



Under
Ethiopian TVET System

Basic Account Works Level II
Learning Guide

Unit of Competence: Develop and Use a Personal Budget

Module Title: Developing and Using a Personal Budget

Module Code: EIS BAW2 M08 0812

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LO 1: Analyze and discuss budgeting as a financial tool

LO 2: Develop a personal budget

LO 3: Implement and monitor the personal budget

LO 1.ANALYZE AND DISCUSS BUDGETING

1.1 The Role Of Budgeting In The Lives Of Different Groups

WHAT IS BUDGET/BUDGETING??? 1,,definition.doc

WHAT IS BUDGET/BUDGETING???...2,,definition .

- A budget is a formal estimate of future revenues & costs
 - Budgeting is a critical step in business planning
 - It puts ideas into numbers for profit or loss measurement
 - Budgets are valuable tools in good management
- A budget is a quantitative plan used as a tool for deciding which activities will be chosen for a future time period.
 - Budgeting is the process of creating a plan to spend your money.



- **Budgeting is simply balancing your expenses with your income.**
 - An estimation of the revenue and expenses over a specified future period of time
- A.** detailed breakdown of costs/revenues is needed for attaining profit/personal goals:
Firms/peoples have to analyze operations to develop reliable estimates of revenues & costs.
1. If budgeting is done right, it forces better thinking about the firm's/peoples goals & purpose & how to achieve them. It forces management/peoples to ask what to be done if certain target levels of sales & costs are to not being realized.
- B.** Making realistic budgets requires clear thinking; as a financial plan of firm's/people's expectations over time, it should be an assessment of what each part of a firm/each activity of a person can accomplish
1. Make separate budgets for each part of business: e.g., for a seed firm there should be separate budget for fertilizer, sales, and production& storage divisions.
2. Combine these to make firm's/households total budget: The separate division budgets can then be put together into one master budget for the entire enterprise.

Why is Budgeting so Important?

- It ensures that you will always have enough money for the things you need and the things that are important to you.
- Keep you out of debt or help you work your way out of debt if you are currently in debt.
- It helps managers better understand their business
- It is a tool which helps to measure business performance.

Benefits of Budgeting

1. Gives you control over your money – A budget is a way of being intentional about the way you spend and save your money. It is said that with budgeting, you control your money and not your money controls you. Budgeting saves you the stress of suddenly having to adjust to lack of funds because you did not initially plan how to spend them. It also helps you decide if you want to sacrifice short term spending like buying coffee every day in exchange for a long term benefit like a cruise vacation or a new HDTV.

2. Keeps you focused on your money goals– You avoid spending unnecessarily on items and services that do not contribute to attaining your financial goals. If you are working with limited resources, budgeting makes it easier to make ends meet.

3. Makes you aware what is going on with your money (keep me posted of...) – With budgeting, you are clear on what money is coming in, how fast it goes out, and where it is going to. Budgeting saves you from wondering every end of the month where your money went. A budget enables you to know what you can afford, take advantage of buying and investing opportunities, and plan how to lower your debt. It also tells you what is important to you based on how you allocate your funds, how your money is working for you, and how far you are towards reaching your financial goals.

4 Helps you organize your spending and savings – By dividing your money into categories of expenditures and savings, a budget makes you aware which category of expenditure takes which portion of your money. That way, it is easy for you to make adjustments. Budget also serves as a reference for organizing your bills, receipts, and financial statements. When all of your financial transactions are organized for tax time or creditor questions, you save time and effort.

5. Makes you decide in advance how your money will work for you.

6. Enables you to save for expected and unexpected costs – Budgeting allows you to plan to set aside money for emergency costs.= contingency budget

7 Enables you to communicate with your significant others about money – If you share your money with your spouse, family, or anyone, a budget can communicate how you use money as a group. This promotes teamwork on working for common financial goals and prevents conflict on how money is used. Creating a budget in tandem with your spouse will avoid conflicts and resolve personal differences on how your money is spent. Budgeting teaches family members spending responsibility and accountability.

8. Provides you with an early warning for potential problems – When you budget and take a “big picture” view, you will see potential money problems in advance, and be able to make adjustments before the problem appears.

