THE NEW NORMAL: STRATEGIC BUDGETING

By Michael E Batts, CPA

A sk many nonprofit leaders for their definition of a budget and you’ll likely receive answers that have a scholarly flair. “The financial quantification of a plan” or “a financial roadmap of our annual mission” or similar words are likely responses.

The reality, however, is that for many nonprofits, such “scholarly” responses are misfires on two counts: first, they do not accurately describe how many organizations really do budgeting and, second, even if they did, they miss a critically important element. Let me explain.

► THE SCHOLARLY DEFINITION VS. REALITY

The actual budgeting exercise in many (if not most) nonprofit organizations involves “guessing” how much money is going to come in during the next fiscal year and then deciding how to spend every nickel of it. (It would be more polite to use a term that is more euphemistic than “guessing,” such as “estimating,” but based on recent economic developments and my conversations with nonprofit leaders across the country, I have learned that the process is often more akin to “guessing.”) The process often has little to do with formally incorporating the organization’s mission into a financial plan.

► ZERO-BASED BUDGETING

In order to genuinely follow the approach of translating the organization’s mission for the year into dollars, a nonprofit should apply “zero-based” budgeting – the practice of deciding what specific activities should be conducted in order to carry out the organization’s mission and what they will cost. True zero-based budgeting does not involve increasing or decreasing the prior year budget. Rather, it starts with a blank sheet and asks the program director, for example, to list each activity or program he believes should be conducted during the year and to apply a cost to each one. So, when adjustments are made, they are not in the form of “10 percent across the board,” they are in the form of “let’s eliminate the spring conference.” Applied across the entire organization to every department, true zero-based budgeting has an amazing knack for ferreting out waste and nonessential activity. It also allows nonprofit leaders to make specific priority decisions on an activity-by-activity or program-by-program basis, rather than in simple percentages or dollar amounts. It facilitates surgery with a scalpel as opposed to an ax.

► THE MISSING ELEMENT

Even if a nonprofit organization applies zero-based budgeting, there is the question of the often-missing critical element – how does the budget fit into the organization’s overall financial plan and how does it help the organization achieve its financial objectives?

Before a nonprofit can answer that question, it must assess whether it has a financial plan and financial objectives. A financial plan and financial objectives include such elements as:

- Establishing an operating reserve of $ (amount) by (date)
- Ensuring that the organization will have ample time and liquidity to reduce expenses in the event of a sudden and unexpected downturn in revenues
- Reducing debt by $ (amount) within a stated period of time
- Building a maintenance and replacement fund of $ (amount) within (number) years

► THE FALSE COMFORT OF A “BALANCED BUDGET”

In order to ensure that the nonprofit organization has adequate financial capacity to carry out its programs and activities, its leaders must ensure that the organization’s financial plan is sound. Sound financial management includes development and approval of a responsible operating budget. Many nonprofits operate under the belief that there is something improper about generating a positive bottom line – that is, a surplus of revenues over expenses. In fact, in many nonprofit organizations, a desirable budget is a “balanced budget.” While operating a balanced budget may sound like an admirable goal, it simply means that the organization expects to incur expenses equal to its revenues, with no room for error. The term “balanced budget” sounds attractive because we would all give our right arms to see our government operate with a balanced budget! But that is no way to improve a nonprofit’s financial condition. What’s more, since a balanced budget plan leaves no room for error, an unexpected dip in revenues can cause immediate financial stress for an organization and its leaders.

A better approach to budgeting involves determining the organization’s desired financial condition (liquidity, reserves, debt levels, etc.) and the desired timetable for achieving it. With a long-term plan for improving financial condition, the organization can develop operating budgets that not only provide for carrying out its mission but also contemplate surpluses to contribute toward the desired financial condition. A nonprofit organization that has not operated following such a plan may need to reduce program or other expenses in order to implement a strategy of producing responsible budget surpluses.

► CONCLUSION

Recent economic developments have made it clear that strategic budgeting is essential for the sound financial operation of a nonprofit organization. A casual approach to budgeting, with no over-arching financial plan, can lead to great stress and lasting damage to the nonprofit. However, with proper diligence, including the use of tools like zero-based budgeting and a responsible financial plan, nonprofit leaders can proactively help their organization establish a stronger financial foundation that, in the long-run, should help the organization be more effective in carrying out its mission.

Parts of this article were excerpted from the book Board Member Orientation - The Concise and Complete Guide to Nonprofit Board Service by Michael E. Batts, managing partner, from Batts Morrison Wales & Lee, an independent member of the BDO Seldman Alliance. For more information, contact Mike at batts@nonprofitcpa.com or Kelli Boyle at kboyle@nathanwechsler.com.

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