

Budgeting “That Works” for Nonprofit Organizations

Nonprofit Financial Management in Tough Times

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In nonprofit organizations, as in the for-profit world, it is common to think of accountants as the stewards of organizational finance. And yet, accountants do not create anything. They merely report the facts.

The real stewards of organizational finance are the non-financial managers.

Who are they? Non-financial managers are the people in the trenches, on the front lines and behind the scenes. They are managing programs, running organizations, directing volunteers, raising money, staging special events, writing grants, serving on Boards, managing offices and serving as interns. They are the people whose everyday actions and decisions make or break the financial health of the organization.

Accounting departments, in general, operate “after the fact.” All of the decisions have been made. Accountants report the facts, point fingers, lay blame and slay the mortally wounded. It's up to the non-financial managers to save the world.

Based on varied experiences working with nonprofit leaders, the following budgeting tactics and framework are provided to help non-financial managers address meet their fiduciary financial management needs.

BEHAVIOR-BASED BUDGETING

“Ten Concepts That Make Budgets Really Work for You”

Budgets are under-used and misunderstood. In fact, most people have it backwards: it is all about how you use a budget, not how you build a budget. If you think of your budget as a tool to use daily, you will be motivated to build a better budget.

Budgets exist to answer one simple question: “*Financially, are we OK?*”

The question must be asked over and over and over again. It can be asked, however, from two different perspectives: “The “I” and “We” Questions”

“How am “I” doing as a manager?”

“How are “We” doing as an organization?”

With this in mind, let's look at the 10 Components of Behavior-Based Budgeting (the concept of using budgets in a manner that influences a person's behavior) and learn how to answer these two questions.

10 STEPS – BEHAVIOR-BASED BUDGETING
Ownership
1. Identifying the Owner – The Non-Financial Manager
2. Creating Reasons for Ownership
Management
3. Use-Based System
4. Time Is On Our Side
5. Report Design
Building the Budget
6. Time-Line
7. Chart of Accounts
8. Assumptions
9. Training
10. Backgrounders & the Approval Process

OWNERSHIP

1. Identifying the non-financial manager as the owner of the budget process is critical. Non-financial managers are the end-users, the primary users, of the budget. The non-financial managers are not in the accounting department; they are managing the programs and operations of the organization. The non-financial managers have the most impact on the organization's inflow and outflow of funds. The budget exists to support them in their decision-making. They are at the center of the budget process.

2. You cannot force ownership on a person. Individuals must accept ownership. We must create compelling, inherent and self-evident reasons for non-financial managers to take ownership over a process most people find unrewarding, tiresome or worse not useful. This may not happen immediately. Non-financial managers will only buy in" to the ownership concept once they realize that a behavior-based budget can help them perform their jobs.

MANAGEMENT

3. Budgets are created to be used, and used every day. Things that you use every day are essential to your existence: your car, your computer, your toothbrush, your coffeemaker. For a budget to be elevated to this "essential" status, it must provide maximum return benefits to the user. Budgets seldom do. But budgets will when they can be used to raise the awareness levels of managers and, thereby, alter their behavior. This happens when budgets are properly integrated into your organization's management reports and paired with rolling projections, as seen below.

4. Non-financial managers must understand and believe that Time Is On Their Side. In other words, they must learn to take advantage of time, rather than making time the enemy. Identifying trends (either positive or negative) earlier in the year rather than later, creates more time to change or take advantage of that trend.

Using Real-Time Monthly Budgets helps maximize budget use and effectiveness. A real-time monthly budget system breaks down each budget line into monthly segments that, as closely as possible, matches' expectations of occurrence to months in the calendar. This allows you to compare a three-month actual result to a three-month budget.

For example, a \$10,000 postage expense is budgeted for a year-end appeal mailing for donations, with an expectation of sending an initial appeal letter in November followed by a single reminder letter 30 days later. A Real-Time Monthly Budget would show \$0 budgeted for months January through October, \$6,500 for November (first mailing), and \$3,500 for December (reminder mailing).

Rolling Projections constantly re-evaluate circumstances and apply current best-known information to project remainder of the year results.

For example, interest income was budgeted at \$12,000 for the year. Since January, interest rates have fallen due to a rapidly slowing economy. This catches you by surprise and after three months you have earned only \$2,000, which is \$1,000 under your three-month budget target of \$3,000. You quickly realize that interest income will be down an additional \$3,000 for the rest of the year. Using rolling projections in the March financial report, you show an additional reduction of \$3,000 to the interest income line for the remainder of the year, decreasing your original budget target from \$12,000 to a revised projected target of \$8,000. You now have nine months to stabilize and make adjustments.

Rolling projections allow you to look at a transaction today in terms of year-end dollars.

The key is time. Raising awareness is essential, but raising awareness without time to react is devastating. By raising awareness 60, 90, or even 120 days earlier in the year, the benefits and cost savings realized can be astounding.

For example, you realize in April that you will need to trim salary expenses by 5%. There are a lot of options to make adjustments: delay new hires, delay salary increases, reduce benefits, curtail overtime and use of temporary help. Had you waited until October or November to not realized this problem until November, your options for adjustment are severely limited and almost impossible. In fact to save 5% with one month left in the year you would have to terminate 60% of your workforce.

The combination of Real-Time Monthly Budgets and Rolling Projections gives each non-financial manager two benchmarks that provide early warning signs. Monthly budgets provide a more exacting point of reference, and rolling projections provide a view to year-end results.

This takes us to Report Design.

5. A well-designed financial management report that brings Steps 3 and 4 together literally creates the picture. If the report is designed correctly, the non-financial manager will be able to

use peripheral vision to view budget, actual, historical and projected results all at once. This provides a wealth of interrelated information that directly answers the two questions:

How am “I” doing as a manager?

