



The Budget Process

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The Budget Process

Budgets

The Budget Process

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Budgets:

➤ **The budget is:**

- The Board of Director's operating directive for management.
- A blueprint for action.
- A means of controlling activities.
- One method of measuring results.

➤ **An effective budget is:**

- Realistic – the budget should present a reasonable estimate of the upcoming revenue, expenditures, and cash flows of the organization's activities.
- Consistent – the budget must be consistent with the organization's mission and long-term objectives.
- Flexible – If major changes in funding, activities or programs occur, the budget should be modified.

➤ **Budget methods:**

- **Zero-Based Budget** – is evaluating the expected funding and activities for the upcoming year and basing the budget on those expectations. The advantage of the zero-based budgeting method is that it forces the nonprofit to think through all the factors that impact the organization's financial position. Also, because of the use of numeric inputs, it makes it easier for the nonprofit to find the reason behind budget variances. Some budget inputs used may include:
 - Number of clients to be served.
 - Number of staff needed.
 - Expected hours needed.
 - Current salary levels plus any expected increases.
 - Other expenditures needed.
 - Normal fixed costs, like rent, utilities, etc.

- **Baseline Budget** – uses the current year’s activity levels, funding levels and expenses as a base to build the upcoming budget. The advantage to the baseline budget method is that it is less time consuming. Because it can become mechanical and may not take into effect changing program needs of the organization, it is recommended to use a blended zero-based and baseline method every third year. Changes to the base budget would include:
 - Planned salary increases.
 - Planned efficiency measures.
 - Planned other cost increases, like projected increases in gasoline prices.
 - Additional revenues and costs associated with new programs or activities or new initiatives.

- **Grant Budgets** – Grant periods often vary from a nonprofit’s fiscal year. Because of this, the remaining portions of grants at the end of a fiscal year need to be added to the upcoming year’s budget. Also, any projected grants for the upcoming year need to have portions of their budgets added to the nonprofit’s fiscal year budget. Example #1 shows how to include grants in a budget.

- **Budgets and performance measurements** – Budgets are a great resource to measure a nonprofit’s actual performance against their expected or budgeted performance. The following are examples of measurement tools:
 - Actual revenues and expenses compared to budgeted revenues and expenses by different natural categories. For example grant revenues, salaries, or utilities.
 - Actual revenues and expenses compared to budgeted revenues and expenses by functional categories. For example adoption program’s total expenses compared to expected total expenses.
 - Cash inflows from operations compared to expected cash inflows from operations.
 - The number of staff hours used compared to the budgeted staff hours.
 - The number of client hours billed compared to the budgeted number of client hours.

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The Budget Process (See Figure 1)

- **Board Goals/Strategies** – The board of directors is responsible for setting short-term and long-term goals for the organization. The goals should be driven by the nonprofit’s mission and vision. Strategies should drive the nonprofit closer to their vision.

- **Capital Development Priorities** – From the board’s strategy development capital needs are identified along with a plan for obtaining/financing those needs.

- **3 to 5 Year Corporate Forecast** – From the Board’s strategic plan of action, the nonprofit’s management develops a 3 to 5 year forecast. This forecast uses the board’s goals and

strategies to assign numeric values to categories of revenues and expenses and/or to functional categories. See Example #2.

- 3 to 5 Year Department Forecast – From the overall corporate forecast, departments develop individual forecasts to determine the feasibility of the corporate forecast. At this point the corporate forecast may need to be modified and possibly the board’s strategies may need to be modified. See Example #3.
- Service Level Priorities and Capital Development Priorities are determined from the 3 to 5 Year Forecast. See Board Goals – Example #2.
- 1 Year Department Budget – Each program is budgeted separately. The service level and capital development priorities are the base used to develop the budget. See Example #4. Assumptions are made from these priorities, which may include
 - Percent or dollar amount of salary increases.
 - Whether positions need to added or eliminated.
 - The percentage of benefits to the salaries budgeted – this is driven by determining percentage changes for each benefit. Medical costs are one area which can change this percentage drastically.
 - Changes to fixed costs, which could include increases in rent, utilities and telephone.
 - Operating expenses based on the service level priorities, these assumptions could include:
 - The percentage of costs to number of clients served.
 - Environmental changes like increase in gasoline prices.
 - The cost of the fundraising efforts needed to meet the fundraising targets set in the 3 to 5 Year Forecast.
 - The revenue and expenses continuing to the new fiscal year from grants received.
 - The revenue and expenses from projected grants.
- **Executive Review/Approval of 1 Year Corporate Budget**
 - All of the department budgets are consolidated into a corporate budget.
 - The executive staff and/or the board executive committee review this consolidated budget. Often this review will require modification of the department budgets.
 - The executive staff and/or the board executive committee approve the final version of the corporate budget.

