



Getting a Handle on Your Expenses

Patrick Longhurst

When creating financial models, my colleague, William Jack, and I, are frequently surprised at the lack of information that our clients have relative to their expenses. This is in marked contrast to the details that they can produce concerning their assets, liabilities and future sources of income. For this reason I decided to devote this column to the issue of analyzing expenses, both for current budgeting and for future planning.

Budgeting

A reasonable understanding of your current expenses is important as a basis for knowing how much should be available for all sources of saving, including:

- RRSP and Pension Plan contributions,
- RESP payments for eligible children or grandchildren, and
- After-tax savings for future special events.

In our experience many individuals have no idea where their money goes and why they have nothing left at the end of the year. An analysis will help them identify potential sources of expense reduction which should not be too painful. Many of us get into the habit of eating lunch out every day or buying coffee at frequent intervals without appreciating the impact on our annual expenses (and our waistlines!). On a more positive note, the budgeting process may reveal that there is genuine money left over.

In terms of the process to be used for the analysis, we normally recommend the use of a simple Excel spreadsheet, or some proprietary software like Quicken. The more important issue is the commitment to stick with the process for a number of months, so that the results are representative of your annual spending patterns. Some tips that we have learned along the way:

- It can be helpful to try to concentrate your spending on a particular credit or debit card. This way you can

download the information with a minimal amount of work. But please remember to pay off your credit cards in full every month!

- Don't obsess over where the cash goes. This can be very annoying for your spouse or other family members. Try giving yourself a miscellaneous cash allowance each week, and keeping track of the more significant items.
- You will need to eliminate major, one-time purchases from your analysis. But, when you are projecting your expenses for the year, do remember to add in any special events which will impact on your spending.
- Don't be tempted to do any binge shopping during the month before you start keeping records. You are only fooling yourself!

Projecting

When you have completed your current spending analysis, you are in a position to make short-term savings plans and to make any resolutions about expense controls. Now, we come to the more challenging part of the process: projecting long-term expenses for modelling purposes. In order to have your best estimate for the future, we recommend the following process:

1 To the extent that you can, anticipate lifestyle changes which will impact on your regular expenses. These could include: your children leaving home, an age at which you might sell your house or cottage and move to, say, a condominium, or, a point at which you or your spouse might stop driving.

2 Divide your current expenses up into categories to help your planning. These could include: home-related expenses, vehicle-related expenses, lifestyle expenses, insurance, vacations, debt payments, and charitable donations.

3 Create a listing of special expenses which you think you will be faced with. These could include: family weddings, home repairs and renovations, special vacations, new

car purchases, and financial help to children.

4 Hardest of all, try to imagine the final years of your life and the way you would like to spend them. Do you want to remain in your family home? Is it likely that you will be in a seniors' residence? Do you have insurance to cover the costs of long-term care?

Based on this information you should be able to create a reasonable estimate of your expenses which can be incorporated into a financial model. For example, if you plan to remain in your family home until age 80, then it would be reasonable to assume that your home-related expenses can be based on your current home expenses plus an annual allowance for inflation. If you expect that your children will leave home at age 25, then you can anticipate a reduction in food, car insurance and telephone bills!

Even when you follow the process that I have described, it is most unlikely that your actual future expenses will mirror your best estimates. This is equally true for the projection of your income items. The best any of us can do is to create a model which best reflects our current expectations. What you will have done is create a benchmark against which you can measure your actual experience. Then in three to five years time, you can repeat the process, armed with a new vision of the future and an increased understanding of the recent financial past.

Regular readers of this column will know that my favourite expression is "use the best dishes". I was recently reminded that it is only when an individual has done some basic budgeting that they can be sure they have the financial freedom to allocate money to pure enjoyment. It was that comment which prompted me to write the column. My key point remains: Do not deny yourself pleasure now because of some unspecified concerns about the future.

And a Special Bonus Tax Update!

Before signing off this month, I also wanted to make some comments about some changes to the tax system which will affect your 2007 returns. I must preface this by reminding you that I am not a tax expert, so take these comments for what they are worth!

First, on the topic of splitting pension income, I believe this could be attractive for a lot of eligible taxpayers. However, I do not think it is intuitively obvious how much any individual should split. Clearly, the main objective is to move yourself down a tax bracket, by transferring some taxable income to your spouse. Just be sure you do not move your spouse up into your bracket in the process! Other potential objectives of pension income splitting could be to provide a pension income credit for an eligible spouse who might not have one, or to try to avoid the OAS

clawback. But remember to make sure you are not losing the spouse or common-law partner amount in the process. So, my advice is to test the impact of pension income splitting at various levels to try to optimize your position. Do not assume that 50 percent splitting will always give you the best outcome.

Another interesting new credit is the children's fitness amount. This applies to fees paid in 2007 for, "registering your or your common-law partner's child in a prescribed program of physical activity." The maximum amount that may be claimed is \$500 per child. I find it very interesting to see which programs CRA regards as prescribed. Presumably hockey or soccer training would be eligible. Scouts and Guides are not.

Finally, the rules governing public transit passes have been changed. It is no longer necessary to buy a monthly pass to obtain a tax credit. You can also claim the cost of shorter duration passes "if each pass entitles you to unlimited travel for an uninterrupted period of at least 5 days and you purchase enough of these passes so that you are entitled to unlimited travel for at least 20 days in any 28-day period." So, if you are taking a vacation in the second half of May and do not buy your weekly passes, then you get no credit for the whole month. I wonder who designs these things!

Anyway, have fun with your tax returns, and keep those e-mails coming!

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