'll be able to make the most of your money today, and look forward to a stable financial future.

Benefits of budgeting

Beyond relieving stress, which is one of the first positive effects you'll notice, there are many benefits ahead as you embark on this journey:

- Keeping your total expenses within your available income
- Understanding the places and proportions of where your spending goes
- Meeting due dates for bills, so that you can avoid costly interest charges and penalties
- Avoiding panic when large, unanticipated expenses arise, by adopting simple routines to create reserves
- Priming yourself to adjust spending habits, as necessary, if you need to bring things back in alignment
- Allowing you to spend confidently in the present, save painlessly for the future, and ultimately meet your lifetime financial goals comfortably along the way

If you're new to budgeting, this may sound both inviting and intimidating. To ease into it, we'll begin with some guiding principles and simple tax concepts, followed by a look at typical budget categories for a Canadian household, then outline a practical process for you to get started on your own monthly budget.

The evolution of money, and money-minding

The phrase 'cold hard cash' is a reminder that, historically, money has been something tangible. And almost as long as it has existed, money has been loaned and borrowed between creditors and debtors. Over the last century, we've witnessed the rise of credit cards, debit cards, electronic banking and now digital currencies. All of these have made money more accessible. At the same time, these modern conveniences compel us to adapt how we manage this valuable, but limited, resource.

Like money itself, budgeting was at one time mostly manual, using pencil, paper and perhaps the physical separation of dollars into envelopes. And while the tools have progressed — from the earliest calculators and electronic spreadsheets, to dedicated websites and now mobile apps — budgeting remains a very personal exercise, with the goal being to find a routine that works, that you understand, and that you can maintain.

Whatever your current knowledge, personal style, and chosen technology, the purpose here is to give you the motivation to get started and the confidence to succeed. As with any new routine, especially one that may be a change in direction and intended to be a long-term commitment, the first step can be daunting. Rest assured that once you are underway, you can make changes catered to your financial resources, your planning skills, and the way you live your life.

After-tax income = spendable cash

While you may think of your income as an hourly rate or annual salary, that's not what you can spend. What matters for budgeting is the net amount in your hands *after tax*.

If you are paid a consistent salary, you can use your paycheque to estimate your monthly spendable income. That's obvious if you are paid monthly or semi-monthly. If you are paid bi-weekly or weekly, multiply by two or four to get a rough figure to start with, though technically there are 4.3 weeks in a month on average.

You may have to take a different approach if your income varies due to commissions or part-time hours, or if you have non-employment sources like support payments, rental income, or investment income. If that's you, take a look at your Notice of Assessment from last year's income tax return to see your total income and taxes paid. Take the difference between these two figures and divide by 12 to estimate your monthly spendable cash.

Bear in mind that we're using informed estimates to create the budget, fully expecting to make small adjustments every few months. In particular, if your annual income is above the maximum level for premiums on Employment Insurance and Canada Pension Plan (respectively $61,500 and $66,600 in 2023), at some point in the year you'll see a bump in your net payroll deposit. That will be one of the happier opportunities for adjustment.

Does monthly or weekly fit you best?

We're illustrating monthly budgeting, which works well if your priority is your recurring monthly bills, like utilities and car insurance. This makes for straightforward math, allowing you to set aside the exact amount (or half of it) from each paycheque when you are paid monthly or semi-monthly, for example on the 1st and 15th.

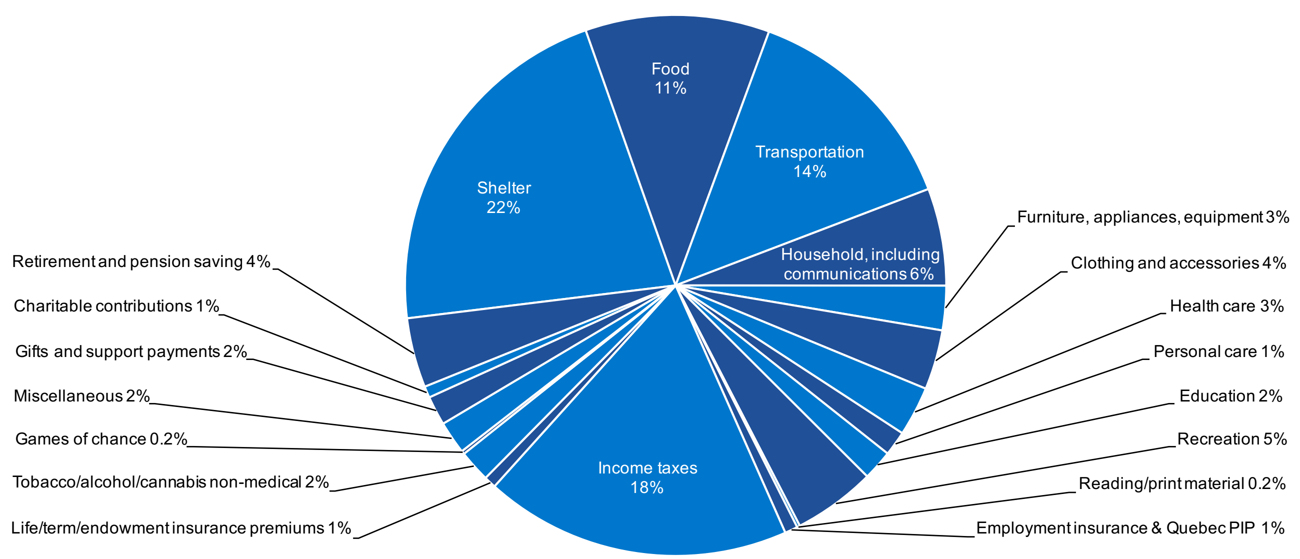
On the other hand, a weekly budget can make it easier to keep on top of day-to-day spending if you are paid weekly or bi-weekly, as there are always seven days in a week, whereas the number of days in a month varies.

