DWD Book Project: Advanced Budgeting (using Cash-flow)

In addition to drawing up a "statement of affairs", one thing that is often overlooked and particularly useful is a cash-flow forecast-type-budget-thing...
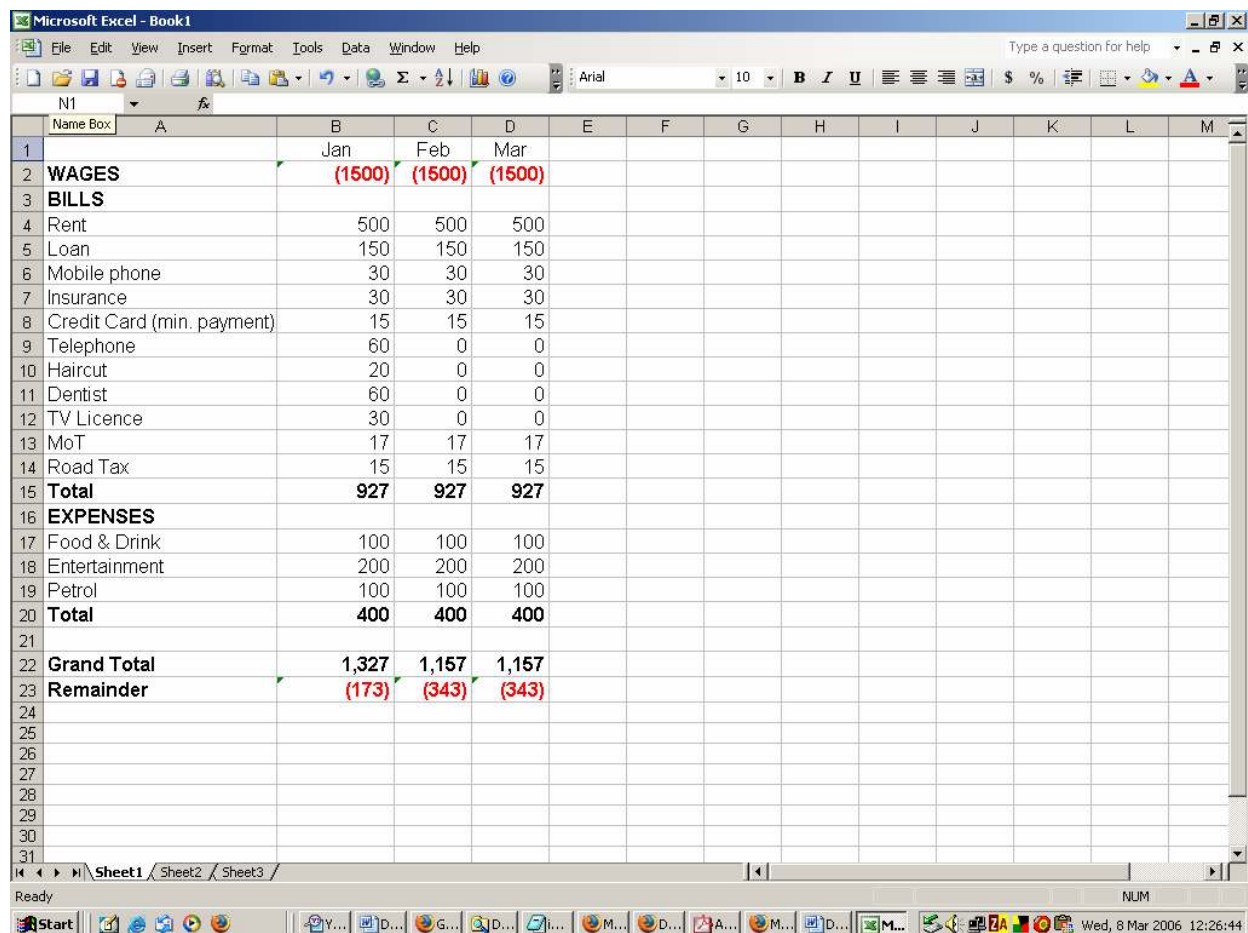
<u>Monthly Budgets Vs Cash-flow Budgets</u>

Typically, there a 2 main types of bill; monthly and quarterly. When drawing up a budget, usually, people simply stick the monthly numbers in. However, its all well and good saying that you have to pay my TV licence fee every 3 months at £30, which if you break it down over those 3 months works out as £10 a month, but you're NOT actually paying £10 a month are you? Well, in a way, yes you are… BUT this distorts the situation. A cash-flow budget shows the variation in your bills for the month and the money left over allowing you to plan more effectively.