9. Helps you determine if you can take debt and how much – Taking debt is not necessarily a bad thing if the debt is necessary or you can afford it. Budgeting shows you how much a debt load you can realistically take without being stressed or if taking the debt load is worth it.

10. Enables you to produce extra money – In budgeting, you get to identify and eliminate unnecessary spending like late fees, penalties and interests. These seemingly small saving can add up over time.

1.2 The importance of setting financial goals

1. Acts as a roadmap – Creating a budget will reveal where every Birr is currently being spent. The visual representation of the actual expenditures reveals the direction followed. When the course being followed is incorrect, the budget can be used to re-route your plan. The budget is a living document that must be updated with the changes that occur in your life.

2. Reveals waste - A detailed budget that is compared against the actual monthly expenditures will reveal the incorrect use of money. When money is spent on non-budgeted items, budget shortfalls are created and can be corrected. When you can identify a source of waste you can then take corrective action.

3. Aligns priorities – Family discussions over the budget can reveal differences in priorities that may often cause conflict. Conversations to address the underlying priorities will correct the problems and reduce disagreements over money. Since money is such a stressful part of household/marriage, identifying discrepancies before they become an issue can do a lot of good.

4. Builds new habits – Efforts to stay within the budget will build new spending habits that can be maintained over time. Working within the budget will shift actual expenses from unnecessary categories into the most essential household categories. Money will be available for the most important expenses and debt reduction becomes possible.

5. Reduces stress – Following the budget throughout the year gives everyone an accurate picture of the financial health of the family. Guesses are no longer required to determine if large purchases and vacations are affordable. When annual expenses are budgeted each month, sufficient funds will exist to pay the bill when it becomes due.

6. Controls spending – If expenditures exceed budgeted amounts, corrections can be made in the coming months to control the monthly flow of money. When outstanding debt is weighing on the monthly finances, the budget can show areas where spending can be reduced to find the money to repay the debt.

7. Coordinates efforts – Setting budget amounts allows every family member to provide input. If the family goal is to have an annual vacation, simple reminders can be given in response to

why money cannot be spent on other categories until enough money is saved for the vacation. The budget acts as a barometer for the family finances.

8. Transforms money into a tool – Budgeting all monthly expenditures will change the mindset toward money. Instead of spending impulsively, **money will be valued as a tool to reach goals and fulfill needs. Children raised under a budget will learn the value of money because they are involved in some of the decisions necessary to establish the budget.**

9. Creates margin – Debt repayment and living according to the budget will move the family toward living within the monthly income. As less money is spent, excess income becomes available and is considered financial margin. These funds can then be applied to other financial goals.

10. Grows savings – Budgeting activities make money available to save some of the monthly income for various reasons. Short- and long-term goals can be reached through savings efforts that seemed impossible just months before a budget was created. Savings becomes the highest priority and money can be saved ahead of paying the bills **since every expense is closely monitored and compared to the budget.**

11. Accelerates financial goals – As margin is created within the financial budget and savings becomes a priority, the family can move toward major goals like funding college education for each child. Many goals can be set and reached because the budget has been used consistently to monitor the financial activities.

While budgeting requires some time in the early months, learning to maintain a budget will pay dividends in ways never imagined. Schedule monthly budget reviews and stick to a strict plan to bring the financial health of the family in line with the goals. **Reward the family for staying within the budget and remember that not all rewards are monetary.**

Budgeting is the most basic and the most effective tool for managing your money. Yet, most people avoid doing it because it is additional work, much like cutting your lawn or fixing the roof. Budgeting also connotes that you have to give up and stop yourself from enjoying stuff.

What budgeting actually does is clearly show you how you allocate your money and present you the choices on what stuff to enjoy – based on your financial limitations. It will save you the grief of overspending and being too much in debt. Budgeting does not stop you from enjoying stuff, it ensures that you enjoy stuff when you want it.

1.3 Obstacles that might prevent financial goals being achieved

2. **Lack of resources (proper resources analysis & utilization).** Decisions that affect expenses whether they are day-to-day living expense decisions or long term debt decisions, like student loans, lead to an inability to save adequately for long term financial goals.
3. **No goals in the first place.** We call this the “seat of the pants” plan. Without a roadmap any highway will take you there. The majority of baby boomers might fit into this category. For

most of them it's too late and they are going to work many more years and retire at a much lower standard of living than they otherwise might of because they never planned ahead.