For now, choose the way that appeals to you, knowing you can switch later as your routines develop.

A window on Canadian household spending

The *Statistics Canada Survey of Household Spending* (SHS) provides a window on what we and our neighbours are doing with our money. The SHS is conducted in the ten provinces and three territorial capitals every two years, with a two-year lag until results are published. Questionnaires are used to collect information on large, infrequent purchases, with insight on smaller everyday expenses coming from analysis of expenditure diaries kept by representative individuals. This then is linked to income tax data to match responses to household income.

Survey of Household Spending, 2019 *



* Statistics Canada. Table 11-10-0222-01 Household spending, Canada, regions and provinces – Release date: 2021-01-22 – https://www150.statcan.gc.ca/t1/tbl1/en/tv.action?pid=1110022201

The pie chart in the box shows the percentage breakdown of household spending across the country. Of course, spending will vary according to income level, location, age and demographic profile. And even for those similarly situated, each individual and household will have their own preferences.

All that said, this is the big picture view of where the money is going for Canadians as a whole. Approximately HALF of our spending falls into four categories — **food, shelter, transportation and communications** — and it's well over two-thirds of our collective revenue once income taxes are levied.

While the exact figures and proportions should not be taken as a prediction or prescription for your own finances, keep these major categories and the one-half proportion in mind as we turn to look at your own spending.

Estimating your own spending

Whether your ouflow exceeds income, or you want to better manage where the dollars are going, a snapshot of your present position will give you a baseline to work from. For that, review your last three months of chequing and credit card statements. This will capture your taps, swipes and formal sign-offs, but you may have to fill in with estimates if you use cash regularly. Fortunately, the big stuff is likely on those statements, though the little things can certainly add up – which is why we want to capture as many transactions as possible.

Each expense can then to be categorized, and the categories summed up. You can select from the 20 categories in the SHS chart, combining some to make the task more manageable if that feels like too many. In reality, there are well over 300 sub-categories in the SHS, which is great for academic research, but not for personal planning.

Here's an example how you could map those SHS spending categories into half as many budget categories:

Example personal budgeting categories:	SHS spending categories covered:
1. Shelter	• Shelter
2. Transportation	• Transportation
3. Food, groceries	• Food • Personal care
4. Household, communications	• Household, including communications
5. Tax reserves (much of which will be by payroll withholding)	• Income taxes • Employment insurance & Quebec PIP
6. Clothing & grooming	• Clothing and accessories • Health care
7. Gifts & support obligations	• Gifts and support payments • Charitable contributions • Miscellaneous
8. Entertainment & recreation	• Recreation • Reading/print material • Games of chance • Tobacco/alcohol/cannabis non-medical
9. Furniture & appliances	• Furniture, appliances, equipment
10. Emergency, reserves & savings	• Retirement and pension saving • Education • Life/term/endowment insurance premiums

Remember, you're building a process you can understand and maintain, so be honest and kind to yourself if you need to simplify. It's better to be imperfect and underway than to be paralyzed in the starting blocks.

Mapping and navigating your way forward

The objective at the beginning is to create a log of where your money is *currently going*. With that knowledge and grounding, you can then determine whether and what changes will get you to where you feel it *should be going*. Following are some themes and strategies to consider as you put your budget into action.

