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# Using the Reasonableness Test in Creating Your Budget



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## What is the reasonableness test?

When forecasting what the future might bring, whether in terms of income or expenses, it is always prudent to ask what is actually reasonable to expect. The question is simple, but the answer, often, is not. The reasonableness test is most difficult to apply in areas where you have little experience and the outcome might vary significantly. This is where doing a bit of research will narrow your focus to what is truly reasonable, thereby minimizing guesswork.

## There are many sources to aid you in determining what is reasonable for a given situation

- Your own experience--In many cases, you already have experience with what you need to forecast. That experience is usually the most reliable source and therefore should be the first one you consider.
- The experience of others--Relatives and friends might have experience in some areas where you do not. If you feel comfortable seeking their guidance, they can be a handy source.
- Service and product providers--Those who have what you are likely to need are usually happy to estimate the cost of their services and products.

**Caution:** *Be wary of unexpectedly low cost estimates. This is frequently done to dissuade you from buying from a competitor. For high-cost items, obtaining estimates from multiple sources is always recommended. Based on the information obtained, it will be easier to make a decision about what is reasonable.*

- Professional financial guidance--Those who provide professional financial services are often excellent sources for determining whether an estimate is reasonable. These include accountants, financial planners, tax planners, and estate planners. If you own a business, then business planners/consultants can also be a helpful resource. If these professionals frequently deal with the items you're estimating, they can review your estimate in light of their experience.

## The reasonableness test is an especially useful tool when budgeting

The reasonableness test is extremely important when estimating expenses. Underestimating an expense item can have a disastrous effect on a budget, while overestimating can lead to missed opportunities. The reasonableness test aids in budgeting more accurately, thereby facilitating the best possible use of funds to achieve financial objectives.

Estimating income is another process that calls for use of the reasonableness test. If part or all of your income is from sources subject to high variability, estimating can be tricky. You may depend heavily on income from investments or a small business in which you hold ownership. Such income typically depends on numerous factors that must be taken into account when estimating.

## What is reasonable for you may be different from what is reasonable for someone else

Remember that everyone's circumstances are unique. Consequently, what is reasonable for someone else might not be reasonable in your own situation. Frequently, there are underlying factors that influence what is reasonable for each individual. For example, someone with a chronic medical condition might reasonably estimate much higher health-care expenses than someone who is consistently healthy. Similarly, a family of six would estimate much higher household and child-care expenses than a couple with one child.

**Tip:** *When seeking estimates or advice concerning the reasonableness of your own estimates, ask as many questions as you can.*

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