According to Wilder, the seven obstacles to financial success are:

- **Debt.** Not all debt is bad, of course. A reasonable mortgage on a sensible home is fine. But consumer debt — or a bad mortgage on a big house — is an enemy to financial success. In fact, bad debt may be the biggest enemy to financial success.
- **Taxes.** It's our responsibility to pay the taxes we owe, but we're under no obligation to pay more than that. "It is not unpatriotic to reduce paying your taxes," Wilder writes. We should instead actively work to keep our tax burden as low as possible.
- **Inflation.** Inflation is wealth's silent enemy. It will not destroy you all at once. But it's always there, nibbling at the corners of your life, consuming a little cash every year. It's impossible to keep inflation completely at bay, but you can learn to mitigate its effects.
- **Investment mistakes.** As many investors have learned recently, poorly structured investment portfolios can be a killer. This obstacle is overcome through education, through an understanding of diversification and asset allocation, by taking the emotion out of investing.
- **Emergencies.** The final barrier to financial success is the unexpected: unemployment, death, illness, and legal complications. Without a plan for emergencies, you leave yourself at the mercy of the fickle fates. Carry adequate insurance and maintain an emergency fund!

Lack of information 2. Lack of skill 3. Limiting beliefs 4. Wellbeing 5. Other people 6. Own motivation 7. Time 8. Money 9. Fear

Lo 2. DEVELOP A PERSONAL BUDGET

A **personal budget** is the money that will be allocated to an individual/s to meet their eligible expenses & needs.

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Building personal budgets.xls

House hold budget.xls

2.1prepare spreadsheet for recording all budget information

Building personal budgets.xls

House hold budget.xls

A spreadsheet is a sheet of paper that shows accounting or other data in rows and columns; a spreadsheet is also a computer application program that simulates a physical spreadsheet by capturing, displaying, and manipulating data arranged in rows and columns. The spreadsheet is one of the most popular uses of the personal computer.

In a spreadsheet, spaces that hold items of data are called cells. Each cell is labeled according to its placement (for example, A1, A2, A3...) and may have an absolute or relative reference to the cells around it. A spreadsheet is generally designed to hold numerical data and short text strings. Spreadsheets usually provide the ability to portray data relationships graphically. Spreadsheets generally do not offer the ability to structure and label data items as fully as a database and usually do not offer the ability to query the database. **In general, a spreadsheet is a much simpler program than a database program.**

Daniel Bricklin and Bob Frankston created the first spreadsheet application, VisiCalc (for "visible calculator"). Lotus 1-2-3 came next, followed by Microsoft Excel. While Lotus 1-2-3 was the first to introduce cell names and macros, Microsoft Excel implemented a graphical user interface and the ability to point and click using a mouse. There are many other spreadsheet applications on the market today; however, **Lotus 1-2-3 and Microsoft Excel continue to be the most popular.**

How to create a budget spreadsheet

Building personal budgets, video, F:\texts\texts\excel\Infiniteskills - Microsoft Excel For Business Training Video\03. Managing Money With Excel\03_02-Building Budgets - Part 1.mp4

building personal budgets.xls

House hold budget.xls

Using spreadsheets to help you plan your budget can be useful because it can help with complex calculations and you can see at a look incomings and outgoings. It also means that any changes

to figures can be automatically updated in calculations by the spreadsheet so that it does all the hard work.

Using a budget in this way can be used for many different things such as preparing for Christmas, vacations, household capital purchases etc.

2.3 Identify and List All Sources of Income, Fixed Expenses and Variable Expenses

A. Sources/Types of Income

In fact, when you get right down to it, there are **three broad types of income** you can generate:

1. Earned Income
2. Portfolio Income
3. Passive Income

Any money you ever make (other than maybe winning the lottery or receiving an inheritance) will fall into one of these income categories. And each income category has its own set of benefits and drawbacks. Additionally, successful investors (i.e., Specialists/speculators) have good reason to prefer certain types of income over the others.

Let's dig a little bit deeper...

