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What the experts say

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Separating their business and personal spending/income is important to the Wattersons' overall budget. And they definitely need to budget. I recommend to clients that have a fluctuating income to go back over the past 12 months and divide all income into 12 equal parts. This gives a more realistic outlook as to what their income looks like, and can be updated each time a big project gets paid out.

They should also divide their yearly variable expenses (i.e. vacations, home insurance, car insurance) into 12 equal payments so that they know the money is there when needed. It may take a year to get this going, but is well worth it, as they won't have to use credit for these expenses. With a variable monthly income, it is all the more important that they don't carry a credit card balance from one month to the next.

Although fixed expenses are a reality, it would be a good idea for them to prioritize their variable expenses and decide what could be paid month-to-month and what could wait. A 40-year amortization may have been the only way to get the $2,000 mortgage payment to work within their monthly budget, but I would like to see them re-amortize to a lower number in the next few years.

Since the Wattersons own their own company, it is very important they have disability insurance so that the business can pay the bills and continue to run if one spouse or both can't work for a period of time. They should build an emergency fund that can cover three to six months of living expenses ($12,000 to $24,000). A high-interest account would be a great fit and is cashable at any time. And they should try to use bank accounts that won't charge any fees as their $142 in fees per month can be used more effectively elsewhere.

Although retirement planning isn't top of mind, it would be a good exercise to create a simple plan now as a starting point. They should remember that their company could be a small or big piece of their overall retirement fund.

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To misquote Oscar Wilde: "[Saving], like art, means drawing a line someplace." Now that Calvin and Susie are adults, parents and in business, they need to set up some boundaries and create some concrete limitations. Of course, budgeting for a young family with self-employed varying income is a lesson in frustration. I suggest the opposite: Rather than trying to fix the expenses, the Wattersons should set up a series of fixed saving plans to meet their goals.

The first step is to normalize their income to make planning easier. They should transfer a fixed amount from their business account each month into a joint personal household account to cover their core living expenses. They are currently spending way more than that, but by limiting the transfer it will illustrate the shortfall in their budgeting.

After that, they can create a savings account for short-term spending like day care and travel. But with their 95% mortgage, they need to have a big, secure cash cushion to maintain their incomes during a possible dry spell.

The expansion of the business should be delayed for a couple of reasons. They cannot expand until they get some structure in their business life. Certain expenses and uncertain income is a killer combination: They need to at least know their costs and expenditures since they will seldom ever know their income. They then need to determine the profitability of their expansion in the face of the new costs created, and to consider a probable recession and what that will do to their business revenue. Also, if they want to have more kids, do they really want to expand their workload?