

BUDGET BASICS

Nonprofit Budgeting 101
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Introductions

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Seven Characteristics of Financially Healthy Nonprofits

1. Sufficient income to ensure stable programming
2. Internal source of cash or ready access to cash in times of shortfall
3. Engage in income-based, rather than budget-based spending
4. Retains a positive cash flow at the end of each year
5. In year's of a deficit, sufficient surpluses have been accumulated to cover current year's deficit
6. Established or plans to establish an operating reserve to finance growth and cash shortfalls
7. Board and Management hold themselves responsible for financial stability

What is income based spending?

- A. Begins with realistic income projections
- B. Determines realistic costs of next year's service delivery through:
 - 1. Analysis of last year's costs
 - 2. Consideration of current market conditions
 - 3. Functional cost allocations

Operating Reserves/Surpluses

Operating Reserves/Surpluses – Similar to retained earnings or owner's equity in business enterprises. Funds, usually accumulated over several years, which are available for use by the organization at the discretion of the Board. (unrestricted monies)

Operating Reserves/ Surpluses (Continued)

- A balance between operating income and expenses must be maintained in order to survive
- Most organizations can expect to incur some operating deficit at some time
- Achieving the balance is considered a challenge due to:
 - Fickle funders
 - Economic conditions
 - Federal, State and Local funders reduce grants and contracts

What Function Do Operating Reserves Play?

- Enable the organization to survive operating shortfalls
- Enhance the flexibility of an organization to develop new programs, replace outdated programs or expand interests and services
- Expand credit opportunities and permit favorable financing of growth and expansion. This includes permitting a change in direction or focus of programs and activities

How Much Reserve is Enough?

- Operating reserves needed by an organization depends upon its individual characteristics and circumstances, as follows:
 - Reliability of the sources of income
 - Are they predictable (example – Board based membership) versus unpredictable (example – grants and contributions)
 - Is cash flow irregular?

How Much Reserve is Enough? (Continued)

- Availability of external financing
- Stability of expenses
 - Are expenses fixed and predictable
- Nature of liabilities
 - Noncurrent liabilities and debt reduce operating flexibility and access to external financing and increase risk of penalties and interest for untimely repayment
- Nature of other assets
 - Any unrestricted investments or endowments
- Nature of Opportunities
 - Example – Organization planning to buy a building within the next three years, whenever a good deal becomes available would require a high level of reserves



What did the previous slides
have to do with Budgeting?

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A realistic budget is a tool to forecast and monitor your organization's financial health. A budget is the way in which the reality of limited resources can help management try to prioritize objectives.

Types of Budgets

- Operational Budget
- Program or Activity Budget
- Capital Expenditure Budget
- Cash Flow Budget
- Non-Financial Budget

Operational Budget

Operational –

All expected sources of revenue (contributions, grants, membership dues, etc.), followed by the expected expenditure of those funds on an operational basis.

Program or Activity Budget

Program or Activity –

Budgets which are tied to specific funding sources, such as government or corporate grants, that detail the funds expected to be received from each source and their expected use.

Capital Expenditure Budget

Capital Budget –

Used to project revenue and expenditures for tangible items (such as land, buildings and equipment), which will provide benefit to the organization over an extended period of time.

Cash Flow Budget

Cash Flow Budget –

Used to project the cash receipts and required cash expenditures over a given period of time

Non-Financial Budget

Non-Financial Budget

Another useful tool by management. Most common type is a time (manpower) budget. It allows management to visually see if the organization is making the most efficient use of its staff for a particular event or period of time

Preparation

- Must be realistic, accurate and controlled
- To ensure realistic budgets, all levels of the organization must be involved in the budget preparation process
- Typically the following would be involved in the process:
 - Program Managers, Controller, CFO, ED, Treasurer, and the Board of Directors

Preparation (Continued)