1. Earned Income

Earned income is any income that is generated by working. Your salary or money made from hourly employment (regardless of whether that salary or hourly income came from working for someone else or from your own "consulting") is considered earned income.

Some activities that generate earned income include:

- Working a job
- Owning a small business
- Consulting
- Gambling
- Any other activity that **pays based on time/effort spent**

While earned income is the most common mechanism for making money, its **obvious downside** is that **(1)**once you stop working, you stop making money. Additionally, because the amount of money that is made through earned income is directly proportional to the time and effort you spend working, **(2)**it's difficult for someone to make more earned income without either learning a new (or more valuable) skill or working longer hours. Additionally, **(3)**earned income is taxed at a higher rate than any other type of income.

One huge benefit of earned income over the other income types is that **(1)** you generally don't need any startup capital in order to make earned income, which explains why most people rely

on earned income from the start of their working life. **(2)** In fact, earned income is a great way to start your investing career, as it allows you to save up cash that will help you generate the other two types of income...

2. Portfolio Income

Portfolio income is any income generated **by selling an investment** at a higher price than you paid for it. Some people refer to portfolio income as “**capital gains**,” because that’s how the money is taxed by the federal government.

Some activities that generate portfolio income include:

- **Trading (buying/selling) Paper Assets (money/capital market instruments)**— Paper assets refer to things like stocks, bonds, mutual funds, ETFs, CDs, T-bills, currencies or other types of futures/derivatives. Stock market investing is the most common generator of portfolio income
- Buying and Selling **Real Estate** (specifically the profit from the sale)
- Buying and Selling of **any other Assets** — Antiques or **cars**, for example, or other types of **collectibles** that have appreciated in value

There are a number of downsides to portfolio income; for example:

- **Require knowledge of speculation.** It often takes a good bit of knowledge and experience to learn how to make money trading paper assets. Unless you have inside knowledge of the companies you’re trading, you must learn to read financial statements or how to analyze market trends if you hope to beat the market
- You often **have little control over your investments**, other than your ability to buy or sell. For example, buying stock in a company still affords you no day-to-day control over the operation of the company, and therefore little day-to-day control over your investment
- Generating portfolio income generally **requires you to have money to invest upfront. Even large gains are inconsequential when the investing amounts are very small (economies of scale, synergy...)**
- Portfolio income is **often taxed at very high rates — equivalent to earned income in many cases**

Portfolio income certainly has **some advantages** over earned income. **(1)** Once you have the knowledge and experience to generate portfolio income on a consistent basis, you can continually reap the benefits (compound your return) by reinvesting after each sale. **(2)** Additionally, any portfolio assets held long-term are generally taxed at a lower rate.

Discuss: the tax rate on long term/capital market instruments investment vs. short term/money market instruments investment. A). on which one do you think is the smaller? B). why???

3. Passive Income

Passive income is money you get from assets you have purchased or created. **(1)**. For example, if you were to buy a house and rent it out for more money than it costs you to pay your mortgage

and other expenses, the profit you make would be considered passive income. **(2).** As another example, if you owned a business that could operate independently of your working for it, any money that you make from the business would be considered passive income (of course, if the businesses success was limited by the number of hours you worked, the income you made would be considered “earned income”).

Some activities that generate passive income include:

- **Rental Income or Note Income from Real Estate**
- **Business Income** (assuming it’s not earned based on amount of time/effort spent — that would be Earned Income)
- **Creating and Selling Intellectual Property** — Books, Patents, Internet Content, etc
- **Affiliate or Multi-Level Marketing**

There are some **major benefits** to passive income over the other two types of income:

- Passive income is **generally recurring income**; once the investment is made, and assuming it is a good investment, the income will continue to come in month-after-month or year-after-year, with little additional work by you. This means that you can essentially “retire” and still continue to grow your net worth
- Investments that generate passive income usually **allow the owners active control over the investment**. For example, if you owned an apartment building or a corporation, you would have say in the day-to-day operations that would ultimately impact the success of your investment
- Passive income investments often allow for the most favorable tax treatment. Corporations can use profits to invest in other passive investments (real estate, for example), and take tax deductions in the process. And real estate can be “traded” for larger real estate, with taxes deferred indefinitely
- **Because it is generally possible to closely approximate the return (or at least the risk) you can expect from passive investments, these investments can often be funded using borrowed money.** For example, a good business plan can attract angel funding or venture capital money. And real estate can often be acquired with a small down payment (20% or less in some cases) with the majority of the money borrowed

As you might suspect from the above overview, **many people consider passive income the holy grail of investing, and the key to long-term wealth.**

B. FIXED EXPENSES

Expenses which do not change in response to reasonable changes in sales or other activity.