For example, take Jack's situation, one month he might have to pay for a haircut (say every 2 months), every now and then he has to pay to go to the dentist (every 6 months), and to add to that he also has monthly and quarterly bills. So what will happen if Jack needs a haircut, to go to the dentist, and pay two quarterly bills in the same month too? This would have a significant impact on his cash-flow and budget for that month whilst, say, the following month Jack might have next to nothing to pay out.
So, the question is how are you going to keep track of all this so you can maximise my debt-repayments and, therefore, pay as little interest as possible? The answer's simple - draw up a cash-flow budget!
Jack, being a clever lad, has drawn up a cash-flow budget for the next 3 months...

	A	B	C	D
		Jan	Feb	Mar
2	WAGES	(1500)	(1500)	(1500)
3	BILLS			
4	Rent	500	500	500
5	Loan	150	150	150
6	Mobile phone	30	30	30
7	Insurance	30	30	30
8	Credit Card (min. payment)	15	15	15
9	Telephone	60	0	0
10	Haircut	20	0	0
11	Dentist	60	0	0
12	TV Licence	30	0	0
13	MoT	17	17	17
14	Road Tax	15	15	15
15	Total	927	927	927
16	EXPENSES			
17	Food & Drink	100	100	100
18	Entertainment	200	200	200
19	Petrol	100	100	100
20	Total	400	400	400
21				
22	Grand Total	1,327	1,157	1,157
23	Remainder	(173)	(343)	(343)

Here we can see how Jack's cash-flow varies from month to month. Some months he has more money than others. Now let's compare this cash-flow budget with the usual monthly budget we all recognise…

	Monthly	Jan
WAGES	(1500)	(1500)
BILLS		
Rent	500	500
Loan	150	150
Mobile phone	30	30
Insurance	30	30
Credit Card (min. p	15	15
Telephone	20	60
Haircut	10	20
Dentist	10	60
TV Licence	10	30
MoT	17	17
Road Tax	15	15
Total	807	927
EXPENSES		
Food & Drink	100	100
Entertainment	200	200
Petrol	100	100
Total	400	400
Grand Total	1,210	1,330
Remainder	(293)	(173)

Whoa! Hang on a minute! Jack's budget says he should have £293 left over at the end of the month but he hasn't – in January he's only got £173. That's a shortage of £120!
It's not all doom and gloom though; take a look at his February budget…

	Monthly	Feb
WAGES	(1500)	(1500)
BILLS		
Rent	500	500
Loan	150	150
Mobile phone	30	30
Insurance	30	30
Credit Card (min. payment)	15	15
Telephone	20	0
Haircut	10	0
Dentist	10	0
TV Licence	10	0
MoT	17	17
Road Tax	15	15
Total	**807**	**757**
EXPENSES		
Food & Drink	100	100
Entertainment	200	200
Petrol	100	100
Total	**400**	**400**
Grand Total	**1,210**	**1,160**
Remainder	(293)	(343)

Hurrah, Jack has £343 left over! That's an extra £50 he wasn't expecting!

Obviously, this is a relatively simple example but more items can be added to the list. If you have kids pocket money to pay every Saturday some months you'll find you pay more than others depending on how many Saturdays there are in the month. Or, for example, you might have a birthday in one particular month which is an extra £30 to splash out on a birthday dinner?

How do you draw up a cash-flow budget?

Bills

Well, it's not rocket science - there are no complicated formulas to calculate, and no fancy super-dooper software. What do you need? A simple spreadsheet (e.g. Microsoft Excel) will do, a calendar, and your bank statements.