- Controller usually coordinates the budgeting process across all levels
- From the bottom up – Start with departments and programs
- Should be linked to organization goals and objectives
 - Goals and objectives should fit into your strategic, long range plan and help you make progress toward your mission
- Since personnel costs typically account for 60 to 70 percent of a nonprofit's total expense budget – Plan for the hidden costs
- Rely on past experience but make sure to take into account upcoming changes. Example – Insurance can have substantial fluctuations from year to year

Cash-Basis and Accrual-Basis Accounting

- Use different criteria for determining when to recognize and record revenue and expenses
- Cash-basis:
 - Revenues are recognized when cash is received and deposited
 - Expenses are recorded when they are paid
- Accrual-basis:
 - Revenues are recognized when earned
 - Expenses are recorded when they are owed

Budget Process

- To be an effective tool for goal-setting and monitoring progress, needs to be completed in enough time for managers and departments to implement procedures that are focused to meet expectations
 - Failure to complete timely will result in lack of employee commitment

Budget Process (Continued)

- Prepare a budget calendar and work backwards from the due date
- Review the comparison of prior year actual results to prior year budgeted amounts to determine whether improvement needs to be made in the budgeting process
- Each department/program manager should be responsible for explaining significant variances between prior year budget and actual current year at interim dates (monthly, quarterly, etc)

Budget Process (Continued)

- Budget preparation should begin with input from the department and program manager level from all areas of the organization
- To facilitate monitoring and accountability, every portion of the budget should be matched to respective revenue and expense accounts in the organization's chart of accounts

Budget Process (Continued)

- Budgeted revenue and expenses should be determined based on prior year actual results, taking into consideration any known/expected changes in the organization (i.e. changes in funding, changes in staff, changes in equipment)

Budget Process (Continued)

- When revenues are uncertain – try to develop budgets for best case, worst case and most likely scenarios. Be sure to consider the effects on expenses as well.
- One individual within the organization should be responsible for gathering budget information from departments, consolidating the budget and coordinating the review of the budgets.
 - Typically controller but can be CFO or ED

Budget Process (Continued)

- Keep careful notes of assumptions that have been made in preparing the budget. Assumptions should be reviewed for reasonableness and consistency.
- Prepare detailed back-up work sheets to compute budget items that are composed of more than one type of expense (salaries, fringe benefits, supplies, insurance)

Budget Process (Continued)

- The original review of the draft budgets should typically be performed by the CFO, treasurer and/or finance committee. Once approved and finalized at that level, it should be passed to the Board for review and final approval
- Any future amendments to the budget should receive Board approval

Budget Process (Continued)

- Budgets can be used to predict cash flows, if depreciation is added back and debt service is deducted in an “add” schedule
- For future reference, note the date on which the budget was prepared, period of time for which it was prepared and the date in which any revisions to the budget are made

Evaluating Results

- Compare budgeted amounts to actual results
- Budget only becomes valuable when compared to what financial results have actually occurred
- Comparison should not take place only at the end of the budget year (after everything has taken place) but monthly as the events are taking place

Evaluating Results (Continued)

- For monthly comparison to work
 - The lines on the budget should correspond with the categories in the accounting system so very little allocating and regrouping needs to take place (use budget tool in QuickBooks)
 - Budget needs to be created on a monthly basis and roll up into an annual total. Some revenue and expenditures may fluctuate differently throughout the year and not be broken out on a 1/12 method.