Fixed and Variable Expenses

Business expenses are categorized in two ways: fixed expenses and variable expenses.

Fixed expenses or costs are those that do not fluctuate with changes in production level or sales volume. They include such expenses as rent, insurance, dues and subscriptions, equipment

leases, payments on loans, depreciation, management salaries, and advertising. **Variable costs are those that respond directly and proportionately to changes in activity level or volume**, such as raw materials, hourly production wages, sales commissions, inventory, packaging supplies, and shipping costs.

Although fixed costs do not vary with changes in production or sales volume, they may change over time. As a result, fixed costs are sometimes called **period costs**. Some fixed costs are incurred at the **discretion** of a company's management, such as advertising and promotional expense, while others are not. It is important to remember that all non-discretionary fixed costs will be incurred even if production or sales volume falls to zero (**Shutdown cost**). **Although production and sales volume are the main factors determining the level of variable costs incurred by a company**, these costs also may fluctuate in relation to other factors, such as changes in suppliers' prices or seasonal promotional efforts. **Some expenses may have both fixed and variable (mixed) elements.** For example, a company may pay a sales person a monthly salary (a fixed cost) plus a percentage commission for every unit sold above a certain level (a variable cost).

DEFINITION OF 'VARIABLE COST'

Variable costs are those costs that **vary depending on a company's production volume**; they rise as production increases and fall as production decreases. Variable costs differ from fixed costs such as rent, advertising, insurance and office supplies, which tend to remain the same regardless of production output. Fixed costs and variable costs comprise total cost.

INVESTOPEDIA EXPLAINS 'VARIABLE EXPENCES/COST'

Variable costs can include direct material costs or direct labor costs necessary to complete a certain project. For example, a company may have variable costs associated with the packaging of one of its products. As the company moves more of this product, the costs for packaging will increase. Conversely, when fewer of these products are sold the costs for packaging will consequently decrease.

2.4. Calculate surplus or deficit budget

Budget Surplus

This happens if the income weighs more than your spending/expenses
e.g. Income = 2000 birr

Spending = 1300 birr

Budget surplus is 700 birr.

How Does A Budget Surplus Happen?

- Peoples may have cut back on their spending
- people increase their income

Budget Deficit

This happens if Peoples spend more money than theirIncome.

e.g. Income = 2000 Birr

Spending = 2100 Birr

Budget Deficit =100 Birr

How Does A Budget Deficit Happen?

- People may have spent more money.
- Lower income.
- Inflation

2.5 Ways to Reduce Expenses or Increase Income

If you can reduce the cost of your monthly fixed expenses, you will find your budgeting is much more successful and you'll have less stress about saving money. With that in mind, here are 5 simple ways to cut your monthly expenses:

A).Waysto Reduce Expenses

1. Reduce your food bill

Easier said than done, right? Well, yes. But the "food" category is often the one with the most potential for reduction. When I finally took a hard look at my own budget, I realized one of the places where money was leaking out was in my spending on food. I was eating out every day at lunch because I never **took the time to make lunch at home**. At the same time, I was **having dinner at restaurants** almost every weekend, and I was not closely monitoring how much I paid for **groceries**.

At the same time, find tricks to make weekend cooking more enjoyable. Whether it's listening to the radio or doing some "team cooking" with your significant other, focus on having fun with the entire process of making a meal (rather than feeling the urge to visit a restaurant). You might find you have more fun with a leisurely meal at home than at a restaurant anyway!

2. Take advantage of free entertainment

Do you know how much you pay for all your entertainment in one whole month? Adding up your spending on cable TV, Internet, movie subscriptions like Netflix, concerts or sporting events you attend, happy hours with friends, etc., you may see that your entertainment spending is hundreds of dollars per month.

