

Board Development

Budgeting for Not-for-Profit Organizations

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What is a budget?

An operating budget is a financial plan of action prepared for a specific period of time. It is the estimated cost of operating shown in financial terms. This is the most common type of budget and references to "budgets" in this Information Bulletin refer primarily to operating budgets.

Budgeting is putting together a realistic financial plan for the organization. The board of a not-for-profit organization must plan by setting organizational goals and determining priorities. These are outlined in the strategic plan. The organization must then determine the dollars needed to carry out those goals and priorities, and this information is reflected in the annual operating budget.

Budgeting is a process. You take information or facts that you know to be true, make reasonable assumptions about the future and project forward on what will be coming into the organization in the way of revenues and what will be flowing out of the organization in the way of expenses. These financial projections are estimates and not "guesstimates". They are well thought out using historical data as well as what you know about foreseeable future events. For example, if you had salary expenses of \$100,000 for the prior year for three people then you would not use this same amount in the next year's budget if you know you are hiring two additional staff.

During the budgeting process you take similar items and estimate the amount that will either be spent (expenses) or received as income (revenue) over a period of time. For example, you might have a category called office supplies where you estimate what will be spent for office supplies for the period. Your budget will show a summary total amount called office supplies expenses rather than a listing estimating the cost of each item under this heading. Use the same categories as reflected in your chart of accounts.

Budgets must be timely and accurate. They are prepared with a lot of thought, time and effort and the approved budget must then be reviewed throughout the year. The organization as a whole must agree to the budget cycle and the

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Board Development: **Budgeting for Not-for-Profit Organizations**

The budget is the financial plan of action based on the board's decisions for the future of the organization.

priorities and goals of the organization as reflected in financial terms in the annual budget.

The approved budget forms the basis for action. The draft budget should be provided to the board members in advance of the board meeting so they have ample time to review. Once the budget has been approved, it is usually passed over to the senior staff person for management and implementation. Remember that the board is a collective body and no one board member can make changes to an approved budget.

Preparing a budget for a not-for-profit organization can be on a small scale or a much bigger scale and the complexity is affected by the size and nature of the programs, size of the budget and number of funders and employees.

Steps involved in budgeting

First you must determine when the budget is to be presented to the board. Then back it up about three months to give adequate time for preparation. You need to gather information, prepare the budget, get it approved and finally, monitor the budget throughout the year.

1. Gather budget information
 - Ask for information and direction.
 - Obtain input from key stakeholders.
 - Link the budget to the organization's goals and priorities.
 - Be aware of budgeting policies and other financial policies.
 - Gather information from the prior period or periods.
2. Prepare the budget
 - Use facts and document your assumptions.
 - Facts plus assumptions equals projections.
 - Allow yourself plenty of time to think things through.
 - Forecast the revenues and compare to your estimated expenses.
 - Follow the financial policies and budget guidelines of the organization.
 - Identify fixed and variable costs.
 - Be realistic.
3. Receive approval
 - Finalize the budget and present to the board for approval.
 - Be organized when presenting the budget and be prepared to answer questions.
 - Make adjustments if new information comes to light during the presentation.
 - Communicate the approved budget within the organization.

4. Monitor and evaluate the approved budget
 - Identify and review variances.
 - Determine reasons for significant variances.
 - Determine whether the organization is on track.
 - Review information monthly and be accountable.
 - Manage the budget and take corrective action if needed.
 - Begin preparing information for the next budget cycle.

Budget preparation

The budget should coincide with your normal annual reporting period. Start the budget preparation process early as it will always take longer than you think. Develop a budget calendar with timelines and due dates for key pieces of the budget process. Make sure that those involved in this collaborative process know these target dates and the implications if these dates are not met.

Common sense and good judgment are essential to the preparation of a well thought out budget. Always keep good notes on facts and assumptions you make. This information will be invaluable when you prepare subsequent budgets. Be familiar with the prior year's data and events that occurred during the year. Will similar events occur again during this budget year?

One person does not prepare the budget on their own but rather budget preparation is coordinated by one person. Take the time to ask for and obtain information from people in your organization who are 'in the know'. Committee chairs can estimate the expenses they are likely to incur during the year and program coordinators know their programs and the associated costs. A fringe benefit of involving many people in the budget process is a sense of buy-in!