Grab your bank statements, look at the monthly bills that go out, and list all these with the amounts each month. Next take the quarterly bills and do the same. Put the minimum payment amounts for any credit cards in, and ONLY the minimum payments, for each month. Now look at haircuts, dental visits, any regular other things and add them in too…

	A	B	C	D	E	F	G	H	I	J	K	L	M
2		Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
3	**WAGES**	-1,500	-1,500	-1,500	-1,500	-1,500	-1,500	-1,500	-1,500	-1,500	-1,500	-1,500	-1,500
4	**BILLS**												
5	Rent	500	500	500	500	500	500	500	500	500	500	500	500
6	Loan	150	150	150	150	150	150	150	150	150	150	150	150
7	Mobile phone	30	30	30	30	30	30	30	30	30	30	30	30
8	Insurance	30	30	30	30	30	30	30	30	30	30	30	30
9	Credit Card 1	15	15	15	15	15	15	15	15	15	15	15	15
10	Credit Card 2	20	20	20	20	20	20	20	20	20	20	20	20
11	Telephone	60	0	0	60	0	0	60	0	0	60	0	0
12	Haircut	20	0	20	0	20	0	20	0	20	0	20	0
13	Dentist	60	0	0	0	0	0	60	0	0	0	0	0
14	TV Licence	30	0	0	30	0	0	30	0	0	30	0	0
15	Magazine Sub	0	15	0	0	15	0	0	15	0	0	15	0
16	**Total**	**915**	**760**	**765**	**835**	**780**	**745**	**915**	**760**	**765**	**835**	**780**	**745**
17	Remainder	-585	-740	-735	-665	-720	-755	-585	-740	-735	-665	-720	-755

And there you have it. All the regular bills are in and you can see what's left. Looking at this table you can see Jack pays his rent, loan, mobile phone, car insurance, and the two credit card minimum payments on a monthly basis. He gets his haircut every 2 months and pays for his telephone, TV licence, and magazine subscription on a quarterly basis. He also visits the dentist every 6 months for a check-up.

Now Jack has variable amounts of cash left over after all these bills go out. Just look at those amounts from £585 to £755 depending on the month. Now what? Now we look at the big once-a-year things…

The big once-a-year things

Things like road tax and MOTs have a nasty habit of being forgotten, only to come back and bite you on the behind, and its well worth putting aside a regular amount into a savings pot. It's a good idea to put this money to a separate savings account so you can avoid an "ooh look there's still £35 in my account let's buy that inflatable cabbage" scenario. Before you know it, you've spent your road tax and MOT money and you're reduced to the miserable world of public transport!

So Jack, being really organised has worked out his road tax is £180 a year. Now rather than waiting until its due and paying it in one big hit he rather cleverly decides to build up a savings pot, which by the time its due will be enough to cover it. This works out at £15 a month.

As we know, Jack isn't stupid and wants to put away some more of his hard-earned cash to cover the next MOT. How much? Well, he has to estimate but, being a bit of a cautious fellow, he decides he'd rather save too much than too little, so he arrives at a figure of about

£200. Over 12 months that works out as £16.67 a month. For simplicity sake, Jack rounds this up to £17 and adds this every month to his savings pot too…

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
SAVINGS POT												
MoT	17	17	17	17	17	17	17	17	17	17	17	17
Road Tax	15	15	15	15	15	15	15	15	15	15	15	15
Xmas	10	10	10	10	10	10	10	10	10	10	10	10
Total	42	42	42	42	42	42	42	42	42	42	42	42
Remainder	(543)	(698)	(693)	(623)	(678)	(713)	(543)	(698)	(693)	(623)	(678)	(713)

Jack has also decided to put some money aside for Christmas since it is an expensive time of year and simply sticks £10 a month away for this. The thing about drawing up a budget like this is it's entirely up to you how you do it. If you spend a lot of money at Christmas then why not put aside some money? If you don't want to, don't bother, it's up to you. If you have kids and tend to spend quite a bit of money on presents then you could do the same for birthdays. In this example, Jack decides not to do this.

Anyway, all in all, every month, Jack puts away £42 a month into a separate savings account. £42 doesn't sound like an awful lot of money does it? But over a year this adds up to a whopping £504! He's saved £204 for his MOT, £180 for road tax, and £120 for Christmas.

The beauty of this is if the MOT only costs £100, then Jack has an extra £104 in savings which he can then use to clear any debt, have a mini-holiday, treat himself to something, or simply leave it in the savings pot in case of emergency.

