



Field Department Resource

How Do We Prepare a Budget?

Most Commonly Asked Nonprofit Management Questions About Financial Management

TIMING OF BUDGET ACTIVITY

At least two or three months before the beginning of your fiscal year you will want to start thinking about the budget for the upcoming year. The budget ordinarily corresponds to your fiscal year, which should be selected to reflect your organization's operating cycle. For example, a theater company might have a fiscal year beginning September 1st to correspond to the beginning of its performance schedule. A nonprofit relying on government funding might choose a fiscal year ending June 30th so that the budget corresponds to the major funding cycle.

WHO SHOULD BE INVOLVED IN THE BUDGET PROCESS?

Staff and board members must participate in each phase of the budgeting process that affects the line items for which they will later be responsible. For too many nonprofit organizations, planning and financial management are activities that divide rather than unite the organization.

Program planning is often viewed as the domain of the executive director, program directors, and the board. Fiscal management is assigned to the bookkeeper, accounting, finance director, and, perhaps, the board treasurer. Program planners and fiscal managers speak different languages and often have different priorities, and may or may not be aware of the importance of the other's approach to the budget process. Program planning decisions often are viewed as failing to reflect economic realities, while fiscal management decisions are often viewed as insensitive to the programmatic mission of the organization.

For this reason, both program staff and financial staff should work with the executive director and board to develop budgets which truly reflect organizational priorities and act as a guide for spending and decision making.

WHAT ARE THE STEPS IN THE BUDGET PROCESS?

The first step in the budget process is a review of program and management achievements and fiscal performance over the year just ending. This includes, but is not limited to, reviewing objectives achieved, comparing budget to actual figures, and looking at the number of people served in each program. By dividing the true cost of each program by the number of people served, you can also analyze the cost per unit of service. Based on this review, new goals and objectives should be discussed and agreed upon in a preliminary way. These goals and objectives should fit into your strategic, long-range plan, and help you make progress towards your mission.

Then, estimate the costs required to achieve your objectives, including staff, supplies, and other resources. Include both program and financial staff in discussions of programmatic costs to make sure that all resources required by programs are considered. Management staff should be included in discussions for their own departmental budgets and how these relate to programmatic objectives. You can rely on past experience, as reflected in budget to actual reports, to determine some of this information for continuing programs. Make sure to take into account upcoming changes,

especially in areas such as insurance, which are subject to significant fluctuations.

Since personnel costs typically account for 60 to 70 percent of a non profit's total expense budget, be sure to plan carefully for this line item. There can be a lot of "hidden" costs associated with new programs. For example, hiring new staff entails: training and support in addition to salaries and benefits; advertising new positions; evaluating your need for additional office space, furniture and equipment; and considering that an expanded staff, whether paid or unpaid, requires additional time for staff meetings, supervision, coordination.

You must budget for income as well as expenses. Even though unpredictable events may influence fees and contributions, you can estimate revenues with some degree of accuracy based on past experience. As with any budgeting based on the past, it is important to make adjustments for future plans and changes when you have sufficient information to anticipate. Grants from foundations, corporations, and government agencies can be more difficult to predict. The financial and fundraising staff, in collaboration with the executive director and fundraising committee of the board, have to make the most realistic assessment possible for budgeting purposes. It may also be useful to develop contingency budgets for more conservative or optimistic projections of revenue.

Note: Contributed revenue should be projected using the best information available. It is not a number derived from the "gap" between projected fees and other earned income and projected expenses.

Finally, compare revenue and expense projections. At different times organizations will choose to incur a deficit, realize a surplus, or simply break even. No rule says that budgets must balance in each budget

period. If you are anticipating a deficit, is it because you are investing moneys raised in prior years into new programs? Does a surplus reflect a board policy to establish an operating reserve to guard against loss of future funding or cash flow shortfalls? Certainly, large deficits can lead to bankruptcy, and large surpluses may mean that the organization is not investing enough of its revenues in serving the public interest. However, for any given budget period, revenue and expenses should be in the relationship that the organization chooses, rather than mechanically "balanced."

If a preliminary budget has been prepared and revenue and expenses are not in the desired relationship, programs and management activities must be reevaluated and adjustments made. Typically, nonprofit organizations find that their initial projections for income and expenses anticipate an unacceptable deficit, and either additional revenue must be generated or activities must be cut back. When reviewing the revenue budget, it is important to avoid the temptation of raising the estimate without changing the plans for generating revenue ("We'll try harder to raise money this year.") The budget should be based on reasonable assumptions you have some grounds for making.

If expenses need to be reduced, it is helpful to determine what each program would cost at different service levels. A fixed percent cut across all expense lines is often not the most effective way to reduce expenses. For instance, do not assume that benefits and costs move together, with each additional dollar spent resulting in an additional dollar of results. The following example illustrates this point.

Example 1: A Tutoring Program

Consider a school that wishes to establish a tutoring program. A coordinator and five tutors might be able to help 50 students (10 students per tutor)

Coordinator salary and fringe benefits	\$30,000
Cost per student:	\$80,000/50 students \$1,600 per student

The same coordinator might be able to run a program with eight tutors and 80 students, lowering the average cost on a per student basis.

Coordinator salary:	\$30,000
Fees for tutors:	\$10,000 per tutor x 8 tutors \$80,000
Cost per student:	\$ 110,000/80 students \$1,375 per student

However, expanding the program beyond eight tutors might require hiring another coordinator, driving the average cost per student even higher than it was originally.

Coordinator salaries and fringe:	\$60,000
Fees for tutors:	\$10,000 per tutor x 9 tutors \$90,000
Cost per student:	\$150,000/90 students \$1,667 per student

Once you have changed your plans and updated your budget so that revenues and expenses are expected to be in the proper relationship, the full board, in its governance role, must approve the plan for the year and the budget. From that point, staff and volunteers begin to put the plan into action and prepare monthly reports comparing actual income and expenses to the budget.

PREPARING A MONTHLY BUDGET

It is useful to prepare monthly budgets that reflect the anticipated timing of revenue and expenses instead of dividing the full budget into twelve equal parts. Therefore, your December fund-raiser revenues would be included in your monthly budgets for October through January, to correspond when ticket sales are coming in. Similarly, if your insurance is due once a year, the entire insurance premium would be reflected in that month's budget, rather than divided into twelve equal parts throughout the year. By preparing monthly budget breakdowns and comparing them with actual dollars spent and received, you can more accurately spot real changes and revise the budget accordingly. Budgets and the budget process can be an important vehicle for better programmatic and financial management and can help your organization better achieve its mission.

WHERE TO GO FOR ADDITIONAL INFORMATION

Dalsimer, John Paul, Self-Help Accounting: A Guide for the Volunteer Treasurer, 1989. Energize Inc., 5450 Wissahickon Avenue, Lobby A, Philadelphia, PA 19144, (800) 395-9800 or (215) 738-0434.

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