I won't tell you to cut off your Internet access, but beyond that, think about how much of this entertainment spending you really need. A Netflix account and premium cable channels may be redundant. Do a quick audit of your costs and decide what you can cut. More importantly, make a commitment to focus on freeways to have fun - such as picnics in the park or local events that are open to the public like summer concerts sponsored by the city. I've often been surprised at how satisfying free entertainment like hosting a board game night with friends can be compared to more costly activities.

4. Don't pay (much) for a gym membership

It's always good to exercise, but these days a lot of gyms cost a hundred dollars per month or more. The reality is, for most people, effective exercise can be done at home with light weights and resistance bands. If you're someone who appreciates exercising in the gym, you can still do it in a frugal way if you find a good deal. There are lots of gyms that advertise discounts online, and one prominent nationwide gym has a very cheap discount available for anyone who shops at Costco (or who has a friend that does). With one of these options, you can still get your workout while reducing your monthly expenses.

5. Remember that fashion is fleeting, but clothes are not

How much do you spend on clothes per month? One quick way to find out is to tally up all your clothing purchases over the last 6 months and then divide the total amount by six. That average will tell you what to expect on a monthly basis. Then think long and hard about whether you really need any new clothes. It's one thing to replace a pair of worn-out jeans that you've worn for years. But it's another thing to buy a new pair of jeans every couple of months. Remember, you're not going to save money unless you focus your spending on things you need, not just things you want.

B). Ways to Increase Income/Revenue

1. Start a Side Business

What skills do you have that others need or want? Are you a teacher? Mow lawns or paint in the summer and over breaks. If you have older children, enlist them in your money making scheme. Are you a whiz at selling on eBay? Offer to sell other peoples stuff on eBay or Craigslist for a commission. Is your skill writing and editing? Promote your proofreading and editing expertise. Do you have a particular in demand skill or subject knowledge? Offer tutoring or teach a class. Everyone has some particular skill; sell yours. Elance and Odesk offer a forum for freelancers to market their skills.

2. New Job with a New Employer

A new job with a new employer offers great possibilities, not only for an improvement in pay but also for a change of direction and working for a better or more suitable employer with greater prospects for the future.

3. Take On An Extra Job

Take on an extra job - This can boost income but remember the point I made above about working smart. If you take on an extra job, try to find one that advances your skills in some way, provides training or experience that might prove valuable. Choose a job you LOVE or could provide an entree to such a job. Where possible always look at each opportunity as a step towards where you want to be - even if it is an emergency second job!

4. Work More Overtime

You can undoubtedly earn more by working overtime if it is available. However, life is for living and unless you LOVE your work, this should only ever be a short-term solution. A stop gap to another solution.

5. Create an Extra Business

There has never been more opportunities to start home-based and internet-based businesses. Each era has its areas of opportunity and currently the internet is it. Many of these businesses are ideal for running part-time or in the evenings. Things as simple as completing surveys or taking part in online focus groups to running your own internet web site. Even if you have little skill, these opportunities are there, here is a list of potential money earners you might want to consider.

A. Other Family Members Contributions

If you are part of a family unit, consider getting others to contribute to the house-hold also. Your spouse, even your children can all find activities or jobs that might contribute to the house-hold income.

B. Government Support & Tax Breaks

Make sure you are claiming all the government support you are entitled to and use all your tax breaks. If your spouse is not earning, find ways of using her tax allowances to reduce your tax bill.

C. Maximize Asset Earning

Make sure all your assets are earning their maximum. All savings are earning at the best rates. If you have a spare room, consider renting it out. Use your creative imagination to maximise the earning power of what you already have.

LO 3. Implement and monitor the personal budget

3.1 Plan and budget

What's the difference between a budget and a financial plan?

A personal budget...

A personal budget is essentially a guideline to follow with regards to spending. It breaks down expenses into categories (i.e. rent, electric bills, etc..) for a certain time period (usually weekly, monthly, or yearly).

Once all expenses are put into the budget, they're added up to get a total. This figure is then used to subtract against the total amount of income made for the same time period. The result is how much money can be saved for that time period. If the goal is to save more money, then expenditures can be changed or dropped from the budget (if possible).

A financial plan...