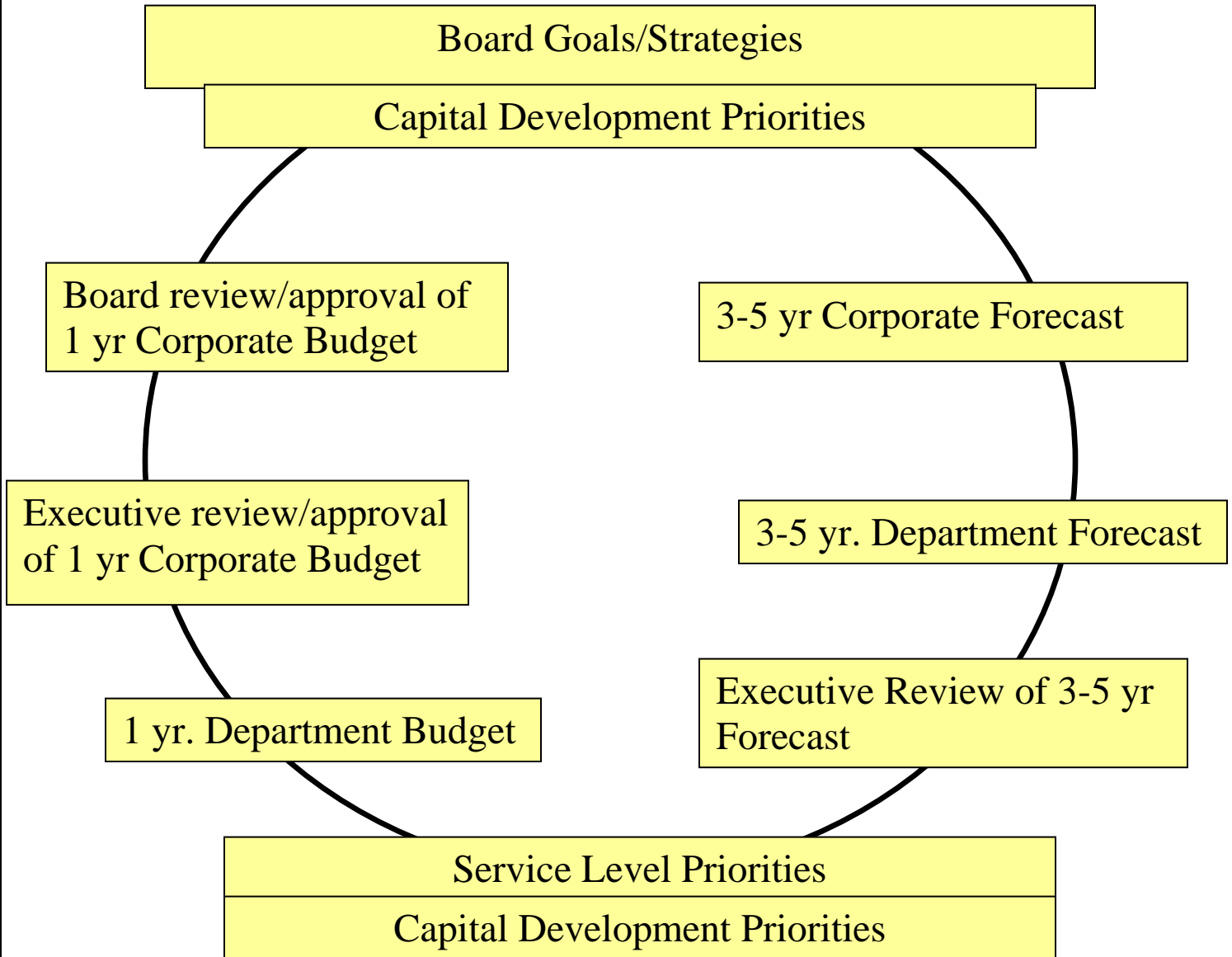
➤ **Board Review and Approval**

- The board of directors will review the corporate budget. It is good to give the board the assumptions used in the budget and how these assumptions were determined from the 3 to 5 year forecasts. The board needs to see the linkage from their strategies and goals to the annual budget. It is wise to present the annual budget to the board several meetings before the fiscal year begins, so they have an opportunity to suggest modifications.
- The board of directors approves the final version of the budget.

