

## Budgeting for busy people

By Phillip Win (Director and Senior Financial Planner, Profile Financial Services)

If only I had a dollar for every time I've heard a client groan on being asked to do a budget! After 15 years as a financial adviser, I'd be a very wealthy person. The truth is, budgeting is not an easy task, and it's one that most of us have chosen to avoid. By not planning, we're hoping that somehow we'll manage to start living comfortably within our means and accumulating wealth through some mystical process whereby intention is translated into results without any intervening hard work! If you believe in "The Secret", this will make perfect sense to you. Unfortunately I've rarely seen it actually happen. If you've made a New Year's resolution to get your finances on track, I can pretty much guarantee it won't be achieved unless you devote some time to budgeting.



It's a basic fact of human nature that we are inclined to avoid tasks that are painful and repeat those that bring us happiness. The relevance to budgeting? Compare spending an evening at home drawing up a budget plan, while relaxing watching TV or going out with friends. Compare home renovations, a nice new car, travel, eating out and so on with boring old investing or paying off the mortgage. It's more fun, and much easier, to spend now and hope the future will take care of itself.

For professionals and small business people such as dentists, the process can be even harder. Taking time to plan personal financial success often takes a back seat as we instead focus on business and career success. We figure, if we invest lots of time and energy in making the business more successful, that's bound to pay off for me personally in the long run – isn't it? The sad truth is, it often doesn't. I have seen numerous cases of partnerships falling over, bankruptcies, illness, divorce etc dissipating business and career achievements, and people being left with nothing personally to show for a lifetime of hard work.

The good news is, it is within the control of almost all of us to live an enjoyable lifestyle now while still making sensible provision for the future. I have clients who never earned or drew more than about \$40,000 a year, but nevertheless managed to accumulate seven figure sums by retirement. I also have (new) clients with personal incomes north of \$400,000 per year who are in debt and have very little accumulated as yet for their future.

It's my unenviable task to sell the old-fashioned unsexy virtues of thrift, forward planning and hard work! It's not quite as bad as blood, sweat and tears that I have to offer. But there is a war on, in a way, or at least a battle – the battle for personal financial freedom.

So how do you win the battle? While budgeting can be tough, there are ways to make the process easier. The approach I've found most successful over the years does away with the need for detailed analysis of every bill, tracking receipts and so on. With a few simple steps you can set a realistic budget that will put you on the path to personal financial freedom. It should take no more than a single evening to complete, then update each year.

### **1. Set up a personal balance sheet**

Your personal balance sheet will vary according to your stage of life. It should include assets and any associated liabilities/debts attached to those assets. TIP: it is a good start to have your assets being greater than your debts!

Younger dentists will often have more debt on their personal balance sheet that will typically comprise their home, their share of a practice and most likely a motor vehicle. Mid-career dentists should start to see a fall in their level of debt, or at least a change in the type of debt from non-deductible (such as a home) to deductible (such as for investment). Those aiming to retire within the next 5 years or so should see a healthy net asset position that comprises superannuation, personal investments (property and shares) and the value of their practice. There should be little if any debt by this stage – or at least a strategy to pay it off at a point in time such as retirement.

### **2. Plan your income for the year**

The next step is to project how much income you are going to earn for the year. Dentists are often in a position where they can significantly influence or even directly control their personal income or drawings from the business. If you have been in business or have been employed for some years, there is a known pattern of income. This is typically a function of the number of days (and hours each day) you choose to work as well as the type of work that you undertake. Now is a very good time to review, assess and project your income for calendar year 2011. Most dentists will revisit this at the end of financial year, but I encourage you to set a realistic goal for the calendar year now.

### **3. Decide your Net Asset Improvement (NAI) goal**

This goal states by how much you want your net worth to improve over the year. Your NAI goal can cover asset accumulation (ie contributing to superannuation), debt reduction, or a combination of both. (It should not include any projected asset price improvement, as this is beyond your direct control.)

What is a realistic goal for NAI? If you don't know where to start, there are a couple of approaches that can help:

- One rule of thumb is to decide a set proportion of your income that you will commit to using for NAI. If you have no particular figure in mind, I generally suggest starting with a figure of around 20% of your income – it may be more if your expenses are low, and less if you are at a high expenses stage (such as paying private school fees, significant mortgage repayments etc). I would generally suggest a minimum of 10% of income should be considered, however. If this is problematic then a major re-think of spending may be required!
- An alternative approach is to calculate the amount you will need to commit each year to ensure you're on track to deliver the income you require once you stop work. The calculations can be complex and small changes to the assumptions you use can have a very big impact on whether you're likely to achieve your overall goals. Financial advice is generally very helpful here. Your adviser can also help ensure you are making the very best possible use of the funds you can afford to commit to NAI- working out, for example, whether you would be better off reducing debt compared with making concessional contributions to superannuation, and so on.

So have you created a budget yet?

If you have followed the process, you will have the following three inputs:

- (1) A personal balance sheet
- (2) The income that you are going to earn over the next 12 months
- (3) An NAI goal

The difference between the last two numbers represents the amount you can afford to commit to expenses this year – your “expenses budget”. For many people, the process can stop here. You simply direct the amount you've decided on to your chosen NAI goal (debt reduction or asset increase), and anything that's left in the bank account after that represents your expenses budget and can be spent as required.

Other people may wish to go one more step and understand at least at a high level, the makeup of their expenses each year.

#### **4. Understand your fixed vs discretionary expenses**

Your fixed expenses usually include minimum loan repayments, electricity, water, gas, council rates, telephone (fixed and mobile), internet, health insurance, life insurance, car insurance, car registration. This may sound a bit daunting, but all you need is a copy of your last two bills for electricity, water, gas, council rates, telephone, and a quick snapshot of the direct debits for insurances and you have your fixed expenses expenditure figure. You may also have additional expenses you consider non-negotiable (such as private school fees).

Discretionary expenses are simply what's left over after you've subtracted fixed expenses from your expenses budget. This can be allocated to holidays, eating out, movies, gifts, donations etc.

This analysis is very handy to do – it can identify whether your NAI goal is realistic, or show areas where additional savings could be made. It is very common for clients to find, after going through this exercise, that a high proportion of their income could be devoted to NAI based on estimated expenses - and yet, for several years, no savings have actually been achieved! In some cases, we see debt has been steadily increasing even though income has been high and theoretically there should have been plenty available to invest. Never underestimate the power of discretionary expenses to eat away at your financial plans!

I hope I have convinced you of the importance of budgeting, and illustrated some practical ways that this daunting task can be made a little easier.

At Profile Financial Services, we have a range of tools to assist our clients to formulate their budgets, as well as providing guidance on estimating expenditure for given stages of life and lifestyles, based on our extensive experience with many clients in the dental industry. We are also able to illustrate what level of asset accumulation is required to support a lifestyle once the income from a dental practice stops. I strongly encourage you to formulate your planned expenditure sooner rather than later, as the biggest enemy is time - and that is one factor that neither you nor I can control.

Remember - it's not what you **earn**, it's what you **keep** that matters!

#### **About Profile Financial Services**

Profile is an independently-owned boutique financial planning firm with offices in the Sydney CBD and North Parramatta. We have operated for over 20 years, and specialise in serving the wealth creation and protection needs of professionals and small business owners. Many of our clients are dentists, and we run regular education seminars on financial planning specifically for dentists. To find out about upcoming seminars, or to book an obligation-free meeting with a Profile planner, call Aine Love on 02 9683 6422 or email [aine@profileservices.com.au](mailto:aine@profileservices.com.au)

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