

Using the Envelope Budgeting Method in Today's Cashless Society

Traditionally the envelope budgeting method used cash and actual paper envelopes; however, in today's high-tech and often cashless society, that would be a little unrealistic. Some expenses simply cannot be paid in cash and, therefore, we need to find ways to use these tried and true principles of envelope budgeting, in today's world.

The major problem with many budgeting systems has been that they provide after-the-fact information, meaning you create a plan in advance and determine the amount you will spend in each spending category. At the end of the month, you then run a report, which tells you all the categories in which you have overspent. With this approach, the information is not real time—in other words, you did not have the information you needed at the time you were making a purchase decision. Systems like this do not tell you how much is left to spend. An envelope budgeting system provides this critical information.

Even with the significant advantages of the envelope budgeting system, it is only as good as your determination to use it. Meticulous tracking will only prove successful if you are prepared to guide your spending decisions based on the information the envelope system is providing you.



Cash from
Paycheck= \$1,200.00

Mortgage \$400	Gas \$25	Electrical \$75	Vehicle \$100	Groceries \$150	Savings \$75	Misc. \$25
Medical \$90	Gifts \$25	Donations \$25	Taxes \$125	Education \$75	Vacation \$10	

Sum of Envelopes= \$1,200.00

Sum of Paycheck is Equal to Sum of Envelopes

Success will ultimately come from persistent and consistent execution of the success cycle and the envelope budgeting principles. Let's quickly review the envelope method of budgeting:

- ◆ Set money aside in advance of spending requirements
- ◆ Spend from how much is left
- ◆ When you run out money, you must make a choice
- ◆ At the end of the period, what's left is savings

Of course these steps above pre-suppose that you have made the commitment to spend less than you make. Without that, the envelope principles don't work.

When you partner envelope budgeting with the success cycle, you will have a system that really works. The success cycle is made up of four steps:

- ◆ Plan
- ◆ Track
- ◆ Compare
- ◆ Adjust

Your Monthly Spending Plan is the part of the envelope method that coincides with the first step of the Success Cycle – Plan. Your Monthly Spending Plan has defined budget categories, or envelope spending accounts. The next step is to track all of your transactions so that you can compare that information with your plan. You will want to use your plan, along with your tracked transactions, to make informed spending decisions; if you know how much you have spent, how much you have left to spend and how long it has to last, you can make appropriate spending choices that won't limit your options in the future.



How do you realistically track every transaction? Yes, It does seem daunting at first, but it's actually not as hard as it sounds with the help of the right tools. The right tools can make this task simple, even automatic.

The most critical component to successful tracking is the proactive decision to actually do it. Once you have made this decision, you can begin reviewing the variety of implementation tools that are available to help you in your task; and then find the one that is right for you.

There are a variety of implementation tools available that you can use with the envelope budgeting method. Among the options are:

- ◆ Cash-based
- ◆ Paper-based
- ◆ Spreadsheet
- ◆ Software
- ◆ Online System
- ◆ Combination of the above

Choosing an envelope budgeting system.

Finding out which tool is right for you is important to ensure your long-term success. The correct implementation tool must assist you in successfully tracking all expenses and maintaining the balance information that is necessary to make informed spending decisions on a daily basis. Above I mentioned several types of tracking tools, let's review them in 4 basic categories:

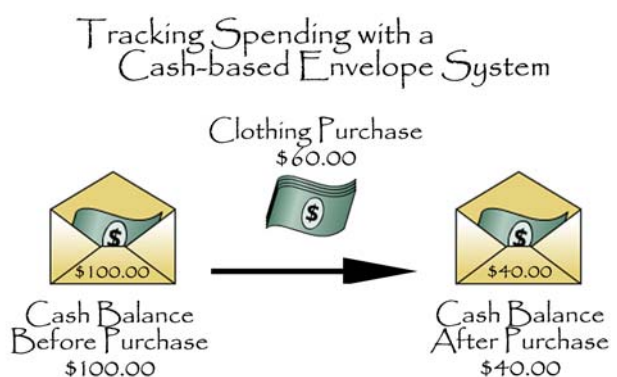
1. Cash
2. Paper ledger or computer spreadsheet
3. Computer-based envelope system
4. Combination of these

Choosing the correct implementation tool for you and your family is a matter of personal preference and lifestyle.

Cash-based envelopes.

The most basic approach to implementing the envelope principles is using a cash-based system. Income allocation and tracking your spending are both very straightforward with cash. Because of these advantages, many people have opted to use the cash system. However, because it is more difficult and inconvenient to make all payments with cash, many people combine a cash-based envelope system with a system that can handle the management of non-cash transactions as well.

Tracking all of your spending is quite simple with a cash envelope system, as every transaction is automatically subtracted from the balance remaining in a particular spending envelope, or account. For example, when you make a clothing purchase, you take the clothing envelope with you and pay for the purchase from the clothing envelope. Let's say you have \$100 left in your clothing envelope, and you are making a \$60 purchase. When you hand the cashier the \$60,



you will have \$40 left in the envelope. Simply write down the transaction on your envelope or place the receipt in the envelope so that you can look back at where your money was spent during the month. When you count up the cash left in the envelope, you will know how much you have left to spend and how long it will need to last.

Paper ledger or computer spreadsheet.