A financial plan is a tool to help you achieve long-term financial objectives. It's kind of like a budget in that it breaks down your expenses, but **it's much more goal-oriented**.

For example, let's say your goal is to save up a certain amount of money for retirement. A financial plan would be your guideline for reaching that retirement goal. Financial plans also differ from budgets because they focus more on income and assets.

3.2 COMPARISONS OF ACTUAL EXPENSES AND INCOME

Actual expenses and income for the period during which the budget is implemented are recorded and compared to budgeted expenses and income with any differences in budgeted and actual amounts looked at and the budget modified where necessary.

Actual Expenses Compared to Budget

Budgeted The amount we budgeted (expected to spend and earn) for the future, first quarter of 2006

Actual The amount we actually spent and earned, for the first quarter 2006

Difference The difference between the budget and actual expenses in Birr or %

The difference between the budget and actual expenses as a percentage

- ✓ Above 100% means we were over budgeted
- ✓ Less than 100% means we were under budgeted.

STATIC BUDGETS AND FLEXIBLE BUDGETS

A **budget report** is prepared to show how actual results compare to the budgeted numbers. It has columns for the actual and budgeted amounts and the differences, or variances, between these amounts. A variance may be favorable or unfavorable. On an income statement budget report, think of how the variance affects net income, and you will know if it is a **favorable or unfavorable variance**. If the actual results cause net income to be higher than budgeted net income (such as more revenues than budgeted or lower than budgeted costs), the variance is favorable. If actual net income is lower than planned (lower revenues than planned and/or higher costs than planned), the variance is unfavorable. **So higher revenues cause a favorable variance, while higher costs and expenses cause an unfavorable variance.**

Static budgets are geared to one level of activity. They work well for evaluating performance when the planned level of activity is the same as the actual level of activity, or when the budget report is prepared for fixed costs. However, if actual performance in a given month or quarter is different from the planned amount, it is difficult to determine whether costs were controlled.

Flexible budgets(Flexible Budgets.ppt) are one way companies deal with different levels of activity. A **flexible budget** provides budgeted data for different levels of activity. Another way of thinking of a flexible budget is a number of static budgets. For example, a restaurant may serve 100, 150, or 300 customers an evening. If a budget is prepared assuming 100 customers will be served, how will the managers be evaluated if 300 customers are served? Similar scenarios exist with merchandising and manufacturing companies. To effectively evaluate the restaurant's performance in controlling costs, management must use a budget prepared for the actual level of activity. This does not mean management ignores differences in sales level, or customers eating in a restaurant, because those differences and the management actions that caused them need to be evaluated, too.

The budget report for the Pickup Trucks Company is a static budget because the budgeted level of units is the same number of units as the original budget. It was not changed for the higher sales level. If it had, the budget report would be as follows:

The flexible budget shows an even higher unfavorable variance than the static budget. This does not always happen but is why flexible budgets are important for giving management an indication of what questions need to be asked.

The master budget or static budget is based on the level of output planned at the start of the budget period. It is static in the sense that the budget is developed for a single planned output level. When variances are computed from a static budget at the end of the period, adjustments are not made to the budgeted amounts for the actual output level in the budget period.

Flexible budget is a budget that is developed by using budgeted revenue or cost amounts, it is adjusted to the actual level of output achieved or expected to be achieved during the budget period. A flexible budget is calculated based on budgeted revenues and budgeted costs at the end of the period when actual output is known. Flexible budget enables managers to compute variances that provide more information than the information from variances in a static budget.

Generally, a static budget is not designed to change with changes in activity levels. Once sales and expenses are estimated, they become the relevant benchmarks. An alternative that has some compelling advantages is the flexible budget. Flexible budgets relate anticipated expenses to observed revenue.

3.3 **Handy hints for managing the personal budget**

A. How to avoid getting into financial difficulties

1. Create a realistic budget and stick to it.

This means periodically checking your budget against your actual spending patterns and readjusting your figures and spending habits accordingly.

2. Don't impulse buy.

When you see something you hadn't planned to buy and don't actually need, don't purchase it on the spot. Go home and think it over. It's less likely you'll return buy it after having had a chance to think it over.