Historical data can be obtained from the books and records. However, if you are using accounting software make sure that all transactions have been recorded and that the user of the software understands accounting practices and terminology. Budgets have been prepared based on good data only to find out later that someone's interpretation was incorrect.

As the budget preparation cycle should commence prior to the completion of the current year, be creative but reasonable in estimating revenue and expenses. If you have ten months of data you may be able to determine a monthly amount and multiply by twelve. Just be aware of the annual expenses that have not yet been paid for the year. Historical data provides considerable information but remember that this information just helps you to estimate what will happen in the future. A good budget is prepared using historical and other data and is based on what you expect will occur in the upcoming year.

The budget policies of the board help create the appropriate degree of board participation in budgetary planning and control.

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Do not forget about new projects. If you have requested new grant funding for a specific project and are uncertain as to whether you will get it, it might be a good idea to prepare two budgets – one with the new funding and one without. Do not automatically assume that if you have made an application you will receive the funding.

Including a narrative with your budget numbers helps to explain the basis by which you prepared the budget. Some of the information might include:

- An overview of the organization and what it does, programs and projects budgeted for.
- A breakdown of information by program/project identifying amounts requested.
- The services/benefits that will be provided and why there is a need.

Ensure that safety margins have been built into the budget but do not go overboard with your estimates.

Budget policies

The budget is a working document which reflects the joint planning effort of many people.

It is important to have budget policies that outline budget responsibilities and guidelines but the preparer also needs to be aware of other policies that affect the preparation of the budget. Personnel policies may outline salary increases and policies on proposed new programs may be in development.

Board approved budget policies will outline specific budget responsibilities such as who has the delegated responsibility for budget preparation. This might be the Executive Director of the organization, a senior staff person, the Treasurer or sometimes it is the Finance Committee. Another policy would clarify whose responsibility it is to monitor the budget, once it is approved by the board.

The Budget Policy Responsibility Matrix shown below can be a helpful tool. Clearly identify who is responsible for each area in your organization by placing an X in the appropriate column.

Responsibility	Senior Staff	Treasurer	The Board
For budgeting preparation			
For budget approval			
For budget monitoring			
For key expenditures decisions (purchase of capital items, hiring of new staff, and wage increases)			

Budget monitoring

On a monthly basis you should be comparing the budgeted amounts for each category with actual figures. By doing this you are comparing what you planned to happen with what actually happened.

The board must decide on the type, frequency and nature of reporting necessary to provide good information on the budget figures vs. actual revenues and expenditures. This is done by comparing each category and providing variance information. It is the board's responsibility to review and question significant variances between budgeted amounts and actual amounts.

What if, when comparing budget to actual figures, you note a significant variance? Ask yourself whether there is a readily apparent reason for this difference. Or do you have to seek out some answers before you can determine why it happened? Is there something in the next budgeting cycle that could be done differently to provide more accurate figures? Has the board approved an expenditure that was not budgeted for?

For example, it may look odd that, in the first month of the budget, a large amount was paid for insurance. In reality it might just be reflecting the fact that the annual insurance policy was due that month and that the premiums increased more than was budgeted for.

By monitoring the budget the organization can track whether they are achieving the goals and priorities set out for the organization. It is important for governance boards to govern and not get involved in the day to day affairs of the organization.

Benefits of budgeting

- If not already established, budgeting can force an organization to set priorities and goals.
- Planning assists the organization to control expenditures and forecast sources and timing of revenues.
- The budgeting process forces an organization not only to have a plan but to have deadlines for planning.
- Budgeting can reduce, to some extent, the need to constantly be reactive as the budgeting process is a proactive approach.
- Good budgeting practices ensure that the organization defines budgeting roles and responsibilities and sets these out in policies.
- Monitoring the budget helps to ensure that funds are available for all planned expenditures. It also lets you know the current state of your finances and helps to control spending.
- Budgeting facilitates monitoring, evaluation and performance measurement.

The existence of budget policy gives assurance that responsibilities are assigned and the basis for board involvement is known.

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- The budget can be used as a communication tool for the organization.
- Someone is assigned the responsibility of following the budget.
- Adherence to budgets can be used as an assessment tool for performance reviews and in some cases can have an impact on salary increases.

Types and ways of budgeting

Operating Budget - Reflects projections of revenue and expenses over a specific time period, usually a one year period. It will include revenues such as grants and fees for service and operating expenses such as salaries and program expenses. This is sometimes referred to as the annual budget.