Evaluating Results (Continued)

- Expect variances
- Understand the reason for the differences from expectations
- Budget process is not complete once the budget is finalized – it needs to be continually monitored to make sure the organization is on track to meet its current period goals

Evaluating Results (Continued)

- Ultimately, the department and program manager is responsible for meeting his or her budget and explaining fluctuations/deviations
- The controller or CFO responsibility is to monitor the budget
- The budget is a planning tool and Monitoring is a controlling tool used to assess whether the budget is realistic and accurate

Evaluating Results (Continued)

- In addition to monthly reviews, a formal mid-year review should be conducted
 - Review past six month actual activity to budget
 - Review approved budget with the projected year end statement
 - Projected year end statements are generated by inputting actual receipts, disbursements, payables, receivables along with realistic projections of what is anticipated within the next six months

Evaluating Results (Continued)

- Since budgets are prepared in advance of the period in which the budget covers, it will be unlikely that the budget will have considered or incorporated all possible outcomes that could occur throughout the year
 - As the year unfolds, it is important to adjust the budget if necessary so that the organization can stay on course but only for certain instances

Budget Checklist

- The following is a checklist that can be used to help you see if your budgeting process is sufficient or whether certain aspects of the process need to be improved
- Answer to the following questions should be YES

Budget Checklist (Continued)

- Relationship to the NFP's Goals:
 1. Are the NFP's program goals and objectives defined?
 2. Is the budget in harmony with the NFP's short-term and long-term goals and objectives?
 3. Has the NFP brainstormed alternative ways to achieve its objectives?
 4. Have priorities been identified? Will they achieve the NFP's goal?
 5. Have all costs associated with each priority been identified in specific terms?

Budget Checklist (Continued)

- Budget Preparation
 1. Does the NFP know how much money it will have or expects to have?
 2. Have those individuals most knowledgeable about the program/activities assisted in the preparation of the budget?
 3. Is the budget preparation being done with the cooperation of all executives within the entity?

Budget Checklist (Continued)

- Budget Preparation (Continued):
 4. Are the budgets prepared in a timely manner? (before the commencement of the budget period)
 5. Are all projected costs included? Are they valid and realistic?
 6. Is the budget either in written or typed form?
 7. Does the NFP have a bookkeeping system to record actual revenue and expenses?

Budget Checklist (Continued)

- Budget Preparation (Continued):
 8. Are all revenue and expense categories in the budget clearly defined and in agreement with the NFP's chart of accounts to allow for later comparison?
 9. Are computations accurate?
 10. Does the budget address debt service and capital outlay?
 11. Does the budget cover all of the NFP's operations and activities?

Budget Checklist (Continued)

- Budget Approval:
 1. Has the Board carefully reviewed and critiqued the budget?
 2. Does the Board understand the budget?
 3. Does the Board ask questions that indicate an understanding of the issues related to revenue and expenses?
 4. Has the Board formally approved the budget?

Budget Checklist (Continued)

- Evaluating Results:
 1. Are the reports of expenses and revenues presented to the Board regularly?
 2. Do these reports compare actual revenues and expenses to budgeted revenues and expenses?
 3. Are adjustments made to the budget during the year based on actual or anticipated changes in revenue and expenses?

Budget Checklist (Continued)

- Evaluating Results (continued):
 4. Does the Board approve all adjustments and revisions to the budget?
 5. Does the Board review any deviations from the budgeted amounts? If so, does the Board take corrective action?
 6. Are the budgets used as benchmarks against which actual performance of executives and managers is measured and reported?
 7. Can the current budget information be used as a basis for future funding?

Questions/Discussion

Budget Exercise

Facts:

- Golf Outing takes place in December and tickets are sold from October to December
- “Gala” Event takes place in March and tickets are sold from January to March
- Insurance is expected to increase 20% in FYE 2009
- No new programs
- Salaries and Benefits constitute 75% of expenses
- Three year grant awarded by County which started on October 1, 2008 in the amount of \$20,000/year

Budget Exercise (Continued)

Facts Continued:

- Economic Conditions not improving:
 - Interest rates decreased to 2% from 4% in the prior year
 - Projecting less contributions
 - Anticipate special event attendance to decrease by 50%
- Membership level is projected to remain consistent with no increase in fee
- Program service revenue is expected to increase by 10% based on an increase of client's served
 - FYE 2008 client's served 1500
- Expenses expected to increase at the rate of 1%
- Raises averaged 3%



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