How are “We” doing as an organization?

A well-designed management report brings all this data together in an easy to use columnar format as follows:

1	2	3	4	5	6	7
Annual Budget	3 Months <u>Budget</u> Current Year	3 Months <u>Actual</u> Current Year	3 Months <u>Actual</u> Last Year	12 Months <u>Actual</u> Last Year	Annual Projection Current Year	Variance Budget to Projection Current Year

How might such a report aid a non-financial manager in answering the two questions? For example:

Jim is in charge of the newsletter at his nonprofit membership organization. Jim has a \$100,000 newsletter budget. Three months into the year Jim has spent \$5,000. It would appear that Jim is in good shape after three months. However, closer inspection reveals other issues.

Jim’s organization does not publish a newsletter in the first quarter of the year. Jim’s budget includes \$3,000 to redesign the newsletter cover. Jim spent \$5,000 on the redesign. Jim spent the excess money to achieve a higher impact design that received a lot of media publicity and attracted the attention of non-members. -As a result new memberships are now expected to increase by 25% over budget. If the expectation holds, new membership revenues will exceed budget by \$50,000 for the year.

Here’s the 3 month budget report:

	1	2	3	4	5	6	7
	Annual Budget	3 Months <u>Budget</u> Current Year	3 Months <u>Actual</u> Current Year	3 Months <u>Actual</u> Last Year	12 Months <u>Actual</u> Last Year	Annual Projection Current Year	Variance Budget to Projection Current Year
EXPENSE							
Newsletter Expenses	\$100,000	\$3,000	\$5,000	—	—	\$102,000	(\$2,000)
REVENUE							
Membership Fees	\$200,000	\$50,000	\$62,500	—	—	\$250,000	+\$50,000
NET							+\$48,000

Using the report, Jim asks himself: “How am I doing as a manager?” It would appear that Jim has headed down a path that will put him in the position of overspending his budget. However, when Jim asks himself “How are we doing as an organization?” he sees a positive shift in revenue that more than offsets his overspending. Jim is having a major impact on the overall health of the organization.

Jim is very ambitious. He looks at the first-quarter results and realizes that, with nine months left in the year and \$95,000 left in his budget, he believes he would not have

trouble saving \$2,000 on his remaining budget and still print additional newsletters, and still have a good chance to come out even for the year and see the organization prosper even more. Thus Jim makes plans now to take action steps over the next nine months that will position him to save the \$2,000.

Once we have non-financial managers focused on the benefits of integrating budgets into their daily decision-making, we can ask them to take ownership in the difficult and time-consuming process of building a budget. Indeed, building a BETTER budget.

The next five components of Behavior-Based Budgets do not cover the entire budget building process. But they do address the areas where nonprofit organizations most frequently fall short and make critical mistakes.

BUILDING THE BUDGET

6. A well-organized and complete budget time-line keeps everybody on the same page. The budget time-line should be prepared in a chronological outline format and be completely clear in its message and purpose. Any non-financial manager who reads the outline should immediately understand its purpose and comprehend what is expected of him or her.

The four phases of the time line are:

Pre-planning phase – This includes defining the budget cycle, setting a start and end date (with approval by the Board), assembling budget preparation forms and data, assigning responsibilities, mapping the accounting system (the chart of accounts), and aligning the budget to strategic initiatives. Allow 2 to 3 weeks.

First-draft phase – This includes group training, individual training, and preparation of first draft (“selfish draft”) and compilation of the components. Allow 3 to 4 weeks.

Alignment phase – This includes individual budget interview meetings, compromise and negotiations, additional budget drafts and final staff proposed budget. Allow 2 to 3 weeks.

Approval phase – This includes assembling the budget for presentation, mapping the approval process, assembling supporting narratives and final adjustments, and obtaining approval. Allow 3 to 4 weeks.

In total, the budget outline will cover between 10 and 14 weeks from the start of the pre-planning phase through final approval.

7. Organizations seldom review their chart of accounts, departments and cost centers. During the Pre-planning phase of the budget time-line, it is important to review the accounting structure. This review allows organizations to assess whether the accounting structure is evolving at the same pace as the organization.

8. Documenting “Assumptions” are where most nonprofit organizations fall short. Documenting assumptions must become a priority. All of the individual line-item details within the budget must be documented. The process starts with creating a standard assumption documentation form that ensures critical details within line-items can be gathered, organized and displayed in a transparent manner. While documenting assumptions is time-consuming, assembling this information almost always leads to new ideas for cost savings and generating additional revenue.

Documenting assumptions avoids the dreaded “SALY Plus 5” disease (Same As Last Year Plus 5% Increase), which perpetuates mistakes and inefficiencies and leaves no room for creativity.

9. Few organizations devote time to training staff in the budget cycle and use of the budget. Training will enhance every aspect of the budget process. Both group and individual training are important. Group training plays off the synergy of a group setting, where there is a free flow of ideas and exchange of information. Individual training is most often structured to improve and add core skills necessary in the performance of one’s job. Group trainings work perfectly at the beginning of the budget cycle, where strategies have to be aligned, resources shared and hurdles overcome. Individual training helps make sure all involved have the same basic skills and removes barriers to engagement in the budget process.

10. Organizations seldom leave time for telling the story and selling the budget. Your budget story should be a good story, but a *short* story. Take the time to assemble a brief budget narrative (backgrounder) for the Board that highlights changes and new initiatives and answers anticipated questions. Time spent on the backgrounder will help the approval process go more smoothly.

It also is important to know how the approval process works in your organization. Work through the details so that budget committees, finance committees, the treasurer and the Board all feel empowered by the process and part of the process.

The common thread in these 10 Components of Behavioral Based Budgeting is empowerment. Behavior- Based Budgeting is all about using and being fully immersed in the budget process.

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