Using a paper ledger or computer spreadsheet system allows you to track all types of spending. This approach works much the same way as the cash-based envelope system, with a few adjustments. Obviously, you will not be allocating actual cash to spending envelopes. However, you will be creating spending accounts that are essentially virtual envelopes. Your cash will stay in your bank account, but you will allocate it to your spending accounts for the purpose of tracking your spending and determining the balance remaining in each spending account on a daily basis.

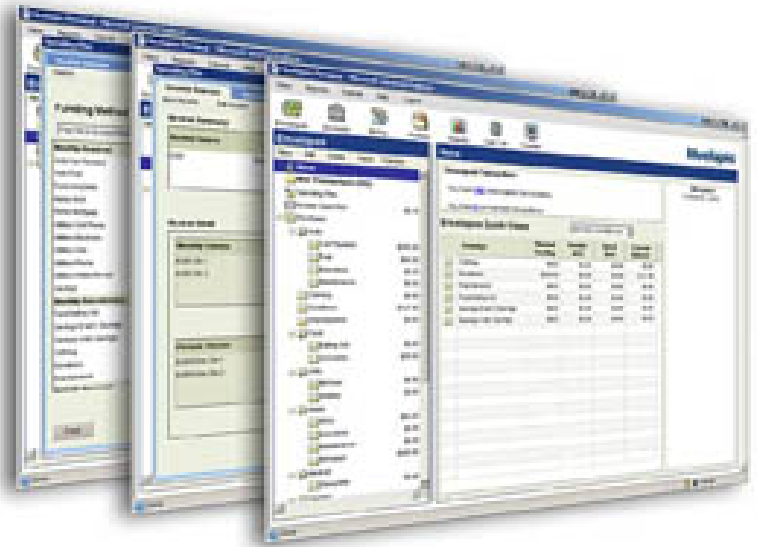
If we use the same example used in the cash-based method above, with the paper-based system, you will need to record the non-cash spending transaction—that is, check, debit card, or other form of payment that you used to buy the \$60.00 in

clothes—in your bank account register, as well as in your clothing account register and subtract that amount from the \$100 balance in the clothing account. The same would be true if you created an account register spreadsheet on the computer.

Computer-based envelope system.

Perhaps the easiest envelope system for most to use is a computer-based or online system. If you are using a fully automated envelope-based computer system, your transaction will be tracked automatically for you. For the example that was used above, you will simply need to download the non-cash transaction and assign it to your clothing spending account.

The system will automatically update the balance remaining in that account for you. You will know exactly how much you have spent, how much you have left to spend and how long it needs to last.



In addition to the above, the right system will help you complete each of the following:

1. Create your monthly spending plan.
2. Set up your spending accounts.
3. Create your funding, or income allocation, plan.
4. Set your initial spending account balances.
5. Ensure your spending accounts and bank accounts are balanced.
6. Allocate your income to spending accounts as defined in your funding plan.
7. Automatically track your transactions.
8. Assign your transactions to the appropriate spending accounts.
9. Split transactions between a number of spending accounts.
10. Set aside money for credit card purchases.
11. Complete a monthly review and make adjustments.

An appropriate computer-based system also will generate a number of important reports, including spending and bank account summary reports. These reports can be printed on a daily basis and carried with you to assist with making sound spending decisions. It also should help facilitate the monthly reconciliation process for your financial institution accounts.

Using a combination of these approaches.

Even if you use a paper ledger system, computer spreadsheet, or computer-based envelope system, there may be certain spending accounts for which you would like to use cash. This is not a problem and can easily be done. Most people who use a combined approach use cash envelopes for many of their monthly discretionary

accounts, such as groceries, entertainment, allowances, and clothing. They find they are able to exact a higher level of control over these spending areas when they are using cash. If you would like to use cash for some of your spending accounts, you will need to go to the bank or ATM once each month and take out enough cash to meet the funding, or income allocation, requirements for these envelopes.

It's about choices, not restrictions.

One of the most often-cited objections to the idea of budgeting is the thought that budgets become restrictive and frustrating. The feeling that they cannot make purchases when they would like to can be very disconcerting for many people. However, in reality, as you spend beyond your income resources, your spending choices become increasingly more restricted. Real, long-lasting choice comes from making the decision to live within your means.

That said, there are many times when making a decision to spend beyond the current resources in a spending account is just fine. Let's say that a desired clothing purchase was \$125. You recall the balance in the clothing envelope is only \$100. In this case, you have to decide if you would like to put off the purchase until you have more money in the clothing envelope, purchase a less expensive item, or transfer money from another envelope to cover the added cost.

As you can see, the information provided using the envelope system has truly empowered you to make an informed decision. Making the decision to transfer money from another envelope is not a problem, because by transferring the funds, you have made a decision to spend less in that area.

Now let's say that you did not have extra money in another envelope to transfer to the clothing envelope. In this case, if you are truly dedicated to living within your means, your only option is to either purchase a less expensive item or wait until you have more money in the clothing envelope. Choosing to spend the extra \$25 when the resources are not available will limit your choices in the future, because you have just created debt above and beyond your monthly net income resources. This means you will be paying more interest next month and further reducing available resources to purchase the things you want or, more importantly need.

Most people are very successful at making sound purchase decisions when they know how much is left to spend. But ultimately, your success in making smart decisions will depend on your resolve to live within your means.

* This article contains excerpts from *Money for Life – Budgeting Success and Financial Fitness in Just 12 Weeks!* and from the *Money for Life Success Planner – A 12-Week Companion to Achieve Financial Fitness* written by Steven B Smith (Dearborn Trade Publications, 2004)