Business Standard

Maintain your own balance sheet

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Plan your big expenses. Otherwise, finances can go haywire.

Cash flow management sounds a very boring financial term, unrelated to a person's income and expenses. Yet, it does form a part of the foundation on which a sound financial plan is built.

Cash flow management is essentially taking stock of your income and expenses and arriving at your net financial position. It includes smoothening of the expenses over the entire year, to avoid the pain of big payouts in a short period of time.

The two main components are income and expenditure. The income head will take into account all your sources of income. That could be salary or business income, rental income, interest, dividends, annuities, royalties, and so on. Certain incomes are received once or twice a year like bonus, variable pay or the unclaimed (taxable) portion of a leave travel concession, and medical allowances. Accounting for all incomes is fairly simple; the difficult part is consolidating data pertaining to expenses, especially if you do not maintain a written record

EXPENSE ACCOUNTING

To make things simpler, you can divide the expenses into fixed and variable components. Fixed components are those that will not change month-on-month; variable expenses will change speriodically.

Fixed expenses could include your rent, monthly instalments, insurance premiums, savings, salaries paid out and domestic help. Variable expenses could include your routine living expenses like grocery, milk, vegetables, fuel, electricity, telephone and mobile bills.

Most of these will be monthly. But there could be some with a quarterly or annual frequency like school fee payment or vehicle maintenance.

There could be other expenses which are irregular in nature. These would include payments for gifts, outings, and other miscellaneous ones like home renovation.

Once the data on these two heads is complete, you can arrive at a fairly accurate picture of how much you are capable of saving every month. During this process, you need to keep a sufficient buffer to absorb any expenses you might have missed out in the whole exercise. This will also cushion the impact of any impulsive spending.

THE SMART WAY TO PLAN

Certain expenses in the fixed category could be large, like a school fee payment or insurance premium payout. The payment dates for these are already known to you. So, you can plan these in a systematic manner. Say, you have a Rs 1 lakh payout every February. You can start a recurring deposit of Rs 8,200 per month. If you get 7.25 per cent for this RD, you will get about Rs 1.01 lakh on maturity. Keep the RD in such a manner that the maturity coincides with your payout dates. Then you will not feel the pinch of a large payment in any particular month.

Similarly, if your bonus payout is in December, and you have a fair idea of the amount you might receive, you can invest it in short-term fixed maturity plans, coinciding with your insurance premium payout in, say, April. This kind of income can also form a part of the contingency fund that will aid you in unforeseen circumstances like a medical emergency or loss of job and so on.

Preparing a cash flow chart systematically can have several benefits. The most obvious one is that you will immediately know whether you are having a cash surplus or deficit. That essentially will tell you whether you are in a position to save money or you will have to cut on expenses.

Many a time, a cash flow chart makes a person realise when there is a big amount of unnecessary expenditure. It also gives a clear picture of affordability of big-ticket expenses, like doing up the interiors of a home or buying a second home. When there is sufficient surplus, you can immediately get into a savings plan which will fulfil your requirements in the desired time frame. This will also take away the guilt of large spending on lifestyle needs, because you know you are prepared for it.

The writer is a certified financial planner