

Envelope System: Budgeting Best Practices

Many people use the popular cash envelope system to manage their spending each month. With this method you insert cash into spending envelopes for different spending categories such as bills, food, entertainment, etc. You then withdraw the cash from the appropriate envelope when you need to purchase something. Overall, I'm a fan of creating a budget and manage spending using this method because it helps people plan their spending and does well to avoid over spending.



Let's take a closer look at envelope system and a few odds and ends of when it works best and when it might be more challenging to use.

Limit Envelopes

In my opinion, envelope budgeting works best when you can limit your spending categories, or envelopes, to approximately 10 or less. Some people like to create multiple subcategories in their budget. For example, my budget has about 10 subcategories for my monthly miscellaneous category. I couldn't imagine keeping the cash straight for all those subcategories and transfer it between each envelope as required. There is just too much management overhead with this many envelopes. In this particular example, envelope budgeting would work better by having one envelope for my miscellaneous spending category.

Problematic Spending

You might find a hybrid approach to cash envelope budgeting works best for you rather than using cash for every spending category. With this hybrid approach you only use cash envelopes for areas in your budget that are problematic, or often difficult to avoid over spending. If you tend to over spend electronically every month for entertainment, clothing, etc., you might choose to manage those spending categories with cash. Simply go to an ATM when you get paid, withdraw the cash you need for the problematic categories and deposit the cash into the appropriate envelopes. Once the cash is gone, you're done spending for the month. You can also quickly count the cash you have left if you're thinking about spending it.

Transferring Money

Envelope budgeting isn't perfect and neither is your spending. More than likely some spending categories are going to require more cash each month than planned, while some will require less. You must be open and flexible to transferring money from one envelope to another to adjust your plan for the month. For example, family comes in town to stay with you and you spend more money on food. You have to be willing to take cash from another envelope, i.e. adjust spending priorities, to fund the food envelope with more money. This is actively managing your spending each month and is required to make sure your budget stays in balance.

Multiple Envelopes for One Shopping Trip

Be careful to plan your spending, or shopping trips wisely. For example, you may find it difficult to carry several cash envelopes with you to the grocery store and have to withdraw from each envelope when checking out. Perhaps one envelope is for toiletry items, one for household goods and one for food. You're better off estimating how much you need from each envelope and withdrawing the cash from each before you go to the store. Once you return from the store you can make sure the appropriate amount of money is returned to each envelope. *Note: This can be difficult to manage if you have too many spending categories as described above.*

Consider Electronic Enveloping Budgeting

Another form of the envelope system is electronic envelope budgeting. With electronic envelope budgeting, such as with Mvelopes Personal, you set up electronic envelopes, set a budget limit and assign electronic transactions to them. I've used Mvelopes money management software for several years and I think it's a great way to leverage this classic method and using today's internet technology. All my transactions from my financial institution are automatically downloaded which makes it easy to assign them to envelopes. And, I can still use the hybrid approach as described above by simply assigning my ATM transaction to the appropriate envelopes. For a thorough review of the Mvelopes system, go to: <http://www.onemoneydesign.com/mvelopes-review/>