RETHINKING YOUR BUDGET:
Leading Your Organization Through a
More Comprehensive Financial Planning Process

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According to the Nonprofit Finance Fund’s “State of the Sector” NFP survey, for responding NFPs:

- 47% ended the year with a surplus
- 13% ended the year with an unplanned deficit
- 53% had 3 months or less of cash on hand
- 60% reported that funders never or rarely cover the full costs of programs they intend to support
- 31% with government funding reported payment delays of more than 30 days
- 32% said their top challenge was pursuing long-term financial sustainability. Other top challenges included raising funding that covered full costs and developing cash reserves.
The solution to these challenges needs to include strategic financial planning and budgeting!
Strategic Importance of Budgeting

- Budgeting is a key tool in overall NFP financial management process – budget to support your vision

- NFPs have to balance their “business reality” with their community purpose/mission
  - You still need to make a profit/build reserves – to “give your surplus a purpose”

- Many donors don’t want to fund NFPs who are in a weak financial position and have no reserves

- NFPs want some independence from funders
Different Types of Budgets

- Operating budget
- Cash flow budget
- Capital budget

NFPs should have all three budgets, and should think about each one strategically.
Operating Budget

- This is a financial reflection of your program plan - what you are going to do and solve in your programs?
  - What goals do you want to achieve in your NFP business, and how much is it going to cost?
  - A budget allows for best use of limited NFP resources
  - A budget “tells the story” of a NFP
Operating Budget – Budgeting Strategically

- First – step back and assess your financial position and “assess your baseline”
  - How can we make our financial picture look better?
  - What are our funders seeing?
  - Look at key ratios and trends over the last 3-5 years, such as:
    - Operating results (“profits”)
    - Level of operating reserves (without property and equipment, Board-designated, and donor-restricted net assets)
      - What is the number of months of operating expenses in operating reserves?
      - Trends in operating results and reserves over time
    - Liquidity – such as current ratio, cash trends, collectibility of receivables
    - Leverage – such as debt/equity ratio
Operating Budget –
Budgeting Strategically (continued)

- If past trends continue – what will the impact be? Determine if any trends need to be “corrected” and make this part of the financial plan
Operating Budget – Budgeting Strategically (continued)

- Second - Look at each program/activity

  - Which programs are our “core” mission programs?
  - How are programs performing financially? How can we improve their performance?
    - Which programs are covering direct costs?
    - Which programs are contributing to overhead?
  - Program and finance departments need to work together and be “thought partners” on the budget – consider program nuances and future changes.
  - If there is a proposed new program – will it fit within our core mission and what will be its financial impact? Can we afford it?
Operating Budget – Budgeting Strategically (continued)

- Look at overhead and infrastructure costs (i.e., IT upgrades, staff development)
  - Goal is to avoid “nonprofit starvation cycle” of never having enough to invest resources in infrastructure
  - Is our overhead “too lean”?

- Understand your revenue concentrations and the related risks – what is the right “mix” of revenue for your NFP?

- Understand your “fixed” costs and obligations (such as leases)

- Identify the “risks” in your budget and what you can do to mitigate them

- Remember that a good budget needs to be “real”
Then – Develop short- and long-term financial plans that align with your strategic plan, and put the plans into action!

- What strategies do we need to incorporate into our financial plans to meet our NFPs goals, short-term and long-term?
- Think about building different types of reserves – such as working capital/operating, stability funds, program expansion reserves, innovation funds.
- Best practice is usually budgeting a 3-5% “profit” each year to grow operating reserves.
  - How much of a safety net do we need?
- Important to have a 3-5 year financial plan and budget
Close monitoring of the actual results to the financial plan is vital.

Compare budget-to-actual year-to-date results.

Always refer back to your original budget. The answer is not simply to change the budget – avoid reforecasting.

Once budget is established, you need to work within the plan.

Need explanations as to why actual results differ from the plan.
Cash Flow Budget

- How does your operating budget match up to your cash flow needs? Consider timing differences.
- When is cash coming in/out the door? Need to have a cash management plan to keep you solvent all year long.
- As part of long-term strategic planning, look at key cash flow ratios and trends over the last 3-5 years, such as cash trends and number of months of expenses in operating cash.
- Best practice is usually having 3-6 months of current assets on hand.
Capital Budget

- What are your future capital needs, and how are you going to pay for them?
  - Capital expenditures can quickly wipe out operating and cash reserves
  - Consider capital “sources” and “uses”

- Consider doing a capital needs study

- It’s important to “cover” depreciation expense as part of your operating budget
  - Capital reserve
Ask Yourself...

According to the Nonprofit Finance Fund’s “State of the Sector” NFP survey, here are some good strategic financial questions for NFPs to ask themselves:

- Do we ask for funding that covers full costs of programs?
- Are we budgeting to build surpluses?
- Can we collaborate with other NFPs to increase our operational efficiency?
- Do we have the financial adaptability necessary to implement the growth or change that we are pursuing?
- Can we influence policy to improve our funding?
Helpful Resources

National Center for Charitable Statistics – Operating Reserve Policy Toolkit for Nonprofit Organizations


The Wallace Foundation – Resources for Nonprofit Financial Management

http://www.wallacefoundation.org/knowledge-center/Resources-for-Financial-Management/Pages/Planning.aspx
Questions & Comments

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