Using multiple accounts

In the past, people may have been limited to a chequing account and one or two savings accounts. These days, it's possible to have ten or more accounts with a financial institution, at little to no extra cost. This can help convert your budget from paper into practice, though having an account for every budget category might be overdoing it.

Whatever number of accounts you settle on, you can arrange it so that on payday the budgeted amounts are shuttled to each of your sub-accounts from your main account automatically. Not only does this guard against accidentally overspending if things had all been in one place, it's also a visible reminder and encouragement that your budgeting is working.

Credit card reserve

One of the most important accounts to consider for your multi-account system is a credit card reserve. Interest charges on credit cards can be very high, so it's best to pay off the balance each month. The idea of this reserve is that when you use your credit card, you immediately (as part of your daily or weekly receipt routine, discussed below) shift the spent amount into it from your main account or relevant side account. That will make sure that you have enough to pay off your balance as soon as the statement arrives.

Of course, you could simply pay directly to the credit card company, skipping the extra step of accumulating the reserve. The benefit of the reserve is that it shows you a running total of *how* you are spending, not just *what* you are spending on. For those who are vulnerable to routinely pulling out their credit card while their growing debt balance is out of plain view, this continuous visual cue could help cut down on excesses.

As well, some credit cards base their bonus points on the statement balance, not the total spent. While points should not be an encouragement to spend more with a credit card, they can offer value if properly managed.

Smoothing spending, within and across years

Some expenses will occur at intervals that don't match your budget timeline:

- To avoid a cash crunch the week that a monthly bill comes due, set aside a quarter (or so) of the expected amount in a side account so that the full amount is there when needed.
- Or for things billed quarterly like property taxes, include a third in your monthly budget, and again allocate the appropriate amount into a side account to accumulate until the billing month comes around.
- This smoothing practice within the year can also be applied across several years, for example a travel account that slowly builds until it is raided for a big bi-annual getaway.

C.L.A.S.P. your receipts

The activity of receipt-gathering is one of the simplest yet extremely powerful habits that you can cultivate. Apart from setting up for later review, this keeps you aware of your spending in real time, which may in turn influence that spending, before and as it happens.

Collect
Collect a receipt for every purchase you make, no matter how small. Whether you pay by cash, debit, credit or online, get a receipt.

Log
Each evening, take two minutes to empty your wallet, purse, pockets and .png folder of all receipts, and clip them together in date order using one of those large-size springy paper clips.

Allocate
Each weekend at the same convenient time, enjoy a half hour date with yourself, rifling through your receipts. Allocate to your budget categories, recording them in the written, digitized or envelope mode you've chosen to use. Circle the date and amount on each receipt to make it easy next week to pick up you where you left off.

Scrutinize

At the same convenient time on the first weekend of the month, extend that date above by an extra half hour, including your significant other if you have one. Let your budget be your guide as to any small adjustments you need to make. This is about aligning your behaviour to the budget you have committed to.

Plan

On a quarterly basis, put the emphasis on the budget itself in that monthly meeting. Accepting that there will be monthly fluctuations, you should be seeing some consistency across a three-month stretch. If this is not happening, consider what changes to make to the budget. The fourth of these meetings will be an annual review leading into a new calendar year, when you can refresh dollar figures and revisit your goals and priorities.

Necessary, discretionary or luxury?

As the need for change becomes evident, use this spectrum of *needs to wants* to help set priorities. The more an item is considered a luxury, the more likely it is a candidate for change. At the same time, it is those discretionary and luxury spends that give pleasure to our lives, so try to maintain life balance even when cutting down.

Seeing R.E.D.

Once you have determined which items need to be addressed, use this acronym to decide how to adjust them:

Reduce … how much you spend on this particular expense or category, but keep it in your budget;

Eliminate … it altogether if it no longer meets your needs;

Defer … some, or all of it, to a later time.

This is your direction and intention, but to execute most effectively, your actions should to be expressed in concrete terms. That means that those reductions need to be in specific dollar amounts or dollar targets, and any deferrals are in precise timeframes or committed dates. Make things countable to make yourself accountable, and give yourself the best shot at success.

Last point: First step

For many of us, the toughest part of budgeting is getting started. As stated earlier, the purpose here is to give you the motivation and confidence to take that first big step.

If you're looking for one last nudge to get going, an excellent tool that can help is the *Budget Planner* from the *Financial Consumer Agency of Canada* (FCAC): https://itools-ioutils.fcac-acfc.gc.ca/BP-PB/budget-planner.
It guides users through the budgeting process, allowing progress to be saved with a unique access key for the user to return to it over time. Whether you are a rookie or veteran with money management, this tool can help you get going and keep going with your budgeting journey.

For more information, please consult your financial advisor and tax professional.