3. Don't buy something just because it's on sale.

Buying a \$500 item on sale for \$400 isn't a \$100 savings if you didn't need the item to begin with. It's spending \$400 unnecessarily. (And it may not have been a real sale -- some stores mark items down almost immediately, to make people think they're getting a bargain.)

4. Get medical insurance if at all possible.

Even a stopgap policy with a large deductible can help if a medical crisis comes up. You can't avoid medical emergencies, but living without medical insurance is an invitation to financial ruin. And if you think you'll just go to the emergency room if something dire comes up, realize two things: 1) This doesn't help you with chronic conditions like cancer, and 2) Although the emergency room can't turn you away for lack of insurance, they still expect you to pay the bills later.

5. Charge items only if you can afford to pay for them now.

If you don't currently have the cash, don't charge based on future income -- sometimes future income doesn't materialize. Meanwhile, you'll be paying exorbitant interest rates, which may wipe out any savings that you gained even by buying an item on sale! Try tossing all your credit cards into a drawer and committing to living without credit for a while.

6. Avoid large rent or house payments.

Obligate yourself only for what you can now afford and increase your mortgage payments only as your income increases. Consider refinancing your house if your payments are unwieldy.

7. Avoid consigning or guaranteeing a loan for someone.

Your signature obligates you as if you were the primary borrower. You can't be sure that the other person will pay.

8. Avoid joint obligations with people who have questionable spending habits -- even a spouse or significant other.

If you incur a joint debt or tax bill, you're probably liable for it all if the other person defaults. In many cases, such liabilities have been known to outlast the relationship.

9. Don't make high-risk investments, such as investments in speculative real estate, penny stocks and junk bonds.

Invest conservatively, opting for certificates of deposit, money market funds, and government bonds.

10. Find alternatives to spending money.

For a friend's birthday, take her on a picnic rather than to an expensive restaurant. When someone suggests that you meet for lunch, propose meeting at the museum on its free day or going for a walk in the park. Instead of buying books and CDs and renting videos, borrow them for free at a library.

B. How to minimise fees and charges imposed by financial institutions

1. Paying Bills

via the Internet or Telephone Banking.

To pay bills without incurring additional fees use. You can even future-date payments so your bills are paid on time, every time. These are all free transactions.

2. Avoid Default Payment Fees

With Phone Banking and Internet Banking it is easy to keep track of the available funds in your account(s). For those times when unexpected expenses do arise or you need to juggle funds, take advantage of a Credit Union Line of Credit.

3. Use telephone banking:

Use Phone Banking or Internet Banking to check your balances day or night and use a Credit Union Overdraft for those unexpected expenses

C. How to use credit card debt effectively

1. Start by Setting a Goal

It's important to establish realistic goals for paying off your high interest credit cards as well as other consumer debt (lines of credit, vehicle loans). While it is easy to run balances up in a short period of time, it will take time and self discipline to pay them off. Monitor your progress regularly to help you stay on track and motivated to reach your goals.

2. Prioritize Your Debts – Credit Cards, Loans, Mortgages and So On...

Make a complete list of all of your debts (outstanding balances, interest rates and charges) and prioritize them in order of importance. Mortgage payments and vehicle payments are typically at the top of most lists as these provide your shelter and transportation to get to and from your job.

Priorities will be different for everyone. Many people want to get rid of the highest interest rate debts first, and others have specific debts like **payday loans** they want to absolve first. You should decide the order in which you will pay back your debts.

3. Create a Monthly Spending Plan

To learn how to get out of debt and to stop borrowing from your credit cards again and again, you will need to create a monthly spending plan for your money. Not only will this ensure you are living within your means (and not way above your means, which is where credit card debt comes from), but it will also give you a set timeline on when you can expect to get debt free.

4 Use Savings to Pay Debt Down Faster

Many people regularly contribute to a savings plan, which is great, but consider that this is money that could help you pay down what you owe faster. Once you have established an emergency fund and are saving for irregular expenses, you may want to consider suspending extra payments to Canada Savings Bonds or other savings accounts until you have paid off what you owe. This is especially beneficial for those who aren't saving for something specific like vehicle repairs.

The money you save by paying down your debts faster will be substantially higher than the interest you will earn in a savings plan. Also consider using income tax refunds, pay increases or other unexpected funds to pay down your debts.