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Creating Your First Budget

Budgeting is one of the first great lessons of personal finance, yet relatively few people are taught the basics of creating one. Or if they're taught, they forget. The inability to measure how much money is coming in and how much is going out is a primary reason for financial illiteracy in this country.

So it's a good idea to go over those basics. The Webster's definition for budget is simple: "A plan for the coordination of resources and expenditures." A budget is both a noun and a verb – a plan and a process. So it makes sense to go over the basic process of budgeting – learning exactly what money is coming in to your life, what's going out and how effectively you're using the difference.

The Income Column: Measuring what's coming in

For most people, this is the easy part. Income is largely made up of the following categories – wages, bonuses, investment income, alimony or other part-time income.

Budgeting is easiest if done on a monthly basis. It's an easy time period with which to measure the inflow and outflow of money and it allows you to see over the course of a year which months tend to be better for income or spending.

How should you record these amounts? Save all pay stubs and other proof of income. Photocopy checks before you deposit them and either build a physical file or start keeping track of income using computer software or online resources like Mint.com.

The Expense Column: Measuring what's going out

Why are expenses tougher? Because tracking every cent you spend can be tough when you've never done it before. This process forces you to save receipts, credit card statements or to physically write down cash amounts in the absence of receipts. Recording and analyzing expenses are generally the most work-intensive part of budgeting, but there's a silver lining – less spending means less recording time!

What are the primary expense categories? Food, shelter and clothing.

What's beyond that? All of your monthly bills. Retirement investments. College savings for your kids. Insurance costs. And everyone's favorite, taxes.

And beyond that? Entertainment expenses – movies, plays, vacations, sports, and of course one of the biggest money drains most people can't stand to give up, cable TV.

How should you record these amounts? The same way you did in the income column.

The upshot

If your expenses match your income, congratulations. Relatively few people can say that, though the recent economic downturn has forced more people to cut debt and boost savings.

But if your expenses are still outrunning your income, you now know you have to start trimming and finding more money for savings, investment or debt reduction.

What should your target be? There are a variety of theories, but you will often hear the term “60 percent solution.” This means aiming for a total spending figure equal to the first 60 percent of your income.

How do you get there? Start by identifying the expenses you can live without – designer coffee, restaurant meals and carryout might be a start. Then start finding ways to whittle down monthly bills – paying more than the minimums on credit card bills, consolidating other debt with lower-rate offers if you can find them. If you can refinance your mortgage affordably, that's another good way to attack the spending side of your budget.

And what do you do with that extra money? First, make sure you have an emergency fund that contains 3-6 months of money to cover living expenses. Then start putting money away for retirement. After that, money for the kids' college fund. Beyond that, extras like vacations, entertainment and other treats.

If this approach seems a bit Spartan, it's a good starting point – indeed, every individual defines the term “financial essentials” a bit differently. But it's important to start prioritizing financial issues correctly. For help, it makes sense to consult a professional like a qualified financial planner and a tax expert to identify ways to save and tip more money into a solid financial future.

And for a look at budgeting tools that won't cost you money, go to [Mint.com](https://www.mint.com).

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