

## Chapter 2: Budgeting

### Five Ways to Organize Your Budget Which Are Not Horribly Tedious!

**No, seriously! This might even be fun!**

“A budget is telling your money where to go instead of wondering where it went.” ~ John C. Maxwell

The most important thing to do with money is to provide it with direction, a cash flow plan, a spending, savings, investing, debt elimination plan, a budget!



A budget is a tool, a philosophy, an on-purpose and written-down money management plan. So, here's the thing: there are lots of different kinds of budgets and the key is to pick a budget that fits the way you live because it will help you meet your financial and personal goals more quickly. A budget is not handcuffs or, I guess, wallet cuffs, but a budget is actually a framework for what's important to you. Care about exercise? Put it in the budget! Charitable giving? Budget it! Like to

spurge on the occasional fancy dinner? It goes in the budget. Want to be a world traveler? You can have a climbing-the-Matterhorn budget line! Want to end up with more money than your friends who are spendthrifts? Just budget enough savings and wait!

There are a couple of reasons why traditional budgets fail. First, people make them way too complicated and depend on other people's categories. I've actually seen a budget broken out into bathroom tissue, Q-tips, and eye drops: really? Instead of being so itemized you lose the will to live; again, make a budget about you, your goals and the things you value.

#### **Remember:**

Your budget will never be perfect; things change. Unexpected income and expenses happen, so don't sweat the really small stuff. Your budget is only a set of guidelines. Of course, if you're regularly overspending your Q-tip line, you may have to adjust your thinking going forward.

Focus on the big expenses. Research tells us that housing and transportation take up the lion's share of folks' budgets. It's great to save a few bucks on, well, Q-tips, but if you're spending 70% of your take-home income on rent, well, Houston, we have a problem!

Make plans based on your real situation. Seriously, I once saw someone base her budget on a series of hypothetical raises in the future! I've even seen someone with a three-lattes-a-day habit think the cost of coffee wasn't important to their budget (hint: at \$3 a latte, that's \$270 per month!). Plan for what is, not what might be! Related to this, don't forget annual expenses. A budget based on February spending will not reflect what happens in December. Try to annualize a budget, and then break it down into monthly projections.

Keep it as simple as you can, unless you like complicated. Basically, find a method of tracking your spending that works for you. I have a friend, well, OK, he's more of an acquaintance, who was telling me about his 128 budget categories. That would totally not work for me, but, it works for him. As the following budgeting methods demonstrate, budgets can be quite different!

## Tracking Your Spending

OK, sorry about this, but any budget model you choose to adopt requires two things: knowing your income and knowing what your expenses really... no really... are.

So, for 30 days, keep all your receipts, and write down everything you spend, online and off, no matter how small. Use paper and pencil, a spreadsheet, Quicken, Mint, or any other personal finance management system. If you really pay attention to detail during this one-month period, I suspect you will learn a lot. The first time I tracked my spending, I was shocked at how much money I was simply wasting. I had no idea my cable bill had migrated into three digits, the monthly cost of coffee shop visits and sodas was ballooning, or how much money I was spending eating out. Tracking my spending allowed me to consider, very possibly for the first time, what was actually important to me. For real, it was not a chore, but an opportunity to completely redefine my financial future based on my goals and my objectives.



Once you have tracked your spending, you can start to put it into categories, such as savings and debt repayment, housing, food, clothing, transportation, medical, hobbies, entertainment, and any other categories that are important to you. Gifts? Travel? Music? Childcare? Q-tips? Remember, it doesn't have to be perfect; just start and feel free to make adjustments as you

progress.

See? That wasn't so painful, right?

Here are a few budgeting approaches that have historically worked for people. Remember, not all approaches are for everyone. The key is to find the one that fits your personality and situation best, so you can meet your goals.



### 1. The Envelope System.

With this popular method, every time you get paid, you put cash in envelopes designated for specific budget categories. So each envelope is labeled (savings and debt repayment, housing, food, clothing, transportation, medical, hobbies, entertainment, and so on), and when that cash is gone, you're done spending for the month. This method is a great way to really concretize the value of each dollar of income. It's probably not the best

idea to just leave cash in actually labeled envelopes hanging around your house or apartment, but I've met folks who have done this. I've heard stories about people realizing they had \$5 left for

food, with three days left in the month. That kind of experience can really alter the relationship one has with money.