- **Board of Directors Monitor the Budget** – If the budget is prepared correctly, it is a blueprint of the board’s strategies and goals. For the board to drive the nonprofit towards its vision, they must monitor the financial results as they compare to the budget. It is critical a comparison of actual results and the approved budget is presented to the board at each of their meetings. See Example #5.

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Budget Planning Map (Figure 1)



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Example #1 – Budgeting for Grants – Unrestricted Portion ONLY

| Sample NPO | | | | | |
|----------------------------|--|--|------------------------------------|---|------------------------------|
| Adoption Project | | | | | |
| | A | B | C | D | A + C |
| | Remaining Grants 2007 – 3 adoptions left | Projected Grants for 2008 Fiscal Year – 15 adoptions | To be spent in 2008 – 10 adoptions | Remaining after 2008 – 5 adoptions left | 2008 Adoption Project Budget |
| Income: | | | | | |
| United Way | 8,215 | 25,000 | 16,667 | 8,333 | 24,882 |
| ABC Foundation | 16,429 | 25,000 | 16,667 | 8,333 | 33,096 |
| State Grant | 1,643 | 20,000 | 13,333 | 6,667 | 14,976 |
| XYZ Foundation | | 50,000 | 33,333 | 16,667 | 33,333 |
| Total Income | 26,287 | 120,000 | 80,000 | 40,000 | 106,287 |
| Expenses: | | | | | |
| Salaries | 10,000 | 52,500 | 35,000 | 17,500 | 45,000 |
| Benefits | 3,175 | 13,125 | 8,750 | 4,375 | 11,925 |
| Mileage | 1,012 | 3,115 | 2,077 | 1,038 | 3,089 |
| Legal Costs | 8,000 | 30,000 | 20,000 | 10,000 | 28,000 |
| Rent and Utilities | 700 | 1,800 | 1,200 | 600 | 1,900 |
| Telephone | 260 | 675 | 450 | 225 | 710 |
| Supplies | 750 | 4,125 | 2,750 | 1,375 | 3,500 |
| Computer Equipment | - | 3,750 | 2,500 | 1,250 | 2,500 |
| Administrative Costs | 2,390 | 10,910 | 7,273 | 3,637 | 9,663 |
| Total Expenses | 26,287 | 120,000 | 80,000 | 40,000 | 106,287 |
| Net Surplus/Deficit | - | - | - | - | - |

NOTE 1: Column A is the grant funds remaining after December 31, 2007. They must be included in the 2008 budget. Column C is the amount from projected grant awards that will be spent in 2008. By adding Column A and Column C you have your 2008 budget.

NOTE 2: Unconditional grants, which include the United Way grants, should be recorded in full as temporary restricted income on the date of the award letter. For the above example the amounts reflected in income may include amounts released from restriction.

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Example #2 – Board Goals/Strategies set to a 3 to 5 year forecast

| Sample NPO | | | |
|--|----------------|----------------|----------------|
| 3-5 Year Corporate Forecast | | | |
| For years ending, | 2008 | 2009 | 2010 |
| Income: | | | |
| Medicaid | 345,000 | 408,538 | 505,121 |
| Contributions | 85,000 | 120,000 | 140,000 |
| Grants | 146,287 | 204,802 | 286,723 |
| Other Income | 2,500 | 2,750 | 3,000 |
| Total Income | 578,787 | 736,090 | 934,844 |
| Expenses: | | | |
| Salaries | 322,500 | 386,730 | 479,780 |
| Benefits | 42,266 | 85,882 | 109,972 |
| Mileage | 12,327 | 15,192 | 19,259 |
| Contractors | 96,200 | 114,809 | 143,048 |
| Accounting Costs | 5,000 | 5,500 | 6,050 |
| Legal Costs | 40,500 | 55,950 | 77,505 |
| Rent and Utilities | 6,500 | 7,660 | 9,231 |
| Telephone | 2,585 | 3,004 | 3,577 |
| Supplies | 10,775 | 12,795 | 15,602 |
| Computer Equipment | 9,750 | 11,610 | 14,106 |
| Depreciation | 10,000 | 10,000 | 10,000 |
| Total Expenses | 558,403 | 709,133 | 888,130 |
| Net Surplus/(Deficit) | 20,384 | 26,957 | 46,714 |
| Board Goals | | | |
| Hours of service for Respite Program – 10% increase for 2008, 15% for 2009 and 20% for 2010 | 9,800 | 11,270 | 13,524 |
| Number of Adoptions – 30% increase for 2008 and 40% for 2009 and 2010 | 13 | 18 | 25 |
| Fundraising Goals | 85,000 | 120,000 | 140,000 |

