

Budgeting: A Guide for Small Nonprofit Organizations



Virginia Society of
Certified Public
Accountants

A free resource provided by the Virginia
Society of Certified Public Accountants

Budgeting: A Guide for Small Nonprofit Organizations

A free resource provided by the Virginia Society of Certified Public Accountants

Introduction

- Selecting the budget committee
- The task of the budget committee
- Setting budget priorities and realities — revenues
- Setting budget priorities and realities — expenses and costs
- When to prepare the budget
- A budget for cash flow
- A budget for capital expenditures — bought or received
- Restricted grants
- Changes to the budget
- Conclusions

Introduction

Nonprofit organizations (NPO) wrestle continually with maintaining and improving their operations, especially during today's uncertain economy. In short, NPOs must constantly strive for sustainability. A well-planned budget will focus on the primary goals and objectives of the organization and provide financial and programmatic adaptability — key ingredients to maximum sustainability.

An organization's financial plan should include budgets for operations and capital. The operating budget reflects the organization's planned financial activities for a year, showing how much revenue it expects from which sources and how much it will spend on operations. The capital budget may include projects which will have ongoing effects on operations.

This guide is written to present the theories and practicalities of budgeting for the NPO staffed by volunteers, whose expertise do not always correspond with the budgeting needs of the organization.

In this guide, Goodworks, Inc., is a hypothetical NPO that receives funds from grants, the general public and sales of logo items. These funds pay for the programs that support

its missions. The example of Goodworks should provide guidance for many NPO budget situations.

Selecting the Budget Committee

A budget is a planning tool for the NPO. The budget committee should reflect the collective knowledge of the organization concerning the goals and objectives for the period in question. Volunteers who serve on the budget committee should have the following qualities:

- A familiarity with prior years' activities and the changes that are contemplated in the year(s) to come, particularly the objectives in the strategic plan
- A desire to serve the organization as a whole rather than to lobby for a particular project
- A knowledge of ordinary budgeting, whether on the personal or business level

While the qualities listed above are desirable, their absence should not preclude excellent service by volunteers who are otherwise interested and dedicated, especially if the volunteers have a desire and willingness to learn about budgeting.

The Task of the Budget Committee

The task of the budget committee is to develop the budget for the next year (or future years, in the case of a multi-year budget). The steps in developing a budget are as follows:

- **Define the budget timeline.** Develop a list of objectives or goals for the year. A familiarity with prior years' activities and the changes that are contemplated in the year(s) to come are necessary to prepare a comprehensive budget. If the organization has a strategic plan, consider activities in the plan that will impact the budget and plan accordingly.
- **Estimate the cost or resources required to achieve each objective or goal.** The previous year's actual expense or budget can be used as a starting point, but the NPO should make budgeting decisions based on many factors, not just the prior year's budget. If the objective or goal involves new programs or activities, estimate the cost by creating an itemized list of all the expenses involved in achieving that particular objective.
- **Estimate the expected dates and amounts of revenue that will be generated.**
- **Compare the expected dates and amounts of revenue to the estimated expenses and ensure that the estimated expenses are lower than the estimated revenues.**
- **Develop the final budget.**

- **Present the budget to the board for approval.**
A final budget should be approved by the board before the start of the organization's next fiscal year.

The timeframe for the budget process generally will consider the calendar year, the fiscal year and the approval process. The calendar year often determines the timing of certain expenses and revenues, particularly end-of-year tax deductible donations. The fiscal year is the period that the NPO uses to measure funds: the federal government has a fiscal year that ends Sept. 30, while many NPOs have a fiscal year that ends June 30. A fiscal year ending June 30 is particularly appropriate for NPOs that intend to complete their audit prior to the deadline of mid-January, a common deadline to submit grant applications. The time required for the approval process generally will determine how long before the end of the fiscal year it must begin.

For example, Goodworks receives a grant from the United Way, but Goodworks' fiscal year might end at a different time than when the United Way requires annual audited financial statements. In such a case, the budget process for the following fiscal year might begin as the current year's United Way statements are prepared. Goodworks' fiscal year ends June 30, but it will submit the United Way application on Jan. 15. Then Goodworks might begin its budget process on Feb. 1, once approval is received.

The need to present the budget to the board for approval will be the overriding constraint in planning the timeframe for the budget process. There must be time to consider, question and change the budget both before and after the presentation to the board. A minimum of three months should be allowed for the process. A wise board that demands full financial statements each month should have a good understanding of the previous year's monthly cash flows and the budget categories that were over- or underfunded.

