

Steps to creating a budget

If you're always wondering how you're going to pay the next bill, feel guilty when you indulge in overpriced treats, and you can't seem to find money to put into savings, then you probably need a budget.

A budget is not a magic potion that will automatically solve all of your money problems, but it will help you gain financial awareness. That, in turn, will help facilitate more responsible decisions.

Lots of people think budgeting is overly tedious, and that living within a budget means never indulging in a \$6 latte or a pair of designer jeans again. The reality, though, is almost the complete opposite. A well-designed budget may initially take time to create, but once it's up and running, it shouldn't take you long to maintain. You'll then sleep better at night knowing you can comfortably cover all your expenses. And, a good budget allows for the occasional treat—without the guilt.

Follow these steps to creating a budget:

Step 1: Gather all your financial information

Collect all of your financial documents and receipts for three consecutive months. This includes all account statements, bills, pay stubs, receipts and more. You can save all these documents over the three months, or you might be able to access this information online, especially if you're a heavy card user who rarely uses cash.

Step 2: Tally up your totals

Divide your documents into expenses and income. Then, list the corresponding numbers on a spreadsheet. As you work through these lists, include occasional and seasonal expenses, dividing these expenditure groups by 12 to spread them evenly throughout the year.

When you have your numbers, take a look at how they match up. In the best-case scenario, your income will exceed your expenses. If the numbers are too close for comfort, or your expenses outweigh your income, you'll need to trim your spending and/or look for ways to boost your income so you don't end up deeply in debt. You can also review your fixed expenses to see if there's any way to bring those values down, such as refinancing your mortgage to a lower rate, switching to cheaper car insurance policy, or cutting out a monthly subscription you don't really need.

Step 3: List all your needs

Take a look at how you've spent your money in the recorded time and weed out all the actual needs from your list. This will include fixed expenses like mortgage/rent payments, savings, insurance premiums, car payments, minimum loan payments and childcare costs; as well as fluctuating but necessary expenses, like groceries, clothing and other dry goods. To keep it simpler, list your fixed expenses first, followed by your non-fixed expenses.

Separating your needs from your wants can get a bit tricky, and you'll need to use your common sense. For example, you need to eat, but do you really need to eat expensive restaurant meals?

As you list each need, write down its corresponding costs and add up the total.

Step 4: List your wants

Your next step is going to be all about the stuff you love to spend money on but can really live without. Include entertainment costs here, as well as eating out, gifts, expensive hobbies and anything else that costs money, but is not an absolute necessity.

Here too, jot down the monthly cost of each item on your list and tally up the total when you're done.

Step 5: Assign dollar amounts to your expenses

You're now ready to do the nitty-gritty work of budgeting. Open up a new spreadsheet and copy your lists of expenses, starting with the fixed-cost needs, then your non-fixed cost needs, and finally listing your wants. Remember to include your occasional and seasonal expenses here as well. Assign a fixed amount to each of these costs and plan to have that amount automatically transferred into a special savings account. This way, when you need to meet that expense, you have the money on hand to cover the cost.

There are several schools of thought when it comes to creating a budget. To keep things simple, we've outlined just two of the most popular budgeting methods for you to choose from.

The traditional budget involves assigning a specific dollar amount to each expense category. If your budget allows, simply use the average amount you've spent in each category for the last three months to set the cap for that expense. For example, if you spent an average of \$600 on groceries, jot down that number near this category in your budget. Continue until every dollar is accounted for and you have enough money in your budget to cover every need, want and occasional expense. If your expenses outweigh your income, you'll need to trim some expenses for your budget to work.

The 50/30/20 budget is simpler but requires more discipline. Set aside 50 percent of your budget for your needs, 30 percent for your wants, and the remaining 20 percent for savings. If you want to use this kind of budget, divide up your numbers accordingly to see if it can work for you. Does 50 percent of your income cover the total amount you listed for your needs? Is 30 percent enough for your wants? If it can work, this type of budget allows for more individual choices each month and less accounting.

Going forward, be sure to spend only the assigned amounts for each expense category.

Lastly, review and adjust as necessary. See if you're staying on track, and if you consistently overspend in a category, move some numbers around and spend less in another area so you have more money available to meet your needs. Remember: A budget should be freeing, not restrictive. If yours is not working for you, adjust and tweak it until it works.