The Budget Process

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Toolkits are designed to provide you with easy to access information on key subject areas that can strengthen your organization.

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The Budget Process

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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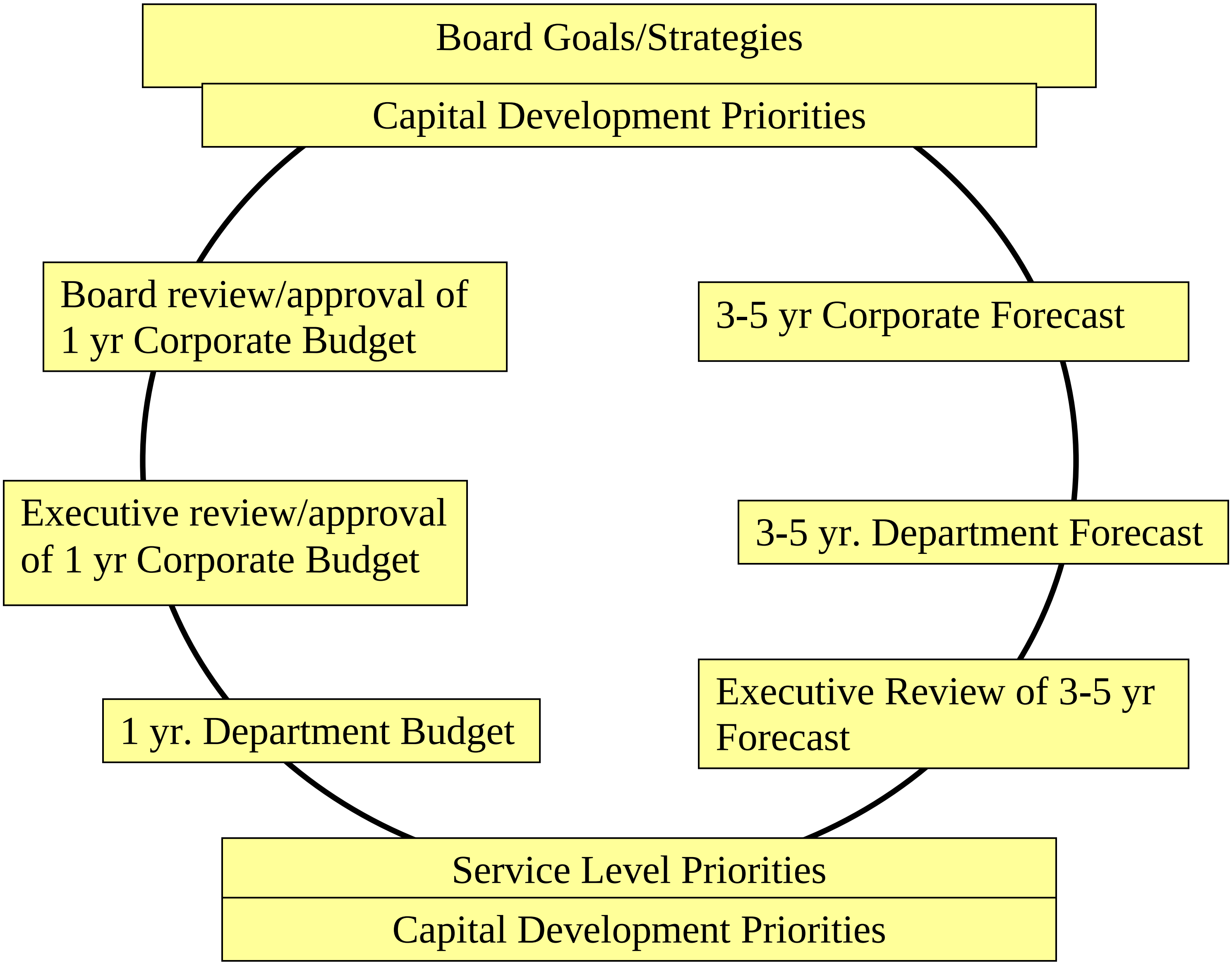
Budget Planning Map
(Figure 1)



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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%
Depriciation	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 spent fourteen years as the CEO or CFO of nonprofit organizations and has five years experience as an external auditor of governmental and nonprofit agencies. Currently, she is a University of New Mexico Anderson School of Business faculty. Janice has developed a graduate level class on nonprofit accounting and the IRS Form 990 at UNM. She has developed nonprofit curriculum for various trainings throughout Albuquerque. Janice has also presented for four years on the IRS Form 990 and other related nonprofit topics. 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.

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