Setting Budget Priorities and Realities — Revenues

The budget committee will need to examine the reasonable expectations of revenue. Each potential source of revenue must be examined to determine possible enhancements in the future. Typical sources of revenue are contributions from the public, grants and endowment/restricted funds income (based on the organization's spending policy), ticket sales, auction proceeds and fees for goods and services. When evaluating each source of revenue, the following questions should be asked:

Public contributions:

- How much do we expect in contributions from the public?
- Are the expectations realistic? Is there a history of increases in past years? What about the economy?
- Has a major contributor had a good year or a bad year financially?
- What are the fundraising possibilities of the organization itself?
- What are the costs of fundraising?

Grants and restricted funds:

- Can the NPO comply with the grantor's requirements? (For example, does the NPO have adequate funds if matching contributions are required or does it have metrics to prove it's meeting the grantor's performance standards?)
- Do separate accounting reports need to be provided to the grant-giving organization?
- Is the use of funds restricted to a particular purpose (e.g., scholarships or building)?
- Does the grant provide an allowance for overhead expenses of the organization?
- Must the organization be audited in order to qualify for the grant?
- Does the grant lead to sustainability, allowing for the creation of a program that can be carried on financially after the grant funds are used?
- Will the grant lead contributors to believe their contributions are not needed?
- Could the grant overwhelm the organization? Sometimes the administration of grants, particularly grants from large government agencies, are beyond the technical skills of most small NPOs.

Ticket sales, auction proceeds and fees for goods and services:

- What are the revenue expectations?
- Are the expectations realistic? Is there a history of success with similar events or products in past years?
- What are the legal and tax implications of the sale?
- Are "suggested donations" better than a fee for a production or fundraiser?
- What are the costs associated with the production or sale?

These questions require knowledge of program plans, fundraising expectations, development activities, grant sources, and local and state laws. Accurate answers are

essential and research may be necessary. Some of these questions can be answered directly from the accounting system. Others will require input from fundraisers and/or grant writers.

A complete and accurate database of contributors can be very helpful in forecasting estimated revenues from donors through general contributions, pledges and grants. Records can be tracked in a simple spreadsheet or using sophisticated accounting software with a Customer Relationship Management (CRM) module.

Setting Budget Priorities and Realities — Expenses and Costs

Usually revenues and expenses are tied together, as in fundraising projects that generate revenue at a certain cost. Excess revenue over expenses can usually be used to cover other expenses of the organization — for example, programs that do not generate revenue and administrative expenses.

Especially when identifying excess revenue to allocate to other costs in the budget, the NPO will need to be careful it doesn't overlook any expenses. It is important to review the bylaws of the NPO for requirements that may place an undue burden on the organization, such as the requirement to have an annual audit by a paid professional rather than by a free, independent volunteer. Also, become familiar with the different types of expenses the organization will need to anticipate during the budget year:

- **Direct costs** relate to a specific project or program. For example, Goodworks contracts for extra staff to hold a new workshop, orders supplies for a community service program and allocates staff time, design and printing costs for a new brochure.
- **Capital expenditures** for items such as cars or real estate provide benefits for the organization long after the budget period ends.
- **Indirect or overhead costs** may not relate to a specific project but may be necessary for its completion. Items such as postage, telephone service, Internet, copier usage or management staff time may be overlooked in the planning process.
- **In-kind contributions of goods or services (“free” expenses and costs)** should be budgeted at fair market value (FMV) for the new Form 990. These expenses and costs can include items such as office space, utilities, parking, security, staff hours, computers and other items provided by donors or a parent NPO. While these in-kind contributions may not have a bottom-line impact (as they are recorded as a revenue when received and as an expense when

used, typically in the same period), NPOs should still budget for and report these contributions when they can be adequately documented. This will give a more accurate picture of the actual total cost for the organization to meet its goals, and whether it qualifies for Forms 990-N, 990-EZ or 990.

As noted in the revenue section, some programs are funded entirely by grants. The budgets for specific grant programs are made at the time of the grant application. These budgets should include not only requests for the specific costs of the program, but also enough to cover the internal costs of administering the program if the grant were awarded. Many programs have been granted based on direct costs, without any consideration of the indirect costs and the incidentals that can add up quickly and overwhelm a well-planned effort.

The costs of managing the grants can be built into the proposal, and for complex programs, the managerial fees will compensate the staff for their extra hours; be sure to provide 1099-MISCs in January for all the staff and contractors who helped manage the grant. Even without reimbursements for managerial expenses, grant programs should never be declined solely because they do not cover all indirect costs.

Planning for programs that are to be covered by general contributions and unrestricted grants entails a budget that has some elasticity to accommodate the unexpected.