So Jack's covered himself for all his regular bills, and the big-once-a-year-things, now what? Well, next is the variable stuff…

The variable stuff

These are things like groceries, petrol which need to be budgeted for. Spending money is also included here, although you could adjust your spending money each month depending on how well you're doing. So here we go, Jack looks at his petrol receipts and works out he spends £100 in petrol each month. He also tends to spend £100 a month on grocery

shopping. And then of course there's the money he's budgeted for going-out, fishing, football subs for his local team, and any other hobbies and interests…

A	B	C	D	E	F	G	H	I	J	K	L	M	N	O	P
1	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec			
2 VARIABLE STUFF															
3 Food & Drink	100	100	100	100	100	100	100	100	100	100	100	100			
4 Entertainment	200	200	200	200	200	200	200	200	200	200	200	200			
5 Birthdays	0	0	0	0	50	0	0	0	50	0	0	0			
6 Petrol	100	100	100	100	100	100	100	100	100	100	100	100			
7 Total	400	400	400	400	450	400	400	400	450	400	400	400			
8 Remainder	(143)	(298)	(293)	(223)	(228)	(313)	(143)	(298)	(243)	(223)	(278)	(313)			

Instead of building up a savings pot for the two birthdays, Jack simply pays it in one-hit in the month. Jack is happy to do this but you might want to put some savings away for this and spread the cost. It's up to you.

Now, you can see what Jack is REALLY left with after all his wages have been allocated to various things. He's got his wages, paid his monthly and quarterly bills, put some savings away for the big-things, and he's covered his groceries and travel, the odd birthday here and there and even some spending money! Look at the difference; worst case scenario Jack has £143 left, best case, £313. That's a difference of £160! Is that it? Not quite, the last but best bit of all…

Drum roll please…

Clearing the debt

Credit Cards

Now we tackle the credit card debt. Forget the loan for the moment since this is fixed and budgeted for every month. Jack has two credit cards, one with Vulture Finance (credit card 1) and one with Sunshine Credit (credit card 2).

The interest rate on credit card 1 is fixed at 15.9% and on credit card 2 the rate is fixed at 6.0%. So how does Jack make the best possible use of his funds? Remember we've already budgeted for (and paid) the minimum payments. So this money left over is EXTRA money to be thrown at the debt.

For this we're going to apply the principles of "snowballing". Jack is, cunningly, going to pay all of the extra cash left over to clear the Vulture Finance debt (credit card 1) first since this has the highest interest rate and is, therefore, costing him the most. He is going to pay NO extra money to Sunshine Credit (credit card 2) for the time-being - just the minimum payment as already budgeted…

		Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Remainder		(143)	(298)	(293)	(223)	(228)	(313)	(143)	(298)	(243)	(223)	(278)	(313)
CREDIT CARDS	APR												
Vulture Finance	15.90%	143	298	293	223	228	313	40	0	0	0	0	0
Sunshine Credit	6.00%	0	0	0	0	0	0	103	298	243	223	278	313
Total		143	298	293	223	228	313	143	298	243	223	278	313

So in January, February, March, all the way through to June, Jack works hard using all his left-over cash to pay off Vulture Finance, all the time incurring less and less interest. In July it turns out he has only got £40 left on his Vulture Finance credit card so he pays this and banishes the credit card forever! But he's still got money on Sunshine Credit so the extra money is now used to clear this debt off until the balance is gone.

Hey, what about the minimum payment we've already budgeted for Vulture Finance? I hear you cry. Quite rightly so! From August onwards you don't need to budget for this minimum payment anymore. So take out the figure and watch the numbers change…

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	A	B	C	D	E	F	G	H	I	J	K	L	M	N	O
1			Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	
2	BILLS														
3	Credit Card 1		15	15	15	15	15	15	15	0	0	0	0	0	
4	Credit Card 2		20	20	20	20	20	20	20	20	20	20	20	20	
5	Remainder		(143)	(298)	(293)	(223)	(228)	(313)	(143)	(298)	(243)	(223)	(278)	(313)	
6															
7	CREDIT CARDS	APR													
8	Vulture Finance	15.90%	143	298	293	223	228	313	40	0	0	0	0	0	
9	Sunshine Credit	6.00%	0	0	0	0	0	0	103	313	258	238	293	328	
10	Total		143	298	293	223	228	313	143	313	258	238	293	328	

Now compare the two. Because Jack has cleared Vulture Finance from August onwards he doesn't have to pay them any more money… Ever! So the minimum payment amount for Vulture Finance has been removed. This extra £15 now appears as money left over and is also used to clear down the Sunshine Credit debt.