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Example #3 – Department 3 to 5 year forecast with assumptions

| Sample NPO | | | |
|--|-----------------|-----------------|-----------------|
| Respite Program 3-5 Year Budget | | | |
| For years ending, | 2008 | 2009 | 2010 |
| Income: | | | |
| Medicaid | 345,000 | 408,538 | 505,121 |
| Total Income | 345,000 | 408,538 | 505,121 |
| Expenses: | | | |
| Salaries | 185,000 | 221,230 | 276,160 |
| Benefits | 10,000 | 46,458 | 60,755 |
| Mileage | 5,000 | 6,086 | 7,709 |
| Contractors | 95,000 | 113,489 | 141,596 |
| Rent and Utilities | 3,000 | 3,060 | 3,121 |
| Telephone | 1,200 | 1,200 | 1,200 |
| Supplies | 5,200 | 5,200 | 5,200 |
| Computer Equipment | 2,400 | 2,400 | 2,400 |
| Depreciation | 10,000 | 10,000 | 10,000 |
| Administrative Costs | 39,368 | 40,500 | 42,000 |
| Total Expenses | 356,168 | 449,623 | 550,141 |
| Net Surplus/(Deficit) | (11,168) | (41,085) | (45,020) |
| Assumptions: | | | |
| Hours of service | 9,800 | 11,270 | 13,524 |
| Rate per hour of service (3% increase based on historical % raises from Medicaid) | \$ 35.20 | \$ 36.25 | \$ 37.35 |
| Salaries per hour of service (Increase – 6% for 2008 due to new min. wage, 4% for 2009 & 2010 for COLA) | \$ 18.88 | \$ 19.63 | \$ 20.42 |
| % of Benefits to Salaries (increase 1% per year for medical insurance increases) | 20% | 21% | 22% |
| Mileage per hour of service (5% increase per year due to gasoline prices) | \$ 0.51 | \$ 0.54 | \$ 0.57 |
| Contractors cost per hour of service (4% COLA increase per year) | \$ 9.69 | \$ 10.07 | \$ 10.47 |
| Rent & Utilities (2% increase per year based on historical trends) | | | |
| Remaining fixed costs no material change | | | |

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Example #4 – Corporate 1 Year Budget

| Sample NPO | | | | | |
|--|-------------------------|------------------------|---------------------|-------------------------|-------------------------------|
| Budget | | | | | |
| For year ending December 31, 2008 | | | | | |
| | Adoption Project | Respite Program | Fund Raising | Admin- istration | Total Corporate Budget |
| Income: | | | | | |
| Medicaid | | 345,000 | | | 345,000 |
| Contributions | | | 85,000 | | 85,000 |
| Grants | 146,287 | | | | 146,287 |
| Other Income | | | | 2,500 | 2,500 |
| Total Income | 146,287 | 345,000 | 85,000 | 2,500 | 578,787 |
| Expenses: | | | | | |
| Salaries | 62,500 | 185,000 | 35,000 | 40,000 | 322,500 |
| Benefits | 16,300 | 10,000 | 7,000 | 8,966 | 42,266 |
| Mileage | 4,127 | 5,000 | 2,000 | 1,200 | 12,327 |
| Contractors | | 95,000 | - | 1,200 | 96,200 |
| Accounting Costs | | | | 5,000 | 5,000 |
| Legal Costs | 38,000 | - | - | 2,500 | 40,500 |
| Rent and Utilities | 2,500 | 3,000 | 500 | 500 | 6,500 |
| Telephone | 935 | 1,200 | 100 | 350 | 2,585 |
| Supplies | 4,875 | 5,200 | 200 | 500 | 10,775 |
| Computer Equipment | 3,750 | 2,400 | 1,200 | 2,400 | 9,750 |
| Depreciation | 13,300 | 10,000 | - | - | 10,000 |
| Administrative Costs | | 39,368 | 7,448 | (60,116) | - |
| Total Expenses | 146,287 | 356,168 | 53,448 | 2,500 | 558,403 |
| Net Surplus/(Deficit) | - | (11,168) | 31,552 | - | 20,384 |
| | | | | | |
| % of Administrative | 19% | 57% | 11% | | |