When to Prepare the Budget

A budget is a planning tool and should be prepared well in advance. Plenty of time should be allowed for presenting the budget to the board of directors for approval, and for making changes. After your hard work preparing the budget, it may be difficult to recognize good suggestions for improvement, but you must be willing to go back to the drawing board.

Once the budget is prepared and approved, don't put it away in a dark corner. For the budget to be useful and effective, everyone should take it seriously. The budget should be compared with the actual experience on a regular basis (i.e. monthly or quarterly) to allow board members and executive officers to measure whether the organization's goals, set by the budget, are being met.

An example of such a report is shown on the next page. Variances from the budget are reasonable and expected. It is rare that the assumptions made during the budgeting process become reality. Variances provide valuable information to improve decision-making for the remainder of the budget period.

Goodworks, Inc. Comparative Income Statement with Budget 2011

	Actual	Budget	Variance
Income			
Contributions	25,000	27,500	(2,500)
Grants (unrestricted)	6,000	6,000	0
Sales	4,325	4,000	325
Total income	35,325	37,500	(2,175)
Expenses			
Staff	10,000	12,000	(2,000)
Office expense	1,120	1,000	120
Cost of goods sold (COGS)	1,000	1,000	0
Telephone	5,665	6,000	(335)
Counseling	12,000	12,000	0
Bus tickets	4,960	5,000	(40)
Misc. support	510	500	10
Total expenses	35,255	37,500	(2,245)
Excess	70	0	(70)

Ideally, with every presentation of financial information, there should be a comparison of actual revenue and expenses to those budgeted. Other reports may include a comparison of the actual and budget amounts attributable to the same period in previous years and a comparison of projected actual to budget for the entire budget period.

Comparing the variance can help the budgeting committee benchmark its progress and determine any actions to take for the remainder of the budget year. This also allows for learning how to better plan for the future.

In the example above, Goodworks was \$2,500 below its budget on income from contributions and may want to identify why contributions were low. Goodworks also had \$2,245 less in expenses than anticipated in the budget. After identifying the cause, Goodworks may decide that the low income is offset by the savings in expenses and take no further action, or the committee may decide to boost its efforts to identify new donors.

A Budget for Cash Flow

In addition to the comparative income statement, other types of budget reports will help ensure an organization runs smoothly. For the small group, the most important is a cash flow budget. This is the budget of revenues received and expenses paid, broken down monthly to

ensure cash will be there when needed. If an organization expects all of its expenses in the first three months of the year and all of its revenue in the last three months of the year, the organization will be unable to pay expenses unless it has built up a large cash surplus. Plan your cash flows as well as your revenues and expenses.

A Budget for Capital Expenditures — Bought or Received

An organization's capital budget reflects its financial position. Capital expenditures refer to the acquisition of assets whose useful lives are greater than the current period. Although funds for expenditures may be identified and approved in total during the budget process, most companies have a separate process for approving funds for capital assets. Capital expenditures can be very large and have a significant impact on the financial performance of an NPO. Also included in the capital expenditures budget are depreciable in-kind contributions, staff professional development and information technology upgrades and maintenance.

Many times a small organization will borrow assets, board members will use personal assets for the needs of the organization, or donors will provide non-cash items. These non-cash items represent in-kind contributions. The

organization will need to estimate the value of the items for the organization's records. Sometimes the donor can provide the acquisition price, depreciation taken, or residual value of the gift.

The organization cannot and should not provide fair market value (FMV) appraisals to donors. If no valuations are provided, the organization will need to develop an internal Gift Acceptance Policy (GAP) on how to record the donations. A gift acceptance policy allows the board to define the parameters and guidelines for handling different types of donations, eliminating controversial or risky donations and complying with the legal obligations of gift recording and recognition. For example, Goodworks may have a provision in its GAP to record non-appraised gifts of still-operable items at 10 percent of the current retail price.

Some donated items, such as stock or a vehicle, require a transfer of title, which is recorded with local or federal authorities, such as the Virginia Department of Motor Vehicles (www.dmv.state.va.us) or the U.S. Securities and Exchange Commission (www.sec.gov). Make sure this transfer of title is carried through in an orderly and timely manner. Frequently, to provide an exact FMV and to avoid capital losses, the NPO will sell such items on the day they are acquired.

Some gifts bring new responsibilities and expenses to the organization. Questions to consider before accepting a gift include:

- Can you protect this asset?
- Does it need to be insured?
- Do you need a safe deposit box?
- What are the annual operating costs for this asset?
- Does the gift require spare parts or maintenance that can only be provided sole source by the donor, at prices determined by the donor?