Capital Budget - This budget usually relates to the acquisition of buildings or equipment and includes major purchases or acquisitions. It shows the costs of the purchase and the source of funding to cover the costs.

Program Budget - A budget is prepared for each program or service that you provide to your clients. Most not-for-profits have more than one program.

Line Item Budgeting - Uses the previous year's budget category actual amounts as the starting point and then reviews each category.

Zero Based Budgeting - This type of budgeting is often referred to as budgeting from the bottom up. You start at zero and compile a budget from scratch with input from many people within an organization. Revenue and expenses are based solely on future events that you expect to occur and not on what was budgeted in prior periods.

Cash Budget or Projection - Based on cash coming in and cash going out for a specific period of time.

Budget format

Approval and monitoring of the budget is one of the most critical jobs of the board.

The main heading should always contain the organization's name and period covered. Revenue and expense items are then listed by category.

Ideally, total revenues and total expenses should always equal when you prepare a budget, unless you are planning for a specific deficit or surplus amount.

Next is an example of a yearly budget with actual figures inserted later to facilitate close monitoring of budget numbers to actuals.

XYZ Not-for-Profit Organization
Budget to Actuals
For the Three Month Period March 31, 2XXX

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	Approved (Jan-Dec) Annual Budget	Current Month (March) Actual	YTD (Jan- Mar) Actual
Revenue:			
Fees	\$ 5,500.00	\$ 375.00	\$ 4,405.00
Grants	450,000.00	150,000.00	225,000.00
Other revenue	<u>8,000.00</u>	<u>998.45</u>	<u>2,296.54</u>
Total revenue	<u><u>\$ 463,500.00</u></u>	<u><u>\$ 151,373.45</u></u>	<u><u>\$ 231,701.54</u></u>
Expenses:			
Salaries and wages	426,000.00	35,229.11	105,222.13
Membership dues	3,500.00	225.00	985.00
Board/committees	6,500.00	626.13	1,256.24
Rent	13,200.00	1,100.00	3,300.00
Utilities	6,000.00	489.12	1,589.24
Miscellaneous	4,800.00	195.45	4,212.85
Volunteers	<u>3,500.00</u>	<u>233.26</u>	<u>795.25</u>
Total expenses	<u><u>\$ 463,500.00</u></u>	<u><u>\$ 38,098.07</u></u>	<u><u>\$ 117,360.71</u></u>
Surplus/Deficit	\$ _____	<u>\$ 113,275.38</u>	<u>\$ 114,340.83</u>

*For more information, see
Financial Responsibilities of Not-for-Profit Boards, a self-guided workbook published by the Board Development Program and The Muttart Foundation.*

Budgeting terminology

Assumption - An explanation of the basis for determining an amount used in the budget e.g. salary increases for the year were calculated at 5% based on the prior year average of all salary increases.

Cash Flow Projection - Projected cash transactions for the upcoming period. This projection is often done monthly and starts with cash on hand plus cash receipts expected less cash disbursements.

Chart of Accounts - A listing of financial accounts used by the organization and sorted/numbered based on the type of account e.g. assets, liabilities, revenues, expenses and net assets.

Expenses - The costs of doing business. e.g. salaries and wages, office supplies and utilities expenses.

Facts - What you know to be true.

Plan - Well thought out ideas of future actions based on experience from the past, current information and assumptions about the future.

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Revenue - Money coming into the organization from sources such as fees, grants and interest income.

Variable costs - Costs that are sensitive to changes in revenue e.g. the total cost of meals depends on the number of clients.

Variance - The difference between the budgeted amount and the actual amount.

In conclusion.....

- Budgeting is an ongoing annual process.
- The budget is prepared, approved and monitored.
- A good budget reflects the joint planning and collaborative effort of many people.
- The budget belongs to the organization and to no one individual.
- The board has responsibility for setting policies and for approving the budget.
- All board members share in the financial responsibility of an organization.
- Good budgeting is the key to good financial management.
- Accept the fact that no two people will ever prepare the budget using the same logic and rationale, so provide good background information to justify your assumptions.
- Budgets can be changed but must again be brought to the board for approval.
- No financial plan of action is perfect; after all, we cannot foresee everything that will happen in the future.

About the author:

Linda Thorne is a Certified General Accountant. She is a former Board Development Program instructor, works in the not-for-profit sector and has her own company – Learning Opportunities Incorporated.



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