

The Basics of Budgeting

Budgeting is like dieting – you know what you should do, and you even have a pretty good idea of how to go about it, but actually sticking to it is hard! With both budgeting and dieting, we have a sense of deprivation, of being restricted. So how can we get over that hump and make progress?

Keep your eye on your goal and how your life will change once it's achieved. As Dr. Phil would say, how's your current situation working for you? If you continue to overspend and undersave, where will you be six months from now? On the other hand, if you begin incorporating good habits into your lifestyle, how will your life be better? Think about your values and what's most important to you. Chances are, they will be things money can't buy. Look at all the possessions you have – what percentage contributes to your quality of life and what percentage actually diminishes how much you enjoy life?

Figure out what you're spending now. For the next month, keep a pad of paper or some index cards with you and write down every single expense. Whether it's a stick of gum or a utility bill, write it down and put it into a category. This will give you a great idea of where your money's going. Fill out the "Where Does Your Money Go" worksheet and calculate your net cash flow. If it's negative (meaning your expenses are more than your income), then your records for the month will give you a great idea of where you can start cutting.

Pay attention to needs vs. wants. It's extremely tempting to try to keep up with our neighbors or co-workers. But the reality is that we all have our public face that isn't necessarily a realistic picture of our lives. If you can't afford to buy all that stuff, chances are, neither can your neighbors. Can you shop at Wal-Mart instead of Town Center and still meet your needs? Can you drive an older car? Can you wait to purchase something until it's on sale? Can you comparison shop to be sure that you're buying at a competitive price? Can you restrain yourself from impulse buying? The more of these questions to which you can answer "yes", the better your financial outlook.

Have a plan. One easy way to budget is to live on 80% of your take home pay, putting 10% toward charitable giving and 10% into savings (we call that "paying yourself first"). Maybe 10% is a scary number for you, so start with a smaller percentage and work up to it.

Once you've determined the 80% amount, then calculate your budget. How much do you need for groceries, the rent or house payment, utilities, clothes, medical expenses?

Don't forget to set aside an amount each payday for expenses that don't occur regularly, such as insurance premiums and property taxes. Calculate the annual amount of these types of expenses and divide it by the number of paydays to determine how much to set aside for those expenses. Same idea for gifts – determine ahead of time how much you'll spend for Christmas and birthdays and set an amount aside each payday so that you'll be ready when those expenses arise.

Pay cash. If you don't have the cash, don't buy it. One method to force yourself into this mode is the “envelope method.” On each payday, you pull out the amount of money you've budgeted for each item and put it into an envelope for that purpose. If you've budgeted a certain amount and run out of cash before the next payday, then you don't get to spend any more money on that category.

Have three types of savings. Your first line of defense against economic downturn is your emergency account. You need to have at least 3-6 months of your take home pay set aside to cover your expenses in case you lose your job unexpectedly. Some people call this a “financial freedom account” because it provides you just that – freedom from worry. With the current economic situation, some experts are now recommending that instead of 6 months' worth of savings, that you increase that to 8-9 months, because in this economy, it could take you that long to find another job. The point is, you can't afford not to have an emergency account, so start now.

Beyond your emergency savings, you'll have savings for big items you want to purchase in the future. Because you're not going to go into debt for these items, you'll want to have the cash available to buy a car when your current one needs to be replaced, or to buy furniture or other large purchases. This is what we'll call “mid-term” savings.

Finally, you'll want to have money set aside for retirement (this is “long-term” savings). If you have a 401(k) plan available through work, it makes a lot of sense to contribute to it, especially if there's an employer match. Saving through payroll deduction is an easy way to save – if you don't see it, you don't miss it. If you don't have a 401(k) plan, then save in an IRA, either a Roth or traditional IRA. Remember that Social Security will only replace 20% - 40% of your current income, so you'll need to take responsibility for your own retirement account.

“If you don't make the shift from spender to saver at some point in your lifetime, you are dooming yourself to poverty or having to work forever.”

~Ted Benna, father of the 401(k)