## 2. The Zero-Sum or Getting-One-Month-Ahead Budget!

This is an interesting approach, particularly for people who may have a flexible or varied income stream. Basically, you build a budget based on the income and expenses of the prior month. Here's how it works: start by figuring out your monthly expenses. (See? Aren't you glad you tracked your spending for a month or two now?) So, let's say you have expenses of \$1,500 per month, which includes everything, such as living expenses and debt repayment and savings. Once you know your monthly expenses, save enough money to go an entire month without touching your regular income, thus getting one month ahead! For many people, just getting that one month ahead can make all the difference and result in feeling much more in control of their spending. Lastly, save your current month's income to spend next month. By getting one month ahead, it can be a lot easier to look at both income and expenses to see where you can trim expenses and accelerate debt repayment or savings.



## 3. The Balanced Money Formula.

Popularized by Elizabeth Warren and Amelia Warren Tyagi in the book [\*All Your Worth: The Ultimate Lifetime Money Plan\*](#), the Balanced Money Formula is based on your net (after-tax) income and divides expenses into three categories. It says with your take-home pay, you should spend less than 50% on needs, at least 20% on savings, and the rest (about 30%) on wants.

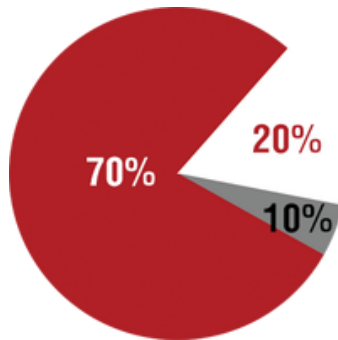
**Needs** include such things as housing, transportation, health care, utilities, insurance, and basic groceries and clothing.

**Savings** includes retirement accounts, emergency savings, and debt repayment.

**Wants** are everything else, such as cable TV, video games, cell phones, concerts, eating out, lattes, hobbies, pets, sports, charity, books and magazines, vacations, and food and clothing beyond the basics.

The authors maintain that keeping these categories in balance is the key to prudent financial management. Many people really like this approach, because it is not too prescriptive and provides great flexibility. But, you ask, what happens if your spending doesn't align with these percentages? I mean my must-haves are at like 68%? The authors suggest that you (1) pay all your must-haves, regardless of the percentage; (2) direct the next 20% of your money into savings, which includes paying down debt; and (3) spend the rest of your money on wants, guilt-free. Do this until your spending comes into balance. One of the great things about this approach is that once your spending comes into balance, you don't have to worry about it anymore. This

budget also allows some fun. With up to 30% in wants, this is a budgeting formula that allows you to have some financial fun, while you're building a better financial future! For more about the Balanced Money Formula, visit our friends at [Get Rich Slowly](#).



#### 4. The 70-20-10 Formula.

This one is similar to the Balanced Money Formula. A related budgeting model from the classic personal finance book [The Richest Man in Babylon](#), also available through the National Library Service for the Blind and Physically Handicapped, suggests that 10% of all you earn is yours to keep (savings), 20% to repay debt, and the rest you find a way on which to live. Originally written as a series of pamphlets in the 1930s, this timeless advice conveys personal finance lessons in rather direct parable form. This approach places savings and debt repayment as first priorities and simply insists that one learns to live on the remainder. For those of us who are better with big picture approaches, this model is the essence of simplicity and will lead to a lifetime of successful financial outcomes.

#### 5. The Anti-Budget Budget, or Pay Yourself First and Don't Sweat the Rest.

Many people organize a budget around expenses and then decide if whatever is left can go to savings or debt repayment. We suggest you turn this formula around and focus first on debt, then savings, and then adjust your spending and lifestyle to the remaining dollars. I have another friend who really likes to save for the future. Years ago he got himself out of debt by using the highest interest debt snowball method. (See our [chapter on debt](#) for more info). Since becoming debt free, he basically saves like 30% from every single check. When I asked him about his other spending, he looked at me quizzically and said that as long as he meets his monthly savings goal, he doesn't track any of his other spending. "That would just give me a headache; I save my 30%, never touch the interest, and just live on what's left over." This may not be a budgeting solution for everyone, but if he's saving 30% of his income, I guess it works for him! Our friends at the Motley Fool wrote about a similar approach with their [5-Minute Budget That Will Make You a Millionaire](#). Basically, they suggest you split your savings in half to pay down high-interest debt and start an emergency savings account. Afford Anything also had a great article, [The Easiest Budget Ever. \(You'll Be Shocked at its Simplicity!\)](#), that offers great tips on how to make this budget strategy work for you. Check them out!

Remember, budgeting is not a one-formula-fits-all approach. Find a method that works for you and includes the things most important to you! A budget that fits your goals, dreams and aspirations should not feel restrictive, but rather, it should feel liberating.

Are there some budgeting tools and tricks we left out? What's your favorite approach we discussed? Have any questions about what we covered? Sound off in the comments section below and continue the conversation.



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