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Example #5 – Budget Performance

| | | | | |
|---------------------------------------|--------------------------------------|-------------------------------------|------------------------|-----------------------|
| Sample NPO | | | | |
| Budget | | | | |
| Natural Category Comparison | | | | |
| | 2008 Corporate Budget | 2008 Actual Expenses | Variance \$ | Variance % |
| Income: | | | | |
| Medicaid | 345,000 | 325,889 | 19,111 | 6% |
| Contributions | 85,000 | 92,100 | (7,100) | -8% |
| Grants | 146,287 | 148,210 | (1,923) | -1% |
| Other Income | 2,500 | 2,487 | 13 | 1% |
| Total Income | 578,787 | 568,686 | 10,101 | 2% |
| Expenses: | | | | |
| Salaries | 322,500 | 368,421 | (45,921) | -12% |
| Benefits | 42,266 | 75,892 | (33,626) | -44% |
| Mileage | 12,327 | 11,438 | 889 | 8% |
| Contractors | 96,200 | 92,300 | 3,900 | 4% |
| Accounting Costs | 5,000 | 5,000 | - | 0% |
| Legal Costs | 40,500 | 25,300 | 15,200 | 60% |
| Rent and Utilities | 6,500 | 6,494 | 4 | 0% |
| Telephone | 2,585 | 2,498 | 87 | 3% |
| Supplies | 10,775 | 10,680 | 95 | 1% |
| Computer Equipment | 9,750 | 9,825 | (75) | -1% |
| Depreciation | 10,000 | 10,000 | - | 0% |
| Total Expenses | 558,403 | 617,850 | (59,447) | -10% |
| Net Surplus/(Deficit) | 20,384 | (49,164) | 69,548 | -141% |
| Functional Category Comparison | | | | |
| Expenses: | | | | |
| Program (w/o allocated admin. costs): | | | | |
| Adoption | 132,987 | 131,258 | 1,729 | 1% |
| Respite | 316,800 | 364,997 | (48,197) | -13% |
| Fundraising | 46,000 | 42,997 | 3,003 | 7% |
| Administration | 62,616 | 78,598 | (15,982) | -20% |
| Total Expenses | 558,403 | 617,850 | (59,447) | -10% |
| Staff Hours Comparison: | | | | |
| Staff hours | 17,081 | 19,269 | (2,188) | -11% |
| Average hourly rate | 18.88 | 19.12 | (0) | -1% |
| Salaries expense | 322,500 | 368,421 | (45,921) | -12% |

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Resources:

Hartfield, Cheryl A. and Paschall, Winford L., PPC's Nonprofit Financial and Accounting Manual, Practioners Publishing Company, Fort Worth, Texas. October 2006.

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About the Author:

Janice Moen has over 25 years of accounting experience, twelve years of which were as Chief Financial Officer or Chief Executive Officer of nonprofit agencies. Janice is currently the CFO of ARCA, a nonprofit providing service to individuals with developmental disabilities. Janice also has five years experience as an external auditor of governmental and nonprofit agencies. Janice received her BBA and Master in Accounting from the Anderson School of Management at the University of New Mexico. Janice was awarded the 2007 Outstanding Member in Corporate Practice Award by the New Mexico Society of CPA's in 2007. She was also recognized as one of the Business Weekly's Top CFO's in 2007. Janice is a member of the American Institute of CPA's and currently serves on the New Mexico Society of CPA's Course Selection Committee and the Anderson School of Management's Accounting Department Advisory Committee.



ARCA, working together to open doors for people with developmental disabilities to be valued members of the community. www.arc-a.org

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