(continued…)

The Loan

Let's assume that a year later Jack has cleared both the credit cards, this is what his budget now looks like:

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
WAGES	(1500)	(1500)	(1500)	(1500)	(1500)	(1500)	(1500)	(1500)	(1500)	(1500)	(1500)	(1500)
BILLS												
Rent	500	500	500	500	500	500	500	500	500	500	500	500
Loan	150	150	150	150	150	150	150	150	150	150	150	150
Mobile phone	30	30	30	30	30	30	30	30	30	30	30	30
Insurance	30	30	30	30	30	30	30	30	30	30	30	30
Credit Card 1	0	0	0	0	0	0	0	0	0	0	0	0
Credit Card 2	0	0	0	0	0	0	0	0	0	0	0	0
Telephone	60	0	0	60	0	0	60	0	0	60	0	0
Haircut	20	0	20	0	20	0	20	0	20	0	20	0
Dentist	60	0	0	0	0	0	60	0	0	0	0	0
TV Licence	30	0	0	30	0	0	30	0	0	30	0	0
Magazine Sub	0	15	0	0	15	0	0	15	0	0	15	0
Total	880	725	730	800	745	710	880	725	730	800	745	710
SAVINGS POT												
MoT	17	17	17	17	17	17	17	17	17	17	17	17
Road Tax	15	15	15	15	15	15	15	15	15	15	15	15
Xmas	10	10	10	10	10	10	10	10	10	10	10	10
Total	42	42	42	42	42	42	42	42	42	42	42	42
VARIABLE STUFF												
Food & Drink	100	100	100	100	100	100	100	100	100	100	100	100
Entertainment	200	200	200	200	200	200	200	200	200	200	200	200
Birthdays	0	0	0	0	50	0	0	0	50	0	0	0
Petrol	100	100	100	100	100	100	100	100	100	100	100	100
Total	400	400	400	400	450	400	400	400	450	400	400	400
Grand Total	1,322	1,167	1,172	1,242	1,237	1,152	1,322	1,167	1,222	1,242	1,187	1,152
Remainder	(178)	(333)	(328)	(258)	(263)	(348)	(178)	(333)	(278)	(259)	(313)	(348)

Now the dilemma is what does he do with all that extra money?

Well, one option would be to move his loan to a 0% card and start clearing that down like the Vulture Finance and Sunshine Credit debts. If he's not comfortable with that, since 0% cards tend to only stay 0% for 6-9 months, he might be able to move it to a credit card offering 5.9% for the life of the balance? Which option you choose is up to you… Maybe he just wants to carry on now and not bother to move the loan at all? Take a break then look at it later?

Let's assume Jack goes for the 5.9% for the life-time of the balance offer and moves his loan over to the credit card. What now? Jack's not stupid, with his knowledge and experience with the other two credit cards he knows exactly what to do. He finds out the minimum payment on his new credit card is £150 (what a coincidence!) but now he has no loan to pay. So Jack's bills stay the same, but now the extra cash is used to pay the new credit card off as fast as he can!

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
WAGES	(1500)	(1500)	(1500)	(1500)	(1500)	(1500)	(1500)	(1500)	(1500)	(1500)	(1500)	(1500)
BILLS												
Loan	0	0	0	0	0	0	0	0	0	0	0	0
Credit Card 1	0	0	0	0	0	0	0	0	0	0	0	0
Credit Card 2	0	0	0	0	0	0	0	0	0	0	0	0
Credit Card 3	150	150	150	150	150	150	150	150	150	150	150	150
Remainder	(178)	(333)	(328)	(258)	(263)	(348)	(178)	(333)	(278)	(258)	(313)	(348)
CREDIT CARDS												
Credit Card 3	178	333	328	258	263	348	178	333	278	258	313	348

Look at that. Jack can pay the minimum payments of £150 a month and use what-ever he's left with after ALL his out-goings and clear somewhere between £328 and £498 a month off his debt. All these payments actually amount to a whopping £5,216 in a year!

The main advantage of credit cards (and flexible loans) over fixed loans, providing the interest rate is nice and low, is you can pay as much as you want and, say you get a rather nice annual bonus at work, you can clear large chunks of debt and reduce the interest you're paying and get it down quickly. This is one of major reasons why, in some cases, consolidation loans are NOT a good idea – you could still be paying off your debts 10 years down the line.

Summary

Of course not everyone is in Jack's position. The point of this book is to show you different ways of dealing with debt. Some readers will be able to use this cash-flow budget and some won't. The most important thing is you deal with your debt. Read up on "Statement of Affairs", "Snowballing", and "Stoozing" as here I've merely scratched the surface. And if anyone wants a bit of help The Motley Fool has a regular army of "Fools" ready and willing to help!

Hope to see you there!