If an asset is housed on premises that do not belong to the organization, then a master list of such assets and their whereabouts should be prepared and maintained in a safe and central location. The organization should have a GAP and an acceptance committee to insure that all gifts are beneficial to the organization and to its mission.

There are other gifts that need accounting and budgeting. One is the forgiveness of rent for space. The FMV of the rent should be recognized on both the budget and actual financial information as income and expense. This type

of recognition gives a better picture of the true state of affairs for the organization. If your NPO no longer receives a space rent-free, could the NPO make up the difference in cash donations in order to pay the rent? This question is best answered when the value of the prior gift is recorded.

Capital budgets can be achieved over a period of years when a fund is established to collect money for a future capital expense. Such funds require a Reserve Study to determine the future expenses and their estimated dates. For example, a \$500 printer that must be replaced in five years requires a sinking fund with \$100/year funding.

Restricted Grants

Budgeting for restricted grants must be done in advance. A careful inquiry of the grantor will allow the NPO to know the expectations of the grantor. As noted in the discussion of revenue sources, there can be many strings tied to grants. For example, Goodworks receives a restricted grant for a particular educational program. The grantor provides a gift of \$10,000,000 for a building. Goodworks would then be required to spend the grant on building-related expenses (e.g., land, architect, permits, material, labor and maintenance), and could not use the money for any other reason.

An NPO should discuss the requirements not only with the grantor, but, if possible, with another organization that has received such a grant in the past. It is vital the restrictions on the grant or gift be clearly documented and understood by all parties. Many NPOs will prepare a jointly signed agreement with the grantor that clearly states the amount of funding, the anticipated date of funding and the restrictions. As a part of the agreement, the NPO should allow for a contingency plan in the possibility of not achieving the requirements for the grant or gift. In this case, the documentation can allow for the reclassification, redirection or refund of the grant.

NPOs should include guidance for the acceptance of restricted grants in its GAP policy, so fundraisers and donors are aware of the policy and agree to allow flexibility under certain conditions. For example, a donor gives a \$50,000 restricted grant for a building that would cost \$1,000,000. If the grant/gift documentation allows for it, the NPO could reclassify the grant/gift to an unrestricted operating grant/gift if the NPO does not receive the \$950,000 needed to complete the building.

Changes to the Budget

Can budgets be changed? Sometimes budgets must change when expectations are not met. Rather than abandon a sound budget plan when an emergency or opportunity arises, an organization should be able to handle the change in an orderly fashion. Continual review of variances, along with forecasting, will allow the NPO to determine if the overall budget is sound or if actual events require a new budget be adopted. Bylaws should be examined for guidance on how an adopted budget can be altered if necessary. Typically, small alterations can be made by the executive officers, while changes beyond a specified threshold would require approval by the board of directors.

If an expected donation that has been budgeted does not materialize, you have several choices. The most obvious is to seek other sources of funds. A CRM module on the accounting system can help identify donors inclined to support the specific shortfall. Next, you can cut expenses. A less obvious option is a rearrangement of expenses. A gift of an asset, as previously discussed, might relieve a budgeted expense. A program that was scheduled to begin in one quarter might be moved to another period, allowing the expenses of that program to be moved as well. All of the decisions above should be made with reference to the budget, as well as to the current cash and financial picture.

Conclusions

Budgets should be a major part of every organization's plan. This plan should allow the flexibility needed to achieve goals with order and success. The documentation of budget assumptions and changes will provide a basis for improving the efficiency of the budgeting process each year.

The material presented herein is designed to provide basic information concerning budgeting for small nonprofit organizations. For further guidance with budgeting needs, NPOs should consult with a Certified Public Accountant (CPA).

The VSCPA offers free resources, including a Nonprofit Pro Bono Assistance program and the Find a CPA directory to help connect nonprofit organizations with a CPA in their geographic location who can best meet their financial and business needs. Visit the VSCPA Nonprofit Resource Center at <http://www.vscpa.com/NPOResources> for more information.

This guide was last updated in September 2012 by CPAs serving on the VSCPA Nonprofit Resource Guides Task Force. CPAs and nonprofit organizations are freely encouraged to email or copy this guide to share with officers and directors serving on nonprofit boards. For permission to duplicate this guide or modify it for any other purpose, please contact the Virginia Society of CPAs at 4309 Cox Road, Glen Allen, VA 23060, (804) 270-5344 or vscpa@vscpa.com.



Virginia Society of
Certified Public
Accountants

Learn more